

FISCAL POLICY IN THE POST-DEFENSE PERIOD

Summary

A study aimed at evolving the basis for a post-defense fiscal program should contain the following elements:

1. A comparative analysis of fiscal policy (foreign financial developments, as well as our own past experience),
2. A presentation of the type of fiscal structure which we are likely to have at the end of the war (as a working basis in the consideration of future programs).
3. A presentation of the essential elements of a post-defense fiscal program (including an examination of the relationship of post-defense fiscal policy to the whole national and international scene),
4. An examination of the means of translating recommendations into policy and action.

Post-Defense Objectives

The generally accepted social objectives of the American people may be translated (at the policy level) into a program, for the post-defense period, which embraces the following:

1. The formulation of a large over-all governmental program of services and expenditures based on our more essential social needs.
2. The evolution of a Federal tax structure which would meet the requirements of encouraging economic stability and progress, as well as those of equity, adequacy, and administrative ease.
3. The development of means of executing unified and coordinated fiscal policies at all levels of government, the extension of national standards of service, and the equalization of fiscal resources among the various areas of the nation.

A Post-Defense Program of Governmental Services and Expenditures

To be treated in the proper context, the study must involve consideration of these factors of post-defense adjustments:

1. Estimated labor supply
2. Estimated plant capacity
3. Estimated backlogs and deferred demands
4. Estimated savings
5. Anticipated volume of private capital expenditures
6. Estimated gross national product and national income.
7. A governmental program necessary to maintain full employment (including programs for the extension of social services; public improvement projects - especially urban redevelopment and housing, and developmental programs on a regional basis; and the integration of our economic system more closely with that of the outside world).

In setting forth the magnitude and character of the probable (and desirable) governmental services and expenditures for the post-defense period, what is important is not the accuracy of the estimates - which merely provide a working basis - but the highlighting of our social needs as well as the broad expenditure requirements of a fiscal policy aimed at full employment.

The gap which will be left by the dropping out of the larger part of defense expenditures must be filled by consumption and net capital formation if we are to maintain full employment. Thus, governmental policies will have to be directed at the expansion of consumption and investment. Furthermore, the Federal Government will have to be prepared to play a balancing role, checking any temporary tendency toward an excessive boom, and, on the other hand, prepared to go forward with large expenditures to compensate for any strong tendency toward deflation and depression. It is extremely important to hold in readiness both an adequate program of useful public improvement projects and programs for the extension of social services.

The limitations upon the taxable resources and borrowing capacities of the States and localities mean that increased expenditures, if left to State and local units, can only be financed out of regressive taxes. Such

taxes can offset almost all of the social benefits and economic stimulus that are derived from the expenditures which they help to cover.

It would be useful to draw up a model based on administrative and economic considerations alone, aiming at an ideal distribution of governmental functions.

### The Federal Tax Structure

How much reliance should be placed on taxation, borrowing, and changes in the money supply as a means of financing the governmental expenditure program depends upon a variety of considerations. It involves judgments with respect to the adequacy of the means of payment, adequate liquidity, the importance under certain conditions of using relatively expansionist and less restrictive methods of financing, the relative desirability of tapping the savings stream through borrowing or through taxation.

A decision as to the desirability of reducing the public debt in the immediate post-defense period (and if it is to be reduced, the rate at which it is to be done), must depend in large part on the vigor of the private investment boom. Furthermore, if a large part of the public debt is to be retired, the character of the tax structure through which the transfer payments (within the community) are effected becomes all-important. If the effect of the transfer is to reduce consumption and increase savings, a serious deflationary movement may be started, or encouraged. Certainly, debt redemption should not precede a proper adjustment of the tax structure. In general, full consideration should be given to the effect of the public debt (1) upon the distribution of income; (2) upon the propensity to consume; (3) upon the supply of funds for investment; and (4) upon the banking system and the efficiency of techniques of credit control.

The formulation of tax policy in the post-defense period must be based chiefly upon considerations of certain desirable relationships of the tax structure to the national economy. In general, we should aim at a tax structure which, in the post-defense period --

1. involves a minimum reduction of consumer purchasing power;
2. generally, is highly progressive at all ranges;
3. discourages any tendency to oversaving;
4. imposes as few obstacles as possible in the way of investment.

An immediate problem in the postwar period will be to maintain consumption levels at a time when there may be a severe reduction in governmental expenditures. A drastic reduction in consumer taxes would stimulate consumption and help maintain these levels. It would be helpful to stress publicly and constantly the fact that the increases in consumption taxes during the defense period have specific purposes -- to control production of certain articles and to prevent inflation -- so as to crystallize sentiment for an immediate reduction in consumption taxes at the end of the defense effort. Attention should also be paid to the possibility of reducing payroll taxes.

It is clear that if regressive taxes are to be substantially reduced, and if our Federal tax structure is to be progressive from top to bottom, the relative importance of the income tax in the Federal revenue system will have to be greatly increased. A mere broadening of the income tax base in terms of reduced personal exemptions and credits for dependents is not enough. Income for income tax purposes should be brought into better harmony with true income. To broaden the income tax base substantially would require revisions in several directions:

1. Taxation of stock dividends and corporate earnings;
2. Disallowance of the personal exemption and credit for dependents in the computation of net income subject to surtax;
3. Taxation of interest from Government securities;
4. Abolition of the privilege enjoyed by husbands and wives of filing separate returns.

The progressivity of the Federal tax structure could further be increased by changes in estate and gift tax provisions.

The question as to whether high surtax rates, corporate taxes generally, and the taxation of capital gains dampen the incentive to invest requires careful attention. In analyzing the problem of private capital investment, the following deserve full treatment:

1. The encouragement of investment through the expansion of consumption;
2. The encouragement of investment in equity capital;
3. The elimination of discrimination against corporations with highly fluctuating incomes;
4. Incentive taxation.

Due consideration must also be given to examining the proper balance between personal and corporate taxation in fulfilling governmental revenue needs.

It seems essential to know how various types (and rates) of taxes are likely to affect business decisions. Indications to business reactions might be obtained through a questionnaire survey conducted by the U. S. Chamber of Commerce, or a similar organization. Businessmen would be asked to indicate their preference for one of, let us say, five combinations of taxes, each calculated to produce substantially the same amount of governmental revenue.

### Federal-State-Local Fiscal Relations

A study of intergovernmental relations might begin with an analysis of the impact of the defense program upon the burdens and fiscal capacities of the States and localities. On the basis of such a study, an estimate of the fiscal position of non-Federal units toward the end of the defense effort could be made. An attempt should also be made to estimate the effects of the proposed service and expenditure program and of the proposed Federal tax structure on the fiscal position of States and localities.

An examination of present trends is helpful in looking toward the formulation of policy, in the post-defense period, in the realm of Federal-State-local fiscal relations. The following trends seem to stand out clearly;

1. The need for continuing governmental expenditure on a large scale;
2. The greater role of the Federal Government;
3. The increasing reliance of State and local governments on regressive taxes;
4. The increasing discrepancies of wealth and of governmental services in various areas of the nation;
5. The increasing need for coordinated fiscal policies at all levels of government in combating the problems of our economy.

These trends point to the need for a fundamental revision in Federal-State-local fiscal relations. An absorption by the Federal Government of those functions which are of direct national interest could have several beneficial effects: (1) Such services could be performed on a high standard level; (2) The field for coordinated and rapid fiscal action would be greatly enhanced; the problems of our economy could be met with all the weapons at the disposal of the nation; (3) The States and localities would be able to finance the services of a local nature out of their own revenues and without the pressure to resort to regressive taxes,

A fundamental revision would require, moreover, that, with very few exceptions, tax collection should be transferred from the States to the Federal Government. States would depend chiefly upon shared taxes, State supplements to Federal taxes, and grants-in-aid. Through the development of such financial dependence upon the Federal Government, States would become, in essence, administrative units -- something which is much to be desired in the face of modern economic exigencies and popular demand for more effective governmental action.

Such revisions do not, however, remove the necessity for additional and more immediate improvements in State and local fiscal structures, and in Federal-State-local fiscal relations. Attention will have to be paid to many other aspects of the problem, among which are:

1. The improvement in the collection of State and local financial data;
2. The equalization of burdens and resources; and
3. The improvement in the means of coordinating fiscal policies at all levels of government.