

ADDRESS BEFORE THE  
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BY

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## THE WAR PROGRAM AND INFLATION

The waging of total war demands the maximum mobilization of striking power. It requires the diversion to the armed forces of a maximum of manpower and materials. Anything less than this would be less than total war effort and would postpone the day of victory. Thus only such manpower and materials should be left over as are necessary to sustain the civilian population and the public morale requisite for the utmost efficiency and production.

The mathematics of the problem are comparatively simple, but the problem is essentially one of human factors and of widely divergent interests, attitudes and assumptions. The difficulties arise largely from the impact the war has on our normal way of living. To the extent that people understand and are willing to sacrifice - and not merely talk about it - civilian requirements of food, clothing, transportation and other needs can be reduced to a minimum. There is, of course, an irreducible minimum. We have scarcely approached it as yet, but we are beginning to feel the pinch and our people appear to be in an increasingly restive mood. They do not appear to realize that in order to wage total war and bring about unconditional surrender as speedily as possible - goals which they are unitedly eager to attain - drastic sacrifice by the civilian population is inevitable. They are inclined to regard all the interferences with their daily lives and all the deprivations as arbitrarily imposed. They do not clearly see that the more we put into the war effort, the less there is left over for them.

If the war were closer to our shores, if the invader were on this continent, if our cities were being bombed as British, Russian and other belligerent populations have been bombed, if the feeling of sudden and imminent danger such as followed Pearl Harbor were ever present, public psychology would be very different. We would complain, no doubt, and rightly, over mistakes, but we would be more inclined to see that the waging of war and the giving up of our comforts at home are all of the same piece; the one the cause of the other. Because all of us who are so far behind the firing lines no longer have the sense of great and overhanging peril, because the astounding success of Russian arms and the victories so far won by our other Allies and by our own forces have so greatly raised our hopes of early victory, we are less than ever reconciled to the sacrifices that no longer seem to be imperatively necessary. Without faith in the American people and in their willingness to fight as valiantly for this land as the Russians and the British are fighting for their own preservation, it would be easy to become disheartened by the many evidences of internal dissension.

No appraisal of the domestic economic scene today can be realistic without taking account of a state of mind attributable primarily, I think, to the fundamental lack of understanding of the fact that the more we put into the fighting front, the more we must take out of the civilian front. As the Director of Economic Stabilization, Mr. Byrnes, stated in a recent address to the American Society of Newspaper Editors:

"There is scarcely an aspect of the struggle against inflation, whether it be wage-control, price-control, profit-control or rationing, in which public understanding and public opinion are not as important as any law or regulation.

"I have no doubt as to the basic willingness of the American people to make the sacrifices and to accept the hardships that total war requires. But I am not so certain that all of them have sufficient understanding of the specific needs and requirements of total war."

And after emphasizing what a stupendous and complicated undertaking it is to organize our total war effort in both its military and civilian aspects, he added:

"It cannot be made simple. Scold the bureaucrats and brass hats as we do, we need them. Without bureaucrats and brass hats we cannot win a total war."

Most of us who serve behind the lines in administrative jobs fall into one category or the other. We need vigilant, corrective criticism, especially when our acts offend the deeply ingrained American sense of fair play or when regulations and administrative acts actually do or appear to make for inequality of sacrifice. Beyond that, however, administrators have a responsibility, first for intelligent formulation and coordination of policies and programs, and then for explaining them so that the public may understand what is proposed and why. We must always remember that democracy rests upon the consent of the governed. The exactions, the regimentation, which cannot be avoided in total war are contrary to the whole spirit of our institutions. In wartime, therefore, it is more than ever incumbent upon those charged with policy making and administrative responsibilities to inform the public fully, so that there will be understanding of the program and the fullest possible cooperation in making effective the controls necessary for a total war effort. As it is, I feel that there has been too much confusion, due in no small degree to failure to develop and implement a well-coordinated domestic program which could be explained to the public in a manner that would bring about the understanding and acceptance necessary to make it effective.

Yet, it is of supreme importance that we never forget that this nation is still in jeopardy, that we are engaged in the most cruel and relentless struggle of our history, that we are still literally fighting for our lives, and the successes so far won will not be crowned with final victory if we falter and fall out among ourselves now. Let us be vigilant and critical, but always with the purpose in mind of doing all that we can to promote the winning of this war.

While I have no competence to judge military needs, I have some small measure of responsibility for trying to appraise economic forces and

effects. Any survey of the domestic economic scene must take account of the fundamental problem of manpower. For that issue, of which we have heard much and will hear much more, is crucial. Upon the way in which it is settled the whole problem of economic stabilization on the home front very largely depends.

In total war there is no clear line of demarcation between the military and civilian front. Production of food and many other things essential for sustaining the civilian population as well as the fighting forces, is as vital as production of planes or tanks. In determining what jobs are essential for the successful prosecution of the war, the Manpower Commission comes face to face with this problem. Many civilian jobs that would be considered essential if we had a surplus of labor and materials are recognized as nonessential today because there are no such surpluses. If we were engaged in a war effort that merely absorbed the slack of manpower and materials, such a relatively limited effort could be supplied without serious impact on the domestic economy. But total war has to be conceived and planned as a total effort, not simply as a drawing off of men and materials that can be readily spared from the civilian front.

Today it is of paramount importance that the total effort be planned as a whole, as one vast undertaking, with a full recognition of the fact that what is now being taken for the war front must come out of the home front. The more we take for the war front, the more readjustment and reorientation become necessary on the home front. There is no alternative.

What is the size of the war effort in terms of manpower? We know what the dollar measurements are, and they so far exceed the totals of any war in history as to make comparisons almost meaningless. In terms of manpower, on the basis of current discussions, the program appears to call for about eleven million men in all of our armed services by the end of this year. This does not include the large civilian personnel employed directly by the armed services. The feeding, housing and equipping of this armed force would be a tremendous task even if they were all to remain within the continental limits of the United States. But millions of them will be in far places. Food, clothing and equipment must be shipped to them over great distances. That entails a far greater drain on manpower than would be the case if they were in the United States.

In addition, our lend-lease program is running at the rate of approximately ten billion dollars a year. This means that the equivalent of another army of workers, possibly some three million of them, engaged in production and shipping by land and sea must devote all their effort to this vital supplying of our Allies, various neutrals, and enslaved peoples whom we are in the process of liberating. What these millions of American workers

furnish and transport under lend-lease is, of course, unavailable for our own use. Moreover, the lend-lease supply must be increased as more occupied territory is recaptured, and particularly if we are to heed the appeals of China and of other Allies for more and more help. So far as I am concerned, I am wholeheartedly for giving all of the aid possible.

Lend-lease enables us to serve as the Arsenal of Democracy, reinforcing and augmenting the striking power of our Allies on the fighting fronts. Now that we are reaching the limits of productive capacity, the question arises as to whether maximum efficiency, maximum striking power and hence the earlier winning of the war, as well as economic stability at home, will be better served by maintaining and increasing lend-lease rather than by reducing it in order to expand our armed forces, if it appears that we cannot do both without disruption of the home front. It should be borne in mind that lend-lease has exactly the reverse effect upon the economy of our Allies that it has on ours, because it enables them to release men for their armed forces without reducing their needed supplies, whereas in our case it requires more men for the needed production and hence reduces the number otherwise available for the armed services. The issue of how to maintain and increase lend-lease and at the same time continue to expand our armed services accordingly becomes extremely acute. As the New York Times summed up the situation editorially:

"Every man added to the armed forces, in short, not only means one man more to supply; it also means one less man to supply him."

We have as yet only begun to realize what all of this program means. It demands of our people an economic and a military effort comparable to that being made by our Allies. It means utilizing our manpower on such a scale that what is left over to support the civilian economy requires a reduction in our standard of living to Spartan levels. It greatly intensifies the inflationary problem.

The question is, can and will the American people accept quickly enough in the comparatively safe atmosphere in which they live the inconveniences and privations which such a program entails? Their present reluctance to do so is reflected in the attitude of Congress, in the hue and cry against bureaucrats, in the attacks on the Manpower Commission, the War Production Board, the War Labor Board, the Office of Price Administration, the Food Administration, and other agencies. The internal economic pressures, the conflicts of interest, make for increasing confusion and lack of unity on the home front. Certainly, a continuation of internal conflict can lead only to impeding the war effort. It is as discouraging to our Allies as it is encouraging to our enemies.

We hear people say on all sides that they are for the all-out war effort, but that what they object to is the domestic program - as if the two were separate and unrelated. Not only must the program and the relationship between the demands of the war and the privations on the home front be understood to be accepted, but without acceptance and public support, the dangers

are vastly increased. The evil which must be warded off on the home front, the threat to economic stability, is real and imminent. The fact that so many prophets cried wolf during the 30's, when the wolf of inflation was imaginary, has made it more difficult for the public to believe in the reality of the danger now.

The reasons for the difference in the situation are clear. At no time in the 30's did we achieve anything approaching full production and employment. We had many millions of idle men. We had unlimited resources and facilities. The buying power competing in the market place for goods was never sufficient to put the least strain on the economy. It fell far short of utilizing our productive capacity. All that is now changed. We are close to the limits of productive capacity. The military program has already produced an acute manpower shortage, though we are still far short of the goal which has been set for the armed services. A rapidly rising tide of purchasing power is engulfing the markets at the very time that the supply of goods, instead of expanding in response to demand, necessarily is shrinking as more and more of our output is diverted to war.

As long as we could expand the armed services by taking up the slack in manpower and productive capacity, there was little disturbance of the economy. Recruiting for the armed forces at this stage, however, on the basis of the present program will be accompanied by increasingly severe strains. They are already causing disruption in many activities, particularly in agricultural production. Reconsideration of the whole problem, therefore, becomes imperative. I agree with the comment made by Senator Maloney of Connecticut, who has just been made chairman of a Senate committee to survey the question of supply on the home front.

"The supply lines of the home front," he said, "are of vital importance to the supply lines on the military front. Our minimum essential civilian needs must be adequately planned for and fully met."

I have stressed the manpower question because this battle against inflation, with which you and I are directly concerned, turns so largely upon it. The more manpower and production are turned from civilian to war purposes and the more civilian buying power continues to expand, the greater becomes the inflationary gap that can only be closed by diverting current incomes into taxes and savings, primarily in the form of subscriptions to war bonds. The more the public recoils from restraints and restrictions because of failure to understand that this regimentation is part and parcel of an all-out war effort, the more difficult it becomes to administer existing and to initiate the additional controls vital to the maintenance of economic stability.

Such responsibilities as you and I have relate primarily to the financing of the war. We should be acutely conscious of the reality of the inflationary dangers and of the need for greater effort than we have yet put forth. We must understand the background in order to realize how urgent is the need for wider education to fire the public with a determination to resist the enemy on the home front as stoutly as on the battle front. The hour is not too late. The Government's program for combating inflation is based on sound principles, but it needs to be greatly expanded and implemented to achieve success.

You, as bankers, have a highly important part to play in conquering the enemy of inflation. Public instinct is right in understanding that inflation means a general and extensive rise in the cost of living - means that dollars become worth less and less in terms of what they can buy. The forces, however, which bring about this disastrous state of affairs are far less generally understood, because they are complex and insidious. Ask the man on the street if he wants to prevent inflation and he will invariably say that he does. But ask him to grasp the economic concepts, particularly the academic terminology that accompanies most discussions of the subject, and he is naturally very confused. He sees clearly that when he pays taxes or buys war bonds he is helping to pay for the war, but he does not see, as a rule, that paying taxes or buying bonds, and particularly he does not see that refraining from demanding higher wages, or higher prices, or larger profits helps to keep the cost of living from going up.

Yet, it is essential that he have a better understanding of these things if he is to be enlisted effectively in this fight against the enemy at home. Not only does the victory of our armed forces rest in no small measure upon the success of this economic battle, but if we fail here at home, even though our armies may be victorious, we may lose the peace and all that we are fighting to protect and preserve.

The banking fraternity has great influence, far beyond its numbers, in informing public opinion. You have many contacts with the public. You can do an educational job of the greatest importance, helping to bring about a better understanding of the program to hold the line against rising living

costs. You can inform those who do not understand and rouse those who are indifferent. You are soon to embark upon a new drive to sell Government securities. The effectiveness of the campaign depends upon how well it is organized so that personal solicitation will be made of every citizen. But you can do far more than ring door bells or make phone calls. You can help awaken the public to the urgency, for their own protection, of curbing the inflationary forces that will otherwise engulf all of us. You can help them to see what only a comparatively small number of our people yet see, that paying taxes and subscribing to war bonds are not simply ways of paying for guns and planes and tanks, but are the most effective means of drawing off excess spending power, thus preventing inflationary increases in the cost of living and the growth of black markets.

Fortune Magazine, in its March issue, aptly summarized the ways in which the inflation menace can be met by emphasizing that one method is to attack the tendency of prices to rise directly, by forbidding them to do so. The other method is to remove the forces making for the rise. To quote from this article:

"The first method might be compared to building dikes to prevent a flood from a steadily rising river, while the other is analogous to diverting a portion of the stream, thus reducing the pressure on the dikes and avoiding the impossible task of going on indefinitely building them higher and stronger. Plainly both types of control are needed, under different circumstances. But it is equally clear that if the river keeps on rising the use of the dikes alone will be inadequate, that they will either overflow or break down. As the engineering profession knows well, only the drawing off of enough of the swelling waters will serve finally to prevent a disastrous flood."

The course we should pursue is plain. Many more billions must be paid in taxes. We must invest many more billions in war bonds and other Government securities. We must extend rationing in order to secure fair distribution of scarce goods. We ought to make a national slogan of that phrase which you will find on your new ration books, "If you don't need it, don't buy it". Far from improving our standard of living, we must be prepared to cut it to the bone. We must endure regulation - which nobody likes or wants - because there is no escape from it if we are to win this war without wrecking the economy. We must stamp out black markets. We must make hoarding the shameful, traitorous thing it is. And while we are doing our utmost to draw off the surplus of purchasing power from the market places, while we are doing all we can to bring about a fair distribution of the goods available for the civilian population, we must exert every possible means of preventing this tide of purchasing power from reaching ever greater dimensions. That means that wages, salaries, farm prices, profits, cannot be permitted to go on rising.

To the extent that we succeed in drawing the existing supply of money into the war effort, it is unnecessary to go to the banks and create new supplies of money. Conversely, to the extent that we fail to draw off the overabundance

of buying power in taxes and savings, the more we have to turn to the inflationary process of bank financing and creation of new supplies of money, a process that for some strange reason does not seem to excite some of our economists as much as the question of the form in which our currency is printed. Yet, the real danger lies in multiplying the money supply represented in bank deposits and not in the form of words that happen to be engraved on the pieces of paper we use for pocket money. The supply of pocket money is trifling in comparison with the supply of bank deposits which the public could, if it wished, convert into currency.

While we all recognize that the transition from a low tax to a high tax country cannot be made overnight, and that allowance must be made for the fact that we came into the war later than our principal Allies, nevertheless, our record in levying taxes and channeling savings, first into our relatively small defense program, then into our very large war program, suffers badly by comparison.

Let me outline the 1942 and 1943 picture in round numbers:

For the calendar year of 1942, the Government spent about \$56 billions. Of this, \$19 billions, or only about one-third, came from taxes and \$37 billions was borrowed, exclusive of an additional \$8 billions which was borrowed to build up Treasury cash balances. Of the total borrowings of \$45 billions, about \$22 billions, or less than one-half, came from non-bank investors, while \$23 billions, or more than half, came from the sale of Government securities to the banks. As a result, during the year 1942 demand deposits and currency increased by more than \$20 billions.

According to estimates for the current calendar year of 1943, the Government will spend about \$100 billions. On the basis of our present tax laws some \$33 billions, or only about a third, will be raised in taxes, and the rest, \$67 billions, will have to come from borrowing. If we do not do a better job in selling more to the public and less to the banks, that is, if the same trend continues in 1943 that we followed in 1942, we would borrow approximately \$33 billions from the public and \$34 billions from the banks. This in turn would result in another large increase in demand deposits and currency, amounting to more than \$30 billions.

In other words, it would mean that our money supply would have increased by more than \$50 billions - that it would have doubled - since the war began. This trend must not be permitted to continue indefinitely.

If it is allowed to continue, if we fail to tax sufficiently, if we fail to divert much more of the current income of the public into the war effort, both through taxes and savings, if we do not rely much less upon creating new money supplies through bank borrowing, we will have sown an economic whirlwind. Its shadow will be seen in the figures of public debt and money supply expanded to explosive proportions. Its effects will be felt by every one of us, most of all by the workers and farmers who make up the vast majority of our people. Any such betrayal of them, of all of our armed forces, because we lacked the courage and the leadership to impose taxes and other restraints would, with justice, recoil upon all of us who have responsibility in any degree for formulating and gaining public acceptance of measures necessary to protect the economic front.

Theoretically, of course, the ideal situation would be one in which the Government recaptured by taxation every dollar it spent in the war effort. Like most worthwhile ideals, this one is equally unattainable and no nation has succeeded in reaching it.

But other nations have come much closer to it than we have so far. Both our Canadian and British allies have done much better. Putting it in general terms, they are financing about half of their expenditures by taxation, while our present taxes will raise less than a third. Of the half that they borrow, about two-thirds is drawn out of public spending power and only one-third from the inflationary process of bank borrowing. Not only are we borrowing about two-thirds of our requirements, instead of one-half, but, as the figures I have cited disclose, so far we have borrowed considerably more from the banks than from the public. We hear it said that comparisons cannot fairly be drawn, but there is no getting around the fact that people in Canada and Great Britain have been asked to give up more of their income in taxes and purchases of Government bonds than we have, and that they therefore have much less left over to spend currently. Let anyone who thinks too much is already being demanded of us in taxation, for example, consider the record of New Zealand. She has met two-thirds of her truly all-out war effort by taxation.

We should aim at raising taxes and compulsory savings equal to at least half of our expenditures. As much as possible of our remaining requirements should come from borrowing from the public, thus reducing to a minimum reliance upon borrowings from the banks. I believe that without further delay Congress should authorize a withholding tax on all income in excess of the income tax exemptions, the withholding tax to amount to 25 per cent if the Victory tax is retained. I think it would be preferable to repeal the Victory tax and make the withholding rate 30 per cent, some part of which, possibly 5 per cent, might be refundable after the war. Such a withholding at the source would not only collect funds before they reach the inflation stream and channel them immediately into the Treasury, but it would insure collection of taxes that are

likely otherwise to escape altogether. The adoption of a high withholding rate would require some form of pay-as-you-go plan.

We must have another general revision of the revenue laws as soon as practicable, and tax rates must be further increased, particularly for the lower and middle income groups where the great increase in purchasing power has developed. Various remaining loopholes need to be closed. Imposition of the withholding tax, however, can be accomplished promptly without waiting for a general revision.

If we fail to absorb enough spending power through the medium of income taxes, based as they are on ability to pay - if we are not willing to impose income taxes comparable to those in Canada and Great Britain - then I can see no practical alternative except resort to the sales tax which can best be applied at the retail level. It has been estimated that an 11 per cent rate might be expected to yield about \$5 billions, if food and other items are not exempted.

While I realize how difficult it would be to gain a general acceptance of the idea, it would be to the interest of labor if all who receive additional half-time or premium pay for the hours worked above the 40-hour week were to accept that premium pay in the form of a post-war credit instead of in dollars that only go to swell the spending stream and thus run the risk of losing their buying power.

Much can be done in this fight on inflation on the production side. For, of course, if production of goods and services were able to keep up with rising supplies of purchasing power, there would be no inflationary problem. We cannot profess to be making an all-out effort unless we all work much longer and harder, unless we avoid absenteeism as well as strikes and other interruptions of the flow of production.

Indeed, if we are to face up to this situation as realistically as we should, we must not only pay far heavier taxes, buy more war bonds, work longer hours, abstain from increased pay, prices and profits, submit to more and more rationing and price controls - in short, we must not only have much more of these things of which we are prone to complain, but we must consider additional measures and techniques demanded by the unprecedented problems resulting from this unprecedented war. I can see no logical reason why, when we are all engaged in this life and death struggle, we should not all be subject to draft and assignment to the duties we can best perform; those on the home front just as much as those on the battle front.

I do not know whether Mr. Harry Hopkins speaks with prophetic voice, but I am in accord with what he had to say in a recent article, taken from the American Magazine, under the title, "You Will Be Mobilized". As he said:

"You can't call a man unpatriotic if he leaves one job to take another at higher wages, when everybody else is doing it. There is no ground for criticizing a manicurist in Denver because she doesn't

"voluntarily go to California and work in an airplane plant. I recently was in Iceland and found plenty of American soldiers, but not enough carpenters and bricklayers. The government had sent the soldiers but had asked the civilian workers, and too many had said, 'Sorry, no.' To ask is not enough."

It does not appeal to my sense of justice that the young men of this nation, who have been dispatched to the four corners of the earth in our armed services, who cannot lay down their weapons and take a day off at will, who cannot shift from job to job as they please, should risk their lives and lose them while we at home quarrel and complain, squabble over dollars, seek to fatten our pocketbooks, to hoard scarce foods and other essentials of life; we who are safe from bombs, whose lives are not in jeopardy; we - too many of us - who act as if these were lush boom times instead of a war to the death.

The conscience of the American people needs to be reawakened to lift us out of this sordid competition, lest greed and selfishness at home cause us to lose all that these men are fighting for, all that we profess to be defending. There is no place for politics in voting measures to protect us from the enemy at home as well as from the enemy abroad. We have by no means supported the war effort when we have done no more than vote the funds necessary for military purposes. It does not make good sense to give this support to the military side of the war and then refuse the measures essential for protection of the home front on which our military effort depends. Inflation can only be conquered by providing the taxation and savings that offset the inflationary effects of the billions appropriated for conduct of the war. Fiscal and monetary authorities are helpless to deal with the problem, either now or in the post-war era unless Congress arms them and other agencies with the necessary weapons of taxation and other means of control. Indeed, to the extent that Congress fails to raise taxes and fails to authorize or to support other protective measures - to the extent that you in this audience tonight and all of us fail to absorb buying power through the sale of war bonds - the monetary authorities have no alternative except to provide the banking system with the reserves with which to buy bonds - and that is the high road to inflation.

Inflation cannot be controlled either now or after the war by a restrictive monetary policy. That would serve only to demoralize the Government bond market. The deficit is the basic source of the inflation danger which we face today, and the danger is magnified to the extent that Congress fails to provide for taxes, savings, and other measures that will help to close the enormous gap between what is being poured out to pay for the war and what is being pulled back in taxes and savings out of this inflationary stream. That gap is widened every time wages, salaries, farm prices, and profits are boosted. If anybody is to have pay increases, let's provide them for the men on the firing line and their families - they are not organized into pressure groups, and they are the ones who are making the greatest sacrifices.

But let us not fool ourselves that we are helping to win this war or to protect this nation by a blind scramble for more pay and profits in this critical hour. We cannot get rich out of this war. We cannot have victory and soft living. The enslaved peoples of this world who look to us for deliverance will not be heartened unless we set a far better example of self-sacrifice and national conscience than we have so far displayed. We can, if we wish, make the choice that will vindicate the contemptuous charge so often hurled at us by Nazi and Japanese propagandists - the charge that the democracies are too soft and too selfish. We will not make that choice, but our people must be rallied and awakened to press the fight against the enemy at home as resolutely as they are resolved to wage it against our enemies abroad.