

Address of
MARRINER S. ECCLES
Chairman of the Board of Governors
of the Federal Reserve System
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of the
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For immediate release

It has not been my privilege heretofore to speak before an audience of tax authorities. While I am grateful to the National Tax Association for inviting me, I am merely a banker and business man and I stand in awe of the tax expert. I have glanced over the record of some of your past proceedings and I am impressed by the breadth and scope of your deliberations and by the learning displayed by your speakers. While I cannot hope to add to your technical enlightenment, I am venturing to outline to you some of the broader national aspects of taxation in relation to fiscal and monetary action that, in my judgment, are of the greatest importance to this country now and in the future. In what I have to say I am, of course, speaking only for myself.

For a long time I have been interested in making fiscal policy play its proper part in a broad program for maintaining that orderly economic progress that ought to go step by step with the steady growth in our human resources and in our technical knowledge. Except during major wars, our State and local governments have until recently been much more important from the financial point of view than the Federal Government. Although Federal revenues and expenditures have greatly expanded during the past decade, it is only since the beginning of the defense program that Federal expenditures have begun to exceed aggregate State and local expenditures. It is only in the current fiscal year that Federal taxes will exceed aggregate State and local taxes. No one who is interested in a more intelligently planned fiscal policy

for the nation as a whole can fail to take account of the financial problems of our State and local units of Government, and of the vast complex of taxing jurisdictions numbering more than 175,000.

The principles that should govern present policy are simple. If we are to attain the broad objectives of our present national policy, expenditures for defense must absorb an increasingly large proportion of our national income. This general policy is, of course, easy to state, but difficult to apply. Our people—business men, labor, farmers—are still thinking mainly in terms of the profits they hope to make rather than of the sacrifices which will be required of all groups of our population. As yet our standard of living has not suffered and relatively few dislocations have resulted. In some localities where there have been sudden large increases in population due to the expansion in defense industry, the strain of providing adequate public services is severe, but in general State and local revenues are exceeding budgetary expectations and relief rolls are diminishing. The temptation is strong to expand Government services and get rid of unpopular taxes. Sound public policy requires that both of these temptations be resisted. Public works not directly connected with defense, no matter how meritorious on general grounds, should be postponed until after the emergency has passed and we can once more afford to devote our men and materials to raising the standard of living of our citizens. I cannot agree with the superficially logical view that State and local taxes should be reduced in order to make it easier for taxpayers to bear the

burden of increased Federal taxes. It is natural for taxpayers to attempt to avoid a reduction in their standard of living, but taxes will not serve the essential purpose of helping to divert resources to defense production unless consumer expenditures are sharply reduced.

State and local government should decrease expenditures. They should not reduce existing tax rates and they should devote surplus revenue to the repayment of debt. This would be anti-inflationary, in harmony with governmental policy. In commenting upon the regulation recently issued by the Board of Governors to dampen consumer instalment credit, I emphasized the importance of the repayment of debt by individuals:

"When incomes are at high levels, that is the time when people should reduce their debts or get out of debt. Our people cannot spend their increased incomes and go into debt for more and more things today without precipitating a price inflation that would recoil ruinously upon all of us... By deferring civilian demand at this time, we can help avoid inflation, we can aid in defense, and we can store up a backlog of buying power that will help offset a post-defense slump."

Repayment of debt by State and local governments is equally important at this time.

Looking ahead, however, to the post-defense period, the problems that we will then be facing will be the same in their essential nature as those that confronted us during the 30's and for which we succeeded in finding only a partial solution until the beginning of large-scale expenditures under the defense program. They are the problems of

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poverty in the midst of plenty; of the capacity to produce outrunning the power to purchase and consume; of millions of able-bodied and skilled workers without employment; of idle plants and factories. Yet, if we have the will, we know the way to meet those problems. We have before our eyes a conclusive demonstration of the way in which vigorous and determined action by Government can transform a situation of general overabundance to a situation of general scarcity within the space of a few months.

The general problem of finding a market for the products of farms and mines and factories that is large enough and stable enough to provide steady employment for all who wish to work is one that confronts all the industrial countries of the modern world. In the United States this problem is complicated by the great size of our country and the diversity of our economic activities. In those parts of the country that were settled earliest, wealth has accumulated and from the very beginning of our economic history accumulated wealth in these areas has sought and found an outlet for investment in the development of the resources of the frontier regions that were one by one opened up to settlement. Year after year this process continued. The result has been a vast aggregation of obligations which the citizens of areas that offered opportunity for investment owed to citizens of areas that had capital seeking investment. Those obligations took various forms: mortgages on urban residential and business properties and on farms, the securities, both stocks and bonds, of mines, public utilities, and other business enterprises, and the obligations of State and local governments. As the loans and invest-

ments grew, the volume of interest, dividends, rents and amortization payments also grew. Debt payments had to be maintained both in times when prices for the produce of debtor areas were high and markets were large and in times when prices were low and markets were restricted.

In general, the creditor areas are also centers of manufacturing, that must look for a market not only to their own citizens but to the country as a whole. The maintenance of economic balance in the country as a whole requires that citizens of debtor areas have enough money income both to maintain interest, amortization and other payments on their obligations to investors in the creditor areas and to maintain at a high level their purchases of the output of the factories of the creditor areas. They must maintain their standing both as good credit risks and as good customers. This healthy state of national economic balance is continually being upset by forces that are entirely outside the control of the States or of the individual businessman and the individual worker. The result is recurrent periods of breakdown and distress, bankruptcy in debtor areas, idle factories in creditor areas and widespread unemployment and hardship in the country as a whole. There is no essential difference between this situation and that resulting from international debts. Both are, in essence, exchange problems. By tariffs, quotas, exchange restrictions, or even by resort to more punitive steps of a military or economic nature, including expropriation, nations attempt to redress the situation. The Federal Government alone can remedy this condition among the States—and taxation is one of the most effective means. Through that medium

funds which the creditor areas drain out of debtor areas through interest, dividends and rents, as well as payments on debt, can be kept flowing back to sustain employment, to keep mines and factories in the debtor areas operating and continuing to yield returns to the creditor areas. I realize that the creditor States complain about paying more in taxes in proportion to what they get back from the Federal Government than do the debtor States. But that is a short-sighted attitude which fails to comprehend that in no other way can the debtor areas continue to yield returns to the creditor areas. I recognize also that the Federal form of government does not adapt itself easily to a centralized and coordinated attack upon problems that must be dealt with as national problems if they are to be dealt with at all.

The problem of maintaining the standing of our citizens as both good credit risks and good customers is basically one of maintaining the national income at levels which represent the fullest possible utilization of our labor supply and other economic resources. Debts which can be easily carried and paid off when the national income is stable or steadily growing become insupportable when income falls. Defaults and bankruptcies used to be the accepted methods of dealing with these difficulties. But such methods are crude and unsatisfactory both in terms of economic values and human values. During the depression we developed better methods by attacking the problem from both ends, by seeking to restore incomes and by adjusting debts of farmers and home owners through the Farm Credit Administration and the Home Owners' Loan Corporation.

In the future, the most important safeguard against the danger of a relapse into the intolerable conditions of the early 30's will be a long-run plan for public investment, adapted to the differing needs and conditions of our different geographical areas. So far as possible, this should take the form of productive public works and expenditures not only to improve the basic conditions which are responsible for keeping the standards of living in some of our States lower than in others, but also to raise the standard of living particularly in the lower income groups wherever they may be. Productive public investment, which should be noncompetitive with private enterprise, means not only roads, public buildings, subsidized housing, bridges, dams and irrigation projects; it also means better education and a higher level of public health and nutrition. The fact that so many of our young men called up for military service were shown on medical examination to be physically unfit is a shameful revelation of our neglect, as a democracy, to deal with national health and nutrition problems.

We will also need to extend and to make more uniform as between citizens living in different States the system of social security benefits. This mechanism is ideally suited to use as an anti-inflationary measure in times like the present and an anti-deflationary measure in periods such as we may have when the defense effort is over. This is the time to build up a reserve by increasing the taxes both for old age and unemployment, decreasing the taxes and drawing on the

reserve as unemployment develops. And to insure that increased current revenues will be followed by an appropriate flow of outpayments when they are needed to combat the deflationary forces of the post-defense period, the old-age insurance system should be converted from its present contributory basis to a system that frankly recognizes and meets the national obligation to provide a minimum of support for all of our needy aged. We should give everyone reaching the age of 65 a minimum of \$30 a month, regardless of the amount of his contribution to the system. Variations in payments to meet local conditions should be made possible by Federal grants matching additional payments made by the States up to \$10 a month, thus enabling maximum payments of \$50 a month. The Federal Government should recapture, by means of the income tax, payments of this type in excess of amounts needed by the aged to bring their total income up to a level representing a minimum standard of comfort. Such a revision would do away with the present complicated set of rules governing benefits; it would completely remove the cost of old-age pensions from the budgets of our less wealthy States; and it would make the support of the aged a national responsibility, as it should be. I also think it essential to nationalize the unemployment insurance program extending the coverage to all workers and increasing the benefits both as to amount and time, increasing the rates and providing that employees contribute 50% of the tax and that it be uniform as to industries.

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If we are to be successful in the objective of creating a high and steadily increasing demand for the products of industry after the defense period, we must adopt a progressive tax system bearing heavily upon savings concentrated in creditor areas and lightly upon the great mass of families of the low income groups. This means that we must get rid of, or at least check the growth of the sort of taxes to which our States have unfortunately been forced to resort more and more in recent years. I am referring to the general sales taxes and the taxes on gasoline, tobacco, and other articles of mass consumption. These have taken on increasing importance in State tax structures in recent years as a consequence of the

inadequacy of the general property tax and the pressure to find funds to finance relief and other welfare expenditures. Although these taxes were enacted with the commendable motive of preserving the solvency and credit standing of our State and local governments, they had an unfortunate effect upon the level of activity in the economy as a whole and were among the factors that made national recovery slow and incomplete until the beginning of the defense program. Their effectiveness as revenue producers is largely attributable to the fact that the Federal Government continued on a deficit basis throughout almost the whole of this period and thereby provided the stimulus for expansion of the consumer expenditures upon which these taxes were levied.

If we are to make progressive taxes the major element of our national tax structure, however, it will not be possible to continue the present system of having both the States and the Federal Government levy taxes on corporate and individual incomes and transfers at death. Increases in the rates of these taxes sufficient to make them contribute a major share of total governmental revenues over the long run would so intensify the existing difficulties that some change in the present chaotic system would be unavoidable. Citizens and corporations in some jurisdictions are lightly taxed because of a fixed policy in their States to compete for the domicile of corporations and persons of wealth. In other States they are heavily taxed because their States have taken the

leadership in the use of progressive taxes. It has long been recognized that uniformity and equity can be attained only by making the total tax levied on income and on gifts and bequests a matter for Federal control. This might be done along the lines suggested to you by Mayor LaGuardia at your conference last year, by the device of allowing a limited tax credit against Federal taxes for State taxes of similar type. We have already adopted this device for purposes of the Federal estate tax and the Federal unemployment compensation tax and we have seen that it does give a powerful incentive to the several States to enact and collect a tax of a particular type, when they are led to do so by the knowledge that the revenue will go to the Federal Government unless they take appropriate action. However, while this device creates a presumption that a State will levy taxes only up to the amount of the Federal tax credit allowed, it does not guarantee the taxpayer against the possibility that a State government hard pressed for revenue may not go considerably beyond this limit and it does not eliminate the possibility that the same income or the same transfer of property at death will be taxed by more than one State. In the end the only thoroughgoing cure for these difficulties lies in a drastic reallocation of taxing powers between the States and the Federal Government. Such an allocation would involve restricting the right to levy taxes on income, gifts and bequests wholly

to the Federal Government with redistribution of a share of the revenue from these sources to the States. I know how controversial this subject is but I think we will have to face, quite frankly, the implication that State revenues will tend to consist more and more of taxes shared with the Federal Government and of grants from the Federal Government, which already make up about 14 per cent of State revenues. The real question is how to retain the valuable elements of local initiative, local control over governmental services and adaptation of services to the differing needs and conditions of differing areas. We have had enough experience with Federal grants and with Federal direct expenditure programs during the depression to know that this problem is not insoluble. We should continue to follow the broad policy that has grown out of these activities of leaving responsibility for initiative as to the type of activity to be undertaken in the hands of State and local government, to leave, wherever possible, the detailed administration in their hands and to provide for Federal supervision only to the extent necessary to insure that funds are wisely, prudently and honestly used. In a program of the magnitude and novelty that characterized Federal spending for recovery, it is not surprising that there were mistakes but the failures as well as the successes of this period of experiment provide a valuable basis for the wise planning of the future.

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I have outlined in a general way some of the main considerations that I think should apply in shaping taxation policy to the needs of the defense and post-defense periods. Let me add, however, that all I have said is based upon my profound conviction that we must make democracy function more effectively in the future than in the past--and that this can be done by democratic processes and methods, primarily by use of the Government's broad functional powers of control. Fiscal and monetary action, properly used, can go far towards correcting the basic causes of economic breakdown. Those over-all, functional powers--of which taxation is the most potent single instrument--need to be supplemented by some direct controls at all times, particularly in a time like the present when we have acute shortages of strategic materials. However, the more wisely and effectively over-all controls are applied, the less will be the area in which there will be need for direct measures.

In the past, we have been slow, often too slow, to recognize changed conditions and to adapt our system to them. We have too often tolerated poverty while we failed to recognize that the proper function of the democratic system is dynamic, not static. Too often what we have thought of as our rights were wrongs for great numbers of our fellow citizens. We can--we must preserve our Constitutional guarantees--freedom of enterprise and initiative, subject only to such limitations and restraints as are necessary to protect the public interest. But we must recognize that the right to work must be coupled with the opportunity to work. Freedom of speech, freedom to worship as we will, freedom of the press,

all of our cherished liberties are of cold comfort to the destitute. There is no reason, except wilful blindness, why we cannot make our system function far better than it ever has before by guaranteeing that no willing, able-bodied worker shall lack for employment and that the aged shall not be in abject want.

I grow impatient--for events move swiftly in the world today--with those in your field and mine who say that fiscal and monetary policies suitable for the past are necessarily appropriate today. It is surprising how many who should know better, who should have learned from the experience of the past decade, still hold that taxation should be based exclusively on considerations of the need for raising revenue, without regard for the social and economic necessities that only the tax instrument can be adapted to meet, if intelligently used by Government.

I recognize fully that in the day when we had a scarcity of capital, when new capital accumulations more or less automatically flowed into new production, it was wise public policy to have taxation contribute so far as possible to capital formation. All that we could amass at home and billions more that we borrowed from abroad went into the rapid expansion of the nation across the face of this continent. But I deny that in a day when capital is over-abundant in relation to the outlets for its private investment it is still wise public policy to encourage its accumulation in stagnant pools. Rather I have favored during the decade of the 30's tax policies that tended to maintain the

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flow of purchasing power in the economy by forcing idle funds back into the circulation stream. That is a departure from the older orthodoxy, to be sure, but it involves no loss of fundamental liberties. It is no threat to democratic institutions. Rather, it is absolutely essential for their preservation. Similarly, I have favored the appropriate accompanying monetary policies. Thus during the depression, I favored making the supply of money abundant and interest rates low in order to create an anti-deflationary climate which would be favorable for recovery provided positive action were taken at the same time in the fiscal field. By the same reasoning, I favor such anti-inflationary fiscal and monetary policies as are possible at this time, when the economy has moved rapidly towards full production and employment, under the stimulus of large defense expenditures.

In the day of capital scarcity, in the day when the gold standard prevailed for most of the world, even though it was never the unmanaged mechanism pictured by its most ardent champions, there may have been logic in relegating taxation to the role of revenue only, and in putting some reliance upon the interest rate as a regulator of economic excesses. But the late 20's disabused our minds of the notion that a high interest rate could curb speculation. The early 30's should have taught us that a negative fiscal policy was both economically and politically untenable. The later 30's should have demonstrated to us convincingly that a more positive policy, even though halting and hampered by widespread resistance, can have the most powerful effect in economic restoration. And the

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present period is giving us irrefutable proof of the degree to which a vastly expanded, positive policy called forth by national peril rather than by deliberate choice, can swiftly transform the economy from under-employment to boom conditions. Unhappily, the boom conditions are largely concentrated in the industrial sectors of the economy in the production of the things of war instead of the things of peace that improve our standards of living. The logic of having taxation play a passive, neutral role in times past, and of having monetary policy responsive to international gold movements, rather than subject to national direction and control, is no longer valid in the world of today. Rather, the respective spheres of fiscal and monetary policy are reversed. Fiscal policy has assumed the greatest importance as a democratic instrument of economic action, while monetary policy assumes a secondary place. Both must be coordinated by deliberate action.

Even a cursory review of the economic history of the last dozen years indicates not only that democratic nations must and can without sacrifice of any fundamental principles use the functional Government controls of fiscal and monetary action, but that no other rational choice is open to those who profess to be in favor of preserving our institutions. The question is no longer whether such functional powers should be turned deliberately to helping us solve our economic problems, but whether we can so organize and coordinate our democratic processes, that the necessary flexibility and administrative discretion will

be afforded to achieve the best results. I am aware of the difficulties. They are inherent in established legislative processes, and the division of powers. They are present, particularly, in the relationship between the Federal Government and the States.

We have not made much progress towards simplification so far, but the time has come when we can no longer continue to tolerate this chaos. For the fact is that with the increasing assumption by modern governments of social and economic responsibilities, in the light of the increasingly important role that governments play in affecting economic conditions, what may have been an endurable conflict in the highly important fields of taxation is now too serious, too much of a limitation upon necessary democratic action, to ignore.

It is not necessary, before this audience, to stress the point that there can be no consistency or continuity of national economic policy, it can have no adequate flexibility, if it must be exercised in conflict rather than in harmony with the States. Manifestly if the Federal Government is to be effective in using its powers to dampen inflationary tendencies, State policies must, on the whole, be aimed in the same direction. In the post-defense era, Federal action to offset a slump will be ineffective to the extent that the States are not prepared to act in concert with Government policy.

In brief, monetary policy should be the servant, not the master, in the economy. We should rely heavily upon fiscal policy, its timing

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and application, as a stabilizing factor and as a motivating force without which monetary policy alone is ineffective. We should utilize and coordinate these over-all instruments of public policy, not only because of their demonstrated effectiveness, but because they are the only logical alternatives to a no longer possible laissez faire, on the one hand, and a regimented, policed economy, of fascist character, on the other. There is no reason why we cannot learn to use them more intelligently in the future than we have in the past, recognizing always that these and other functional controls are at best supplemental to the main driving force of private enterprise. There is no reason why democratic processes cannot be adapted, and every reason why they should be adapted to using these instruments of economic influence to the fullest, not only in the defense period but in the future when the economic problems of a world at peace will ironically be even more difficult to deal with than the economic problems of a world at war.