August 27, 1973

Dr. Henry C. Wallich
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Dear Dr. Wallích,

Thank you for your letter of August 15th and for responding in such detail to my inquiry about indexed securities. You really did not answer my question asking for literature on that subject and if you still happen to have some references to their abandonment I would be interested to see how that question had in fact been discussed.

In return I can offer you a tidbit of news about variable rate mortgages that you may have overlooked.

Trying to retain equity in the face of all kinds of evasion of progressive taxes will never be easy. It is hard to get much enthusiasm for any measure that even preserves the status quo on that scome. For example, we do not have a federal levy on capital assets, except insofar as the inflation of non-monetary values exposes them to the capital gain tax.

I am surprised that your colleagues are so complacent about inflation considering the regressive redistribution this imposes on the old and on the less well-informed about means to protect their interests. Even so I would not regard it as such an extraordinary evil except when it reaches a level where it distorts all other investment decisions. It is hard to see how there can be a very rational allocation of investment capital under the combined stress of tax avoidance and inflation-compensation. As for the proported inequities of tax exemptions of municipal securities, it is difficult for me to see what real injustices remain after the market has done its work. Even so, as you say specific injustices can still have specific remedies. While you were commenting on hasards like fire-loss, I was surprised that you did not point out the inconsistency between taxing income which is allocated to insurance premiums but deducting those losses which were not covered by the insurance. This must be a major incentive to self-insurance which is inequitable insofar as the advantage is only available to large-scale operators.

On page 24 where you discuss the inflation premium on current treasury security, I wonder where to turn first in the quest for the independent variable. I would have thought that the money-supply was the factor being most directly manipulated, and that investors will simply seek to get the best deal they can find with the resources they have available whether or not their expected income after taxes succeeds in meeting the rate of inflation. According to the figures in your Table I purchasing power bonds would have grossly increased the cost of money to the federal government -- and I wonder if you do not have to cirrect those again for the government's recovery of taxes on the interest it paid. I would be interested to see you further analysis of the implications of this shift in the role of the federal debt both from the standards of some hypothesized models of equity and of resource allocation.

Sincerely yours,

Joshua Lederberg
Professor of Genetics

JL/rr
Enclosure