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## THE PROBLEM OF THE APPROACHING DEBT LIMIT

Both the prospective business situation and the more lasting requirements for national prosperity make it urgently desirable that no significant curtailment in the expenditures of the Federal Government be undertaken in the fiscal year 1941. The uncertainty of the prospect for maintaining outlays is due not only to the political strength of the economy sentiment, but, secondarily, to the widespread but fallacious notion that if expenditures remain undiminished, critical obstacles of a financial sort will arise in the coming fiscal year. In order to focus public attention on the really basic issue of economy versus spending, it is important that the fictitious side issue relating to financing be aggressively eliminated. This side issue, if it is permitted to remain active, will enable the opponents of spending to supplement their direct attack by an indirect flanking movement.

Concern over the financing issue originates from two factors. First, the public debt is approaching its statutory limit, and further, extensive Treasury borrowing would necessitate Congressional action to raise the present limit. Second, it is widely believed that taxation has approached the limits of political tolerability.

In this memorandum a series of measures is outlined which is designed to relieve prevailing doubts regarding the Treasury's ability to provide funds for continuing programs of expenditure at their present levels. These measures fall into two groups. The first group consists of tax devices of a type which seem politically feasible and will not encroach significantly upon consumer buying; the second consists of devices to bring the Government's inactive resources into active use in order to meet current outlays and to reduce taxes on consumption.

Among the taxation devices that seem politically feasible and do not significantly impede the flow of income, the following may be worthy of special attention:

a. Raising the income tax on corporations with net income of $25,000 a year and over from the present rate of 18 percent to 23 percent. In a complete form, this proposal would involve a graduation of rates for corporations having income moderately under this figure in order to prevent a sharp jump in the effective rate of taxation as between corporations with net income slightly less than $25,000 and corporations with net income slightly more than $25,000. It may be estimated that this increase would produce additional revenue of $300,000,000. The corporations that will be affected by this change make up only 14 percent of all corporations with net income but receive 93 percent of the net income of all corporations.

b. Allow diminishing exemptions on individual incomes subject to surtax as the size of the income increases. For example, the aggregate exemption allowed for the personal exemption, plus the credit for dependents, could be reduced by the excess of net income over $4,000. Thus the exemption of $2,500 for a married man without children would vanish entirely at the level of $6,500 normal tax net income.

c. In the consideration of proposals for financing agricultural benefits, any new taxes burdening consumption should be avoided. Undesirable taxes of this type include a revival of processing taxes and the disguised form of processing taxes known as the certificate plan. The validity of agriculture's claims for benefits is generally admitted; but at a time when all groups can expect more from an increasing national income, it is unnecessary and harmful to divert income from one group to another by methods that are likely to decrease the total to be divided.

These tax changes, if enacted at the next session of Congress, will not begin to yield increased revenue until March 1941, and any increases in yield they could be expected to produce if income remains at its current level or rises higher may be more than offset by the reduction in the yield of the tax structure as a whole if national income during the calendar year 1940 is not well maintained. The national debt at the end of November was within $3,679,000,000 of the statutory limit. If the debt limit is not raised and if none of the measures outlined below are taken, the Treasury is likely to find itself in an uncomfortable position at the end of the calendar year 1940.

A request to Congress to raise the debt limit during the coming session would, however, be entirely unnecessary if use were made of the potential cash resources represented by the unutilized gold held in the Stabilization Fund and the "free silver" acquired under the Silver Purchase Act against which silver certificates have not yet been issued. The necessity for additional borrowing could be further postponed if the Treasury were willing to reduce its cash balance to the level that was customarily held before 1933, and to rely upon the issue of Treasury bills as a method of emergency financing.

Of these devices, reduction of the Stabilization Fund would yield $1,500,000,000, utilization of free silver about $1,560,000,000, and reduction of the cash balance about $1,000,-000,000. Taken together, all these devices would make about $4,000,000,000 available to the Treasury without the necessity of additional borrowing. This sum would be adequate, when added to the amount of public debt issues that are still authorized ($3,679,000,000), to carry the Treasury well past the end of the fiscal year 1941.

No Congressional action would be required to issue additional silver certificates and to reduce the cash balance. Transfer of part of the Stabilization Fund to the general fund would require amendment of the Gold Reserve Act of 1934. (The full amount, however, could be transferred by Presidential proclamation terminating the Fund under Section 10(c), as amended, of the Gold Reserve Act.)

A strong argument for reduction of the Stabilization Fund could be made on the ground that the many financial shocks and international crises of the past five years have been successfully dealt with by means of the $200,000,000 portion of the Fund in active use. For the duration of the war we can scarcely experience withdrawals of foreign capital not related to goods purchases, and any outflow of capital associated with the restoration of peace and stable political conditions in Europe is likely to be associated with large-scale demands for American exports to be used in the process of reconstruction. We will almost surely return Europe's capital in the form of goods rather than in the form of gold. Moreover, the existence of $5,000,000,000 of excess reserves provides a cushion to prevent gold outflow from having directly restrictive effects on the existing credit structure. To require a $2,000,000,000 Stabilization Fund for this purpose, in addition to the $5,000,000,000 of excess reserves, represents an excess of caution. Five hundred million dollars is ample to finance its operations.

In addition to the Federal Government's resources represented by the general fund balance, the Stabilization Fund and the unutilized silver seigniorage, $1,726,000,000 was held at the end of October as a reserve for the payment of old-age benefits. Under the present provisions of the Social Security Act, this reserve will continue to grow rapidly as pay roll taxes exceed old-age benefit payments. In order to check this unneeded growth in the old-age reserve account and to halt the further issue of special securities to that account, it might be desirable to propose legislation for the suspension of transfers to the old-age reserve account until the balance in the account has fallen below $1.5 billions. This should be accompanied by legislation suspending pay roll taxes until resumption of transfers to the old-age reserve account became necessary. In order that the pay roll records maintained by the Social Security Board may be kept up-to-date, a further provision would be necessary requiring employers to furnish reports on the same basis as if tax payments were currently in effect. The suspension of pay roll taxes (other than unemployment insurance taxes), which an abatement of transfers to the old-age reserve account would make possible, would be nearly equivalent in its economic effects to a comparable amount of income-generating expenditure by the Federal Government.