April 24, 1947.

My dear Mr. Clifford:

Enclosed is a brief note to the President and a memorandum which I have prepared as a result of the discussion at the Cabinet meeting of the price situation. I understood that the President intended to call a subsequent meeting to consider what steps might be taken. Inasmuch as he was good enough to include me in the exploratory meeting, I felt it would not be inappropriate for me to put my own viewpoint on paper, as I shall be in the West during the next two or three weeks.

I also enclose a copy of the memorandum for your information.

Sincerely yours,

M. S. Eccles,
Chairman.

Mr. Clark M. Clifford,
Special Counsel to the President,
The White House,
Washington.

Enclosures

ET:b

April 24, 1947.

My dear Mr. President:

Since you included me in the Cabinet meeting at which the price situation was explored, I thought perhaps I should pass along to you a memorandum of my own viewpoint on possible governmental policy, for whatever it may be worth in the event you have a further discussion of this important subject. Accordingly, I am enclosing the memorandum.

May I add that meetings such as you have called to discuss economic problems seem to me to be most wise, and I appreciate your including me so that the Federal Reserve viewpoint may also be expressed.

Respectfully yours,

M. S. Eccles,
Chairman.

The President,
The White House.

Enclosure

ET:b

4/24/47

GOVERNMENT POLICY IN RELATION TO THE PRICE STRUCTURE

The postwar inflation, unless prolonged by substantial general wage increases and deficit financing, is nearing its end. Its basic causes were the war-created backlog of demand and expansion of buying power without a corresponding increase in civilian goods and services. It could have been largely avoided if the wartime controls, such as allocations of scarce raw materials, building permits, rationing, price and wage controls, as well as the excess profits tax, had not been prematurely abandoned.

Subsequent inflationary developments have created serious maladjustments in the structure of prices, wages and profits. We have had an unprecedented expansion of credit to both business and consumers. Especially dangerous has been the unregulated increase in mortgage credit which, being based on prevailing high prices for real estate, has burdened many home owners, particularly veterans, with long-term debt charges heavier than they will be able to meet out of prospective incomes.

As a result of increased production, the satisfaction of the more urgent demands, and the current high level of prices in relation to incomes, a period of readjustment is impending. The readjustment is inevitable, necessary and, in fact, desirable in order to correct the unbalanced conditions and relationships in the price structure. The longer the readjustment in prices is postponed, the greater will be the amount of unsustainable private debt to be liquidated. In other words, the sooner the readjustment takes place, the less serious it will be, and the quicker we shall reach a stable condition of employment and production.

The country must now take the consequences for having permitted the normal forces of free enterprise to operate unhampered in an abnormal situation in which effective demand far exceeded available supply. Under present circumstances the objective of Government policy should be to prevent further price maladjustments and to hasten correction of existing maladjustments. Inflated prices must be reduced to levels at which the great mass of consumers will be able to purchase goods and services in sufficient volume to maintain a stable high level of production and employment.

Immediate policies recommended.

For the immediate future, therefore, the following policies should be adopted:

1. While inflationary pressures continue, present fiscal policies should be strengthened by reducing Government expenditures as much as possible without impairing the essential functions of Government, and by continued debt retirement.

2. Further general expansion of bank credit should be restrained without raising the general level of interest rates and thus upsetting the Government securities market.

Lending activities of governmental credit agencies should be restricted and liquidation of outstanding credits encouraged. Margin requirements on listed stocks and consumer credit controls should be retained on a restrictive basis as long as heavy demands and rising price pressures continue. Even when the supply of major durable goods exceeds demand, it would be wise to maintain restraints on instalment credit. If they are kept, sellers will be inclined to reach more customers by reducing prices instead of maintaining high prices and reducing terms. In order to regularize the status of this control, the Federal Reserve System should be given permanent power to regulate consumer credit.

3. Government operations in commodity markets in connection with price supporting programs, for export, or for other purposes should be so conducted as to discourage further price advances and to encourage general declines in prices. Further measures should be taken to increase margin requirements in organized commodity markets.

4. Organized labor should limit wage demands, particularly in those areas where wages have risen furthest as compared with prewar levels. Increased wages ought to be avoided, particularly in those areas where they have

risen the most, because further increases would limit or prevent possible price reductions by industry and tend to freeze high prices. Wage increases at this time for organized labor would go only to one group and would make for worse distortion. Price reductions, on the other hand, would benefit everyone. Increased productivity is still the primary need, especially in the building trades where restrictive union rules and monopolistic tactics stand in the way of urgently needed construction, particularly of housing.

5. By reducing prices and operating on narrower profit margins, consistent with sustained employment, business can help to bring about the readjustments necessary for sustained production and employment.

In support of these measures the Government should use all available resources to provide leadership and guidance designed to achieve an early and orderly readjustment, which would prevent further inflation and hence minimize the danger of excessive deflation. The Council of Economic Advisers, in cooperation with the Joint Committee on the Economic Report, other appropriate governmental agencies, and various economic groups, should ascertain and point out the principal distortions in the existing wage-price-profit stfucture and suggest procedures for correcting them. An immediate reduction in prices and profit margins is essential to hold the wage line in the immediate future and avoid excessive deflation later on.

Measures to prevent undue deflation.

The many shortages and the accumulated buying power that will continue to exist are important sustaining forces for the future. Nevertheless, there is real danger that the subsequent readjustment will throw the economy into a deflationary spiral which would reduce prices more than is needed to correct existing maladjustments and so lead to serious and sustained unemployment. Supporting action should not be adopted until necessary readjustments are assured. Preparations to support income and employment, however, should be planned for future use with a view to preventing necessary price readjustments from going too far.

1. A program of tax reduction designed to stimulate consumer purchasing power should be prepared now to be put into effect after incomes have declined. The kind of tax reduction proposed in the House bill is entirely unacceptable for this purpose. What will be needed are reductions in tax liabilities of the lower income groups. This can best be achieved by raising exemptions. An increase in the personal credit from $500 to $750 or $1000, applicable when deflationary forces are well underway, would offer the most practical and effective means of increasing consumer purchases. Reduction in the higher-bracket individual taxes, beyond what would be provided by the increased exemption, or in corporate taxes would not be needed because the supply of savings and

investment incentives are likely to remain adequate, if not excessive, and hence would require no tax stimulus.

2. Consumer credit controls and margin requirements on transactions in commodity and security markets should be relaxed at the proper time.

3. Public works programs and those for foreign lending and relief activities should be ready for expansion.

In the event that a serious depression were allowed to develop, we would again be confronted with a budgetary deficit because of declining revenues. It would be better to incur relatively minor deficits in order to cushion the economy against real depression than to attempt to make budget-balancing the controlling factor. A budgetary surplus is unquestionably appropriate under existing circumstances. A deficit, which would be large and inevitable in a depression, would be appropriate if necessary to offset a severe economic decline. The timing and size of the deficit ought to be determined by the extent of that decline.