C O P Y

MEMORANDUM FOR THE PRESIDENT URGING AN ANTI-INFLATION PROGRAM

On March 17 you directed that an integrated anti-inflation program be formulated by the Secretary of the Treasury, the Price Administrator, the Chairman of the Board of Governors of the Federal Reserve System, the Secretary of Agriculture, and the Director of the Budget. In accord with those instructions we submit the following memorandum. The Secretary of the Treasury, who is in basic disagreement, has already personally submitted his views to you, and to the world.

War expenditures are increasing at a rapid rate. They are now adding more than $2 billion monthly to the incomes of farmers, wage earners, and businessmen. At the same time, war production is cutting deeply into the supply of goods available for civilian use. Prices and the cost of living are rising dangerously although the war program has just begun to take shape. By the end of this year, war expenditures will exceed $6 billion per month, or more than double the present rate. These expenditures are running well ahead of budget estimates.

We have examined the situation carefully. We have analyzed the possibilities of partial programs. We have come to the conclusion that partial programs will not work and that only a simultaneous attack on prices, rents, wages, profits, and mass purchasing power will suffice. Such a comprehensive program is not only economically and politically sound, but the Gallup Poll has indicated that it will arouse strong public approval. The four main elements of the program are discussed

briefly below, followed by an outline in somewhat greater detail (see Addendum).

Price Control

The only way to stop the inflationary spiral is to place a ceiling immediately on all prices -- retail, wholesale, and producers'. This is a strong measure but one which three-fourths of the people are asking for according to the polls.

Since some retail prices (by no means all) do not fully reflect the increased wholesale cost of goods, certain classes of retailers will be squeezed. However, the Office of Price Administration is now formulating supplementary orders lowering the prices of wholesalers' and manufacturers' goods. Conferences on these orders are now being scheduled and substantial relief will be provided by the time retailers must replace present stocks. But this will not be easy. In some cases subsidies will be necessary to hold down the cost of goods. These steps are important because as war production increases, the sales volume of retailers and wholesalers will decline. This also means a squeeze of profits, especially for retailers who constitute the backbone of small business.

The proposed general ceiling includes most foods and all clothing at retail. The Emergency Price Control Act must be stretched if this broad field is to be covered. If the cost of living is to be fully stabilized, the 110 percent parity limitation must be stricken from the price law. Furthermore, the prices of feeds must be held at their

current levels, well below parity, in order to prevent a rise in the prices of meats and dairy products. The Congress must be persuaded that the sale of government-owned stocks should not be restricted.

Wage Control

We propose the proclamation of a policy of stabilization of wage rates, except those below 40 cents an hour.

We do not lightly propose this action. In the long run, a sound labor policy cannot permit wage rates to move up freely while the farmers and small business are controlled. Deep popular resentment would follow the exemption of labor from the general program. On the basis of this resentment, the Congress would sooner or later take steps not only to redress the balance but to strike at the very heart of collective bargaining.

The hope has often been expressed that stabilization of the cost of living would suffice, and that the stabilization of wage rates is unnecessary. This hope is unfounded. The shortage in labor is already such that wage rates in nonmilitary industries are being forced upward by competition.

Wage income is certain to increase even if wage rates are stabilized. The number of employed workers and therefore the family income of workers, will continue to rise. Furthermore, employees will work more hours per week at overtime premiums and they will move up continually from lower to higher paid jobs. We do not propose to stabilize wages below 40 cents an hour.

Stabilization of wage rates eliminates only one important inflationary factor. It reduces the excess of purchasing power over shortened supply so that the remainder of the problem can be managed through fiscal and price control measures. Unless wage rates are controlled, we believe that increased labor costs and increased consumer demand will shatter the price ceiling and thereby discredit price administration and government in general.

Labor leaders may be reluctant at first to accept the policy of wage stabilization. None the less, such a policy basically serves the best interest of labor as well as sound national policy. We are convinced that labor will accept this policy if it is part of a program of equal sacrifice. Stabilization of wage rates will still leave a broad field for constructive union activities.

Profits

Corporate profits in the year 1941, after the payment of taxes, increased at about the same rate as wage and farm incomes. Some salaries and bonuses of management have been blown up out of all reason. These instances are well known to labor and farmers -- they incite demands for higher wages and higher farm prices.

The proposals for profit taxation in the pending Treasury Bill will reduce 1942 profits at the disposal of corporations below the level of 1941. But even these stiff tax proposals will permit some corporations and some individuals to retain unreasonable gains. To remedy this situation, the following measures are suggested:

1. The excess profits tax provisions of pending Treasury proposals should be tightened. While it would be desirable to modify the bases for determining excess profits in order to close all loopholes in taxing excessive profits, that fundamental issue probably should not be reopened at the present time.

2. Unreasonable salaries and bonuses, and salaries and bonuses which have been increased to avoid taxation, should be eliminated by strict application of the internal revenue laws which prohibit deductions of "unreasonable" salaries in computing net income.

3. A ceiling of $50,000, after taxes, should be placed on individual incomes, thereby dramatizing the equality of sacrifice implicit in the proposed over-all program. Moreover, that limit will stifle the criticisms and questionings which have followed recent disclosures of excessive salaries in war industries.

Absorption of Mass Purchasing Power
by taxation and saving

Price and wage stabilization are doomed to failure unless the explosive pressure of excess purchasing power is reduced through appropriate tax and savings measures.

The pending tax bill of the Treasury falls far short of that requirement. Even if wage rates are stabilized and the complete Treasury tax program is enacted immediately, excess purchasing power this year will still amount to more than $10 billion. Furthermore, much of the excess will be in the hands of people who typically spend

almost all of their income. It must be remembered that about half of all consumption is by people whose income is not materially affected by the income tax.

The Treasury voluntary savings program is also hopelessly inadequate to deal with this problem. Less than 10 percent of all savings bonds have been bought by individuals in the lower-income brackets. Over 90 percent of the bonds sold represent merely the normal savings of the middle and higher-income groups.

A voluntary savings program will not sufficiently curtail the consumption of the lower-income groups. To do the job, it is essential to have some type of compulsory universal saving. We are convinced that a voluntary program will not be effective, that it will be extremely inequitable, and that it will undermine public morale and create ill will. It is doubtful whether voluntary savings even with coercive pressure can obtain an adequate volume of subscriptions from the people whose purchasing power must be reduced.

During the last war, the voluntary savings program extended even to badgering school children, to vicious pressures, to odious personal comparisons, and to painting yellow the homes and barns of those who failed to subscribe to the satisfaction of their neighbors. Since coercion is inevitable in any event, it should be placed upon an orderly and equitable basis. An analogy is the universal draft which has proved so superior to a semi-voluntary service system.

We propose a Universal Savings plan, with savings invested in non-negotiable bonds payable after the war when hard times begin. We suggest rates, beginning with 5 percent, and soon to be stepped to 10 percent of incomes after taxes. It would apply to single individuals with incomes over $500, and to married persons with incomes over $1,000. This program will actually cut consumption. It will, we are convinced, be popular and will go far toward dispelling fears of post-war deflation, particularly among the millions of men and women who were unemployed not so long ago.

We do not feel that it would be wise at this time to increase the Treasury tax program beyond the modifications in the excess profits taxes suggested above. We do propose, however, that the Congress be requested to make the following changes in the personal income tax to become effective on January 1, 1943:

> A reduction of exemptions under the individual income tax to $500 for single, $1,000 for married, and $250 for each dependent, with a moderate rate for the lowest income bracket. This reduction will not greatly burden the individuals brought under the income tax for the first time. Its chief effect is to increase the burden for persons in the middle income brackets already subject to the tax. It will provide a broad base for future increases.

We recommend also that the Congress be urged to give early consideration to the proposed extension of the social security program as outlined in the Budget Message.

We have considered at length the role of consumption taxes in a war period. We have concluded not to recommend a war consumption tax at the present time. We believe that such measures as low-bracket income taxes, increased universal savings, and social security taxes are superior to sales taxes. We think, however, that you should announce to the country and to the Congress that you are determined to recommend a war consumption tax if the fiscal program which you suggest should not prove adequate to absorb the excess purchasing power. The stabilization program must be executed under all circumstances -- if necessary by resort to regressive forms of taxation, which are normally undesirable but more desirable than an inflationary price rise.

We recognize that the Congress is likely to enact a sales tax with or without your request. If you indicate that a war consumption tax may be necessary for future use, as stated in your recent Budget Message, you may deter the Congress from enacting it now as a substitute for a portion of the income and profits taxes included in the present Treasury tax bill.

Conclusion

Only a program as drastic and broad as that here outlined can

( ) It might be worth while for you in your message to Congress to say that if, during the last half of 1942 ( ) the cost of living goes up more than 2 points - you will ask Congress for a War Consumption Tax (separately billed emphasizing the fact that funds will go to the Treasury and not into increased prices). H. A. Wallace

stop inflation. Every element is essential to the effectiveness of every other element. Any lesser program must fail. Such failure will be a major defeat. The program we have outlined is more than an anti-inflation program. It is a call to the colors on the civilian front, a call the nation is waiting to hear in the present critical hour of our history.

(Signed)

Claude R. Wickard

Leon Henderson

M. S. Eccles

Harold D. Smith

H. A. Wallace

Attachment.
April 18, 1942

ADDENDUM

OUTLINE OF THE ANTI-INFLATION PROGRAM

1. Prices should be stabilized at present levels.

   A. A maximum price regulation should be issued immediately covering retail, wholesale, and producers' prices which can be frozen under the Emergency Price Control Act of 1942.

   B. Rents should be stabilized within the limits of the Emergency Price Control Act.

   C. Congress should be requested:

      (a) To modify the provision in the Emergency Price Control Act which prevents ceilings on agricultural commodities unless their prices are at or above 110 percent of parity, to permit ceilings at present prices seasonally adjusted or at 100 percent of parity, including Government payments, whichever is higher;

      (b) To authorize such payments or price supports as may be necessary to assure desirable volumes of agricultural production;

      (c) To remove all restrictions against the sale of government-held commodities, and to modify the provision contained in the House Agricultural Appropriation Bill for full parity payments on basic commodities.

2. Wage rates should be stabilized at present levels.

   A. Wage stabilization should be announced by proclamation of a national policy for guidance of the National War Labor Board and other government agencies concerned with labor arbitration and conciliation. The Price Administrator and the chiefs of the procurement agencies should not regard increases in wage rates as a justification for price increases.

   B. The stabilization should not affect wage rates below 40 cents an hour; increases in wage rates in war plants should be permitted only in exceptional cases.

   C. A standard work week of 48 hours should be proclaimed with time-and-a-half paid for overtime above 40 hours.

   D. Double time for Sundays and holidays should be abandoned. Restrictive labor practices should be eliminated.

3. Profits and high incomes should be drastically taxed. Congress should be requested:

   A. To adopt Treasury tax proposals with minor modifications in the excess profits tax (top bracket of 100 percent; modify the optional method for determining excess profits by lowering the capital ratio from 7 and 8 percent to 4 and 5 percent);

   B. To adopt Treasury proposals for closing loopholes in income taxes and for modifying estate and gift taxes;

   C. To put a ceiling of $50,000, after taxation, on individual incomes;

   D. To make full use of provision in the income and profit tax laws disallowing deduction of "unreasonable" salaries in computing net income.

4. Absorb excess purchasing power. Excess purchasing power should be absorbed at an annual rate of about $6 billion during the first half of the fiscal year 1943, and above $10 billion during the second half. Congress should be requested to enact:

   A. A Universal Saving Plan should be adopted to start with 5 percent of income on July 1, and 10 percent on October 1. It would apply to single persons with incomes of $500 or more, and to married persons or persons with dependents with incomes of $1,000 or more. Basis is the whole economic income after taxes without exemption. Adjustments are to be made for borderline income. Immediate redemption of bonds will be permitted in cases of hardship;

   B. Individual income tax collected at the source under present exemptions and deductions; withholding of 10 percent of taxable income starting on July 1, 1942.

      Lower exemptions to $1,000 for married persons, $500 for single persons, $250 for each dependent, with tax rate of 12 percent for first $500 of taxable income; collect at source at 12 percent rate beginning January 1, 1943.

5. Request the Congress to consider the extension in the social security program as proposed in the Budget Message.

6. Leave the door open for war consumption taxation at a later time.

7. Extend rationing of scarce life necessities.

8. Tighten credit controls.

April 17, 1942