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Federal Reserve Bank of St. Louis

LOWER INCOME TAX EXEMPTION?

YES!

Says Marriner S. Eccles

Chairman of the Board of Governors
of the Federal Reserve System

THE SHEER SIZE of the war-financing program which faces the Government of the United States frightens many. The feeling prevails that inflation is unavoidable.

The problem is not one of raising the money. The problem is getting the money in such a way that the inflationary dangers are minimized, that the greatest amount of stability that it is possible to create under these conditions should be created. That safeguard is essential for the maintenance of morale.

Today the supreme objective of the financial policy of the Government, however, is not the avoidance of inflation but rather the maximization of war production. Nevertheless, we can achieve both if we are ready to make the sacrifices about which we have heard and talked so much. Lowering the personal income tax exemption would be one sound step in that direction.

One year ago the United States was spending 150 million dollars a month on defense production. Today we Americans are spending 150 million dollars every three days. In 1943 we shall be spending 150 million dollars every day. This process holds great inflationary possibilities -- unless we can divert the people's income from consumer goods, which we can no longer produce in quantities, to the Federal Treasury's war needs.

We can do that. We can meet the huge War Budget and at the same time cause that desired diversion of frustrated buying power by (1) increasing taxes, and (2) by increasing purchases of Government bonds and defense securities from idle business capital and current savings.

Consider the coming fiscal year, 1942-43. We may expect a national income of about 110 billion dollars. Collection of about one-fourth that amount -- 28 billions -- in taxes would leave a spendable income of about 80 to 85 billion dollars for the American people.

Such an income would make available 15 to 20 billions of savings, which normally would be invested in industry, housing, and other activities curtailed "for the duration". That money can be borrowed for the war program. It is expected that approximately the same amount also can be borrowed from savings already accumulated in banks and elsewhere.

But let us consider more specifically taxation as a source of revenue.

The war budget for 1942-43 calls for tax receipts of 28 billion dollars. Of that sum, existing taxes will bring in about 19 billions. This means that, in accordance with the President's program, we must collect about 9 billions through additional other taxes. The proposal is to collect 2 billions of it from Social Security and the remaining 7 billions from new additional taxes.

How shall we raise those 7 billions?

Corporation taxes, it is clear, will have to be substantially higher than at present. Excess profit taxes will likewise have to be increased. It would seem to me to indicate that excess profits will be almost a thing of the past, and I do not know why this should not be the case.

I am unalterably opposed to a general sales tax, for this form of taxation is in no wise based on an equitable principle of ability to pay. It is a retrogressive rather than a progressive tax.

With the personal income tax, however, we have had almost 30 years experience. We know it to be a fair tax, taxing those who can best afford to pay and exempting those with the least ability to pay. Now, with America engaged in an "all out" battle for its very freedom we shall have to lower the \$1,500 exemption allowed for married persons to \$1,200, and the exemption for single persons from the present \$750 to \$600. At the same time, the \$400 now allowed as deduction for each dependent should be lowered. It may be necessary also moderately to increase the rates on medium incomes.

The practical job of collecting income taxes seems to me to call for a withholding tax. Certainly where so many people will be subject to income tax as is now the case, a withholding tax at the source would greatly lessen not only the expense of collecting the tax but it would collect the tax at the time the income was received and would avoid the recipients of that income spending the funds only to find a year later when the tax was due that they didn't have the funds. It is essential, it seems to me, to have a withholding tax in order that the inflationary effect of the government expenditures would be reduced by avoiding the lag between the expenditure and the time the taxes are paid.

That incomes be increased to keep abreast of rising prices is a fallacious proposal. It would require none of the sacrifices about which we talk so much, even if it could be done. But instead it is the way to inflation for it would be increasing purchasing power out of proportion to the increase in the supply of goods. It has been our unused manpower and production facilities which have prevented inflation of prices thus far, but the defense program will not leave any unused workers or production facilities.

Some may underestimate the American people. I see them eager for action, ready for any sacrifice. The surest way they can get action is to pay for it -- and the American public shows a tremendous disposition to do that quickly and without stint.

Occasionally we hear the wail that taxes may rise so high they will rob business of all incentive to produce. I have no sympathy for any such point of view.

If this war is going to be fought on the basis of what we are going to get out of it instead of what we are going to put into it, we are going to lose. If the only interest of labor is greater wages, if the only interest of business is higher profits, if the only interest of the farmer is higher prices, then we have many tears and much blood to shed.

If the Russians had been fighting for the profit motive instead of their country and homes, I do not believe that they would have had the morale to fight as they have. I hope the businessmen of the United States will set an example to the farmers and laborers and will no longer talk of the profit motive as necessary in order for them to put forth their best efforts and to do their parts. If that is going to be the guiding influence in the determination of what we are going to produce, then we have already lost the battle.

Businessmen who have the most at stake must do the most. They must not expect to pass on the burden to someone else who is less able to bear it and who has far less to lose than we have.

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