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BRITISH EMBASSY,  
WASHINGTON, D. C.,

January 18th, 1940

No. 66

My Lord,

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As reported in my despatch No. 46 B of the 10th January, 1940, the President has now delivered his budget message to the Congress, and I have the honour to enclose herein a memorandum by the Financial Adviser to this Embassy on the subject, together with copies of the budget itself.

under separate cover

Copies of this despatch and of the enclosures are being sent to the High Commissioner for the United Kingdom in Canada, the Prime Minister of Australia, care of the Dominions Office, His Majesty's Treasury and the Department of Overseas Trade.

I have the honour to be,  
with the highest respect,

My Lord,

Your Lordship's most obedient,  
humble servant,

(SGD) LOTHIAN

The Right Honourable  
The Viscount Halifax, K.G.,  
etc., etc., etc.

THE UNITED STATES BUDGET FOR THE  
FISCAL YEAR ENDING JUNE 30TH, 1941.

(cf. Mr. Mallet's despatch No. 68 E  
of January 19th, 1939).

The President delivered his budget message to the Congress on January 3rd, 1940. Copies of the message with summary statements, and of the full budget are annexed.

2. The table below states the budget totals for the years from 1931 onwards. A material change has been made in the form for 1941; by reason of the fact that the former old age reserve account has now been converted into a trust fund, the transfers to this fund out of the proceeds of the Federal insurance contributions (former Social Security taxes) are now deducted from the revenues instead of being added to the expenditures. For purposes of comparison corresponding deductions have been made in the table below back to 1937 when these transactions began. The amounts deducted are shown in brackets in a separate column in order to show the reconciliation with the table in Mr. Mallet's despatch above quoted.

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	<u>Receipts</u>	<u>Expenditures</u> (excluding debt retirement)	<u>Transfers</u> <u>to Trust</u> <u>Funds</u>	<u>Net</u> <u>Deficit</u>
	(million dollars)			
1931	3,190	3,671	--	481
1932	2,006	4,535	--	2,529
1933	2,080	3,864	--	1,784
1934	3,116	6,011	--	2,895
1935	3,800	7,010	--	3,210
1936	4,116	8,666	--	4,550
1937	5,029	8,177	(265)	3,148
1938	5,855	7,239	(387)	1,384
1939	5,165	8,707	(503)	3,542
1940	5,166	9,099	(537)	3,933
(est.)				
1941	5,548	8,424	(603)	2,876
(est.)				

3. The following table gives some details of the comparative figures for 1940 and 1941. Owing to changes in classification some minor details in the division of expenditure between agriculture on the one hand and recovery and relief on the other hand in the original budget for 1940 have had to be guessed.

Receipts/

	<u>1940</u> (Original budget)	<u>1940</u> (Revised)	<u>1941</u>
	(million dollars)		
Receipts	5,669	5,704	6,151
<u>Less</u> Transfers to old age trust fund	<u>570</u>	<u>537</u>	<u>603</u>
	<u>5,099</u>	<u>5,166</u>	<u>5,548</u>
<u>Expenditure</u>			
Legislative, Departmental etc.	918	1,029	990
General Public Works	585	688	641
National Defence	1,320	1,519	1,840
Aids to Agriculture	777	1,317	904
Pensions, Social Security	897	929	998
Recovery and relief Aids to Youth	2,468	2,190	1,556
Interest on debt, and miscellaneous	<u>1,459</u>	<u>1,428</u>	<u>1,496</u>
	<u>8,425</u>	<u>9,099</u>	<u>8,424</u>
<u>Net Deficit</u>	<u>3,326</u>	<u>3,933</u>	<u>2,876</u>

4. As regards the revised estimates for 1940, the chief changes are the increases in estimated expenditure on national defence and on aids to agriculture, and the reduction in the estimated expenditure for recovery and relief. The increased defence requirements have arisen of course from the outbreak of war, the realisation of the defective state of the United States army, and the desire to strengthen the navy against all eventualities; they will be covered by a deficiency appropriation bill now before the Congress. The increase in/



in the agricultural estimates arose principally from the insistence of Congress last summer in voting \$225 million for farm parity payments (while Congress refused at the same time to vote the additional taxes which the President demanded to cover this expense), and the necessity of replacing the losses incurred by the Surplus Commodities Corporation amounting to \$120 million. A small increase has occurred in general public works, due principally to additional appropriations voted by Congress for river and harbour works and military buildings. The reduction in the estimated expenditure for recovery and relief arises from the improvement in conditions since the outbreak of war, though the precise items in the budget affected cannot easily be traced.

The expenditure for 1940 will be the highest in the history of the Union. The deficit will be the largest but for that of 1936, the Veterans Bonus year. At \$3,900 million, the deficit will be very near the forecast given in paragraph 14 of my memorandum of 23rd August, 1939 (Washington despatch No. 972 E of 29th August, 1939.) It is no doubt the increase in defence expenditure which has falsified more recent prophesies of a lower deficit.

Since the 1940 deficit will be financed by drafts on the Treasury General Fund estimated at \$1,150 million, the increase in the public debt will be restricted to about \$2,800 million.

5. For 1941 the principal changes are a further increase in the provision for defence, a reduction in agricultural expenditure to a point somewhat above the original 1940 estimate, and a further reduction in the provision for recovery and relief.

A part of the increase defence expenditure is shown as emergency national defence; this amounts to \$160 million for 1940 and \$300 million for 1941. The normal estimates for national defence have however risen at the same time since 1939 at the rate of approximately \$200 million each year.

To compensate for the increasing defence charge and to make a beginning in the direction of balancing the budget, the other budget items have been severely pruned wherever possible. As regards agriculture, the President has once again refused to insert the provision for parity payments to farmers, and the non-recurrent item for the Surplus Commodities Corporation has dropped out; some increase however has been made in the provision for certain other agricultural services. The provision for recovery and relief has been substantially cut from \$2,468 million (original 1940 estimate) to \$1,556 million. The President, in his budget message gives the number of persons to be kept on the rolls; these together with the comparable figures for 1940 are as follows:

	<u>1940</u>	<u>1941</u>
Works Projects Administration	2,000,000	1,350,000
National Youth Administration	775,000	600,000
Civilian Conservation Corps	281,000	230,000
Total	<u>3,056,000</u>	<u>2,180,000</u>

This represents an almost startling cut, though the President as usual keeps open the possibility of asking for further appropriations for recovery and relief during the course of the year. No such

additional/

additional appropriations seem likely to be required in 1940 - indeed the estimates are now reduced - but for 1941 the President's estimates must necessarily be something of a shot in the dark.

6. At this point the President begins playing tricks. Like a conjurer he suddenly produces a sum of \$700 million in the form of surplus funds which can be handed over by government corporations to the Treasury in reduction of the budget deficit. No details are given regarding this sum and there is nothing at present to show whether the government corporations, if they are to be in a position to repay their borrowings from the Treasury, may not have to reborrow at least part of the sums on the market. If this should prove to be so, the device will merely be one to enable the government indirectly to obtain funds from the market without increasing the part of the public debt which is subject to the \$45,000 million limit.

7. Next the President proposes that Congress should vote increased taxes in 1941 amounting to \$460 million, equivalent to the emergency defence expenditure estimated for the two years 1940 and 1941. The President makes however no specific recommendation as to how this sum should be raised; it is a substantial amount representing very nearly 10% of the existing income, estate, and excise taxes.

8. By this means the President succeeds in reducing the budget deficit from the figure of \$2,876 million given in paragraph 3 above to \$1,716 million. This figure is nicely calculated so that, as far as can be estimated, the public debt will just fail by a comparatively narrow margin to reach the \$45,000

million/



million limit by the end of 1941. If Congress either insists on voting additional appropriations, or fails to vote the additional taxes of \$460 million, they will be up against the necessity of voting an increase in the statutory limit to the debt.

9. A reading of the President's budget message leaves a curious impression of irresponsibility. After remarking that in 1937 the government curtailed its expenditure too abruptly he goes on, without any attempt to go below the surface of the question how far expenditure can be cut without causing a setback in business, to propose in an almost dilettante fashion that the deficit should be cut by about half as a trial. He pays lip service to the view that while government borrowing in times of slump is salutary, the government should repay its borrowings in times of prosperity. Even the reduction of the deficit is not real since it depends in part on a juggle with the funds of the government agencies. The economic argument in the message is in reality besides the mark as it is obvious that the budget figures, after allowing for increased defence expenditure, have been constructed with a single eye to keeping the debt during 1941 within the statutory limit and putting the Congress in the dilemma described above.

10. The reactions in Congress have so far not been very definite. While the deficiency appropriation for defence in 1940 has been voted with few dissentients in the House and will probably pass the Senate without serious difficulty, the President's manoeuvre on the 1941 budget is so plain that no-one is going to be caught by it at this stage. The position may change when the various component parts of the budget come up



in debate and political considerations, and the pressure groups, get to work. The farmers are already demanding the restoration of parity payments. There has been a struggle between the Department of Agriculture and the Treasury as regards the expediency of introducing some new form of processing taxes to provide funds for parity payments. So far the Treasury and the President have held to the view that there should be no fresh taxation "which decreases consumer buying power". If this means, as it apparently does, that there should both be no new processing taxes, and that there should be no increase in excise taxes, it is difficult to see how the additional \$450 million of taxation proposed by the President is going to be raised, since it would represent an addition of no less than 20% to the income and estate taxes alone. There are in fact reports in the press that the Administration is considering the effect of an over-all increase of 10% in the income tax, but the rates of tax on large incomes are already so high that this is next to impossible. The Treasury has, it is true, made an exhaustive study of the tax structure under the direction of Mr. Hanes, but Congress has shown reluctance to approach the subject in a radical manner, and this reluctance will be especially strong in the election year. It seems altogether improbable in fact that Congress can be brought to jump this fence.

11. For the present the leaders of the opposition in Congress cannot very well express any disapproval of a budget which goes so far to meet their objections to continued deficit spending. Senator Harrison, Chairman of the Senate Finance Committee,

has proposed the setting up of a special committee composed of six members each from the Senate Appropriations and Finance Committees and the House Appropriations and Ways and Means Committees; this proposal has been unanimously approved by the Senate, but it is improbable that the jealousies of the members of the House Committees will allow it to pass there. On the other hand the House Appropriations Committee has instructed its sub-committees not to report any appropriations exceeding those in the President's budget. This may be however merely a manoeuvre to defeat Senator Harrison's proposal and to cover up for the time being the dissensions which are bound to arise later both with regard to the levying of new taxes and with regard to the cuts in agricultural services. The test on this latter point will as usual occur rather in the Senate, where the agricultural States are relatively more strongly represented than in the House.

(SGD) G. H. S. PIRSENT

16th January, 1940.