

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

April 17, 1942.

To - Chairman Eccles

From - Mr. Thurston

As Leland told me over the phone that Harold Smith would like to have some draft material by four o'clock yesterday afternoon, when he was to go over to the White House to see Judge Rosenman, I delivered this to him immediately, and he called for another copy this morning.

Until the program is better gelled than it is now, it is difficult to deal with it precisely, but aside from that, I think this text can be much further simplified and the subject made more vivid and dramatic.



E. T.

Attachment

April 16, 1942

This draft of portions of a possible radio talk by the President was prepared at Mr. Eccles' request before he left for Utah. It attempts to translate the economics of inflation into every day language. The part dealing with the program is more tentative than the rest because the program itself is still being negotiated.

E. A. Goldenweiser

April 16, 1942

This evening I want to talk with you about the war front that is nearest to us -- the domestic civilian front. We are fighting this war to preserve the dignity of man -- the importance of the individual in this world. Our battles are being fought on many fronts -- on land, on the sea, under water, and in the air -- in all parts of the world, close by as well as many thousands of miles away. Right action on the home front is vital to all of us; it is vital to those who are doing their bit at home and to those who are away with the armed forces. We want our boys in the service to know that the war effort is not permitted so to disrupt our economy as to make life unnecessarily difficult for their families. Nothing will take the spirit out of a soldier so fast as news that his loved ones at home are suffering want. We must make sure that this does not happen. We also want those who serve in the army and navy to know that the world to which they will return when the victory is won will be a world in which the worth while things of the old order will be preserved. How fully we can achieve this we do not know, but we owe them the pledge that we shall exert every effort to that purpose.

The greatest danger that we face on the economic front is the danger of a runaway rise in prices. Such a rise would reduce the living standard of the people, would rob savings and insurance policies of much of their value, and if carried far enough would lead to a collapse of the entire economic structure. What I want to tell you briefly is why we are in danger of a rapid rise in prices, how all of us would be affected by such a rise, and what we can do to prevent it.

Why are we in danger of a harmful rise in prices? Briefly stated, the answer is that we are producing and paying for more things than ever before in history, but many of these things -- the war materials -- are not for the use of the civilian population; consequently a large part of the money expended for the record output tends to bid up the prices of the limited amount of goods that are for sale.

Our output is 40 per cent larger than at its previous high in 1937. The money that is spent by the Government and by private enterprise in producing these goods is paid to the people and forms a powerful money stream known as the national income. This money stream is now flowing at the rate of \$110 billion a year, compared with \$77 billion in 1940 and \$95 billion in 1941. It finds its way into the pockets of all the people, farmers, wage earners, salaried groups, manufacturers, and merchants. They in turn can do only one of five things with their money -- spend it for what they want to buy, pay taxes, pay debts, save it as money, or invest it. As a matter of fact everyone does more than one of these things with his money, and many do all of them to a greater or less extent. The large recent rise in income, however, has come to many people after long years of hard times and there is evidence that much of the new money is being spent on all kinds of things -- better food, clothes, furniture, and entertainment.

In ordinary times -- that is just what we want. It is the demand of the consumer, that is, of the people, for goods that makes the merchant fill his shelves and the manufacturers employ labor to produce the goods to fill these shelves. It is the demand of the consumer that keeps the wheels of industry turning. And in ordinary times the output of industry is available to the consumer. We did a great deal in the Thirties to increase the demand of consumers for goods and thus to restore prosperity.

But these are not ordinary times. We are at war. The growth in our national output has been in desperately needed airplanes, and tanks, and guns, and ships with which to fight the enemy. This output adds nothing to goods available to the civilian. The money spent by the Government for war goods flows into the pockets of the people -- for the most part, civilians. Consequently, the consumer's demand for goods -- backed by the money he has earned -- is very much larger than the output of the kinds of goods he wants. We are working at capacity -- producing things with which to win the war. We must produce still more war goods -- and to do so we must not only not increase but actually and seriously cut down the production of civilian goods. We have shortages of many raw materials, such as steel, aluminum, lead, magnesium, nickel, tin, copper, chemicals, burlap, rubber, and silk, and we must use whatever quantity of these scarce goods is available for war purposes. Else we cannot win the war.

From the economic point of view, from the point of view of the domestic front, all this means that we have a swollen stream of income -- of money in the hands of many people. This money is burning holes in their pockets, they are eager to buy long-needed or long-desired things as well as to satisfy newly developed wants. For there are no limits to our wants. This enlarged income is bidding for a reduced amount of goods -- and nothing but further reduction is in prospect. What happens in such conditions? The record of history on this score is plain; what happens is a rapid rise in prices. More money with no more goods means more money for each piece of

goods -- in other words -- higher prices. That is what has always happened before, and that is what is already happening and will happen increasingly -- unless we do something about it. This, if I understand them correctly, is what economists mean when they speak of inflation.

There is a further point I wish to make. When there is a race between money and goods and money comes in ahead, prices rise by far more than the winning margin. A 10 per cent excess of money over goods may easily start a 100 per cent rise in some prices, and that may lead to a further increase in money, and a further rise in prices. This in turn leads to speculation and hoarding, to a flight from money whose value is shrinking into goods whose value is rising. A price rise, like a snowball, grows as it rolls -- until it becomes a devastating avalanche.

Let us consider next why a rapid rise in prices is to be avoided. How is it going to affect you or me -- whoever we are -- farmer, wage earner, professional man, manufacturer, merchant?

I want to tell you that I firmly believe that a rapid rise in prices will hurt everyone of us, and if it goes far enough, will ruin us all. You may be a wage earner. Business at the shop has been brisk, your pay has been raised, say, from \$30 a week to \$40 a week. You come home with more money in your envelope. You feel happy. Now, you think, you can buy your boy that bicycle, now your wife can get a new dress, and you can also afford a steak once in a while. But when you discuss the matter with your wife, you find that she has been at her wit's end to manage on your old pay because prices of everything have been going up. She has had to cut down below what is good for the family, she has had to let bills accumulate. Your raise

gives her no margin for new purchases; it does not give her a chance to relax and possibly to satisfy some wish or need. It only pulls her part way out of the hole. You have more dollars but they will buy fewer things. You have gained nothing. In fact, you have lost, because prices have gone up faster than wages and your larger number of dollars buys fewer goods than you could buy before. You are a loser by this turn of affairs. And such money as you may have in a savings account, and in insurance has also lost much of its value in terms of things that it will buy. The money is still there but it may buy only a fraction of what you have counted on. You have lost in real wages/⁻⁻the wages translated into goods that you can use -- and you have lost a considerable part of your savings -- of what you thought of as your economic security.

If you are a salaried man, your condition is no better. If you have an office of your own -- as doctor, dentist, lawyer -- your office costs go up and at home you meet the specter of rising expenses. If you try to pass your higher costs on to your patients or clients, you run into increasing inability to pay, for price advances are bearing down on them also.

How about the farmer? He may get more money for his crops. If he has large cash crops and uses mostly his own labor and that of his family, rising prices may benefit him for a while. The payments on his mortgage will be easier to meet. But the cost of all he buys will rise and his profit will not be as great as he thought. After a while it will be harder for him to sell his crops as the people in the city find it harder

and harder to make ends meet. This is a family unit farmer raising a cash crop. He is in the most advantageous position in a period of rising prices, but he also will suffer if it continues. Most farmers are much worse off. They have to buy food and fuel and fertilizer and to hire labor. They will suffer from a rise in prices of what they have to buy fully as much as, if not more than, they will gain by better prices of what they have to sell. And if human nature is still what it has always been, many of them will also try to enlarge operations by buying more land at fancy prices and will be ruined by the mortgage on that new land in later years. That is what has always happened to farmers during and after a spurt in crop prices.

The manufacturer and the merchant fare much as does the farmer. Costs rise by more than the increase in the price of products or merchandise and after a while the market collapses as customers become pinched by rising costs. Business men who have had experience with it dread inflation like the plague.

I need hardly add that those who have fixed salaries, pensions, or annuities, or who live on incomes derived from Government or other securities -- are the first and the hardest hit by a rise in prices. Their income remains constant while that number of dollars buys less and less of the things they need. This group includes many millions of our people, for example, school teachers.

This is a vicious thing. It causes distress while it is in process and brings disaster in its wake. While the upswing continues -- the people in trying to keep up with rising prices incur bills and other debts, use up their savings, mortgage their homes, and neglect their health and the education of their children. When the rise comes to an end, and it always does come to an end, prices drop rapidly, commitments become unmeetable, debts become unpayable, reserves are depleted -- and the whole economy is prostrate. These are not figures of speech. The Twenties and the Thirties are rich in examples of every kind of price advance and its aftermath. It is not a pleasant thing to contemplate.

I believe that it has been proved as surely as anything in this world that we have nothing to gain and a great deal to lose from an undue rise in prices. It feeds on itself by increasing the cost of everything to the Government and to everyone else; this leads to the need for more money and a further increase of prices. So a vicious cycle gets under way. After it has gathered momentum it is almost impossible to arrest short of disaster.

We are confronted with the danger of an unrestrained advance in prices and we must try our utmost to avert it. The question is, what can we do? As I said in the beginning, the five uses of money are for goods, for debts, for taxes, for savings, and for investment. In so far as money is not spent for goods and goes into the other channels it ceases to bid up prices and helps to avert the danger. This, therefore, is what we must try to achieve. Our program has

been worked out to call a halt to price increases, to distribute the cost of the war ^{as} fairly ^{as may be} among the people, and to divert money into other channels, particularly those that will help finance the war. It must be viewed as a whole. Each part of the program adds its bit to the general picture, and no part can be omitted without seriously endangering the effectiveness of the entire proposal.

To begin with we must pay more taxes. We must view taxes not only as a means of helping to pay for the war but also as a means for absorbing buying power that otherwise would be bidding up prices. No one enjoys paying taxes but we are all willing to contribute to the common effort. Everyone must do his share. We cannot take care of the situation by taxing the well-to-do alone. For one thing, there are not enough of them. We must take from each American in taxes what in our best judgment is his proper share. We must assure the people that no one is left out. Corporations must be so taxed as to recapture from them the extra profits made out of war orders. Individuals must be so taxed as to contribute what they can without sacrifice of health or vigor. Some can contribute more because their incomes have been increased by war activity, others because their incomes have always been large. Those who have more must carry a much heavier burden than those who have less -- but no one must be left out. Taxation is a technical subject -- full of pitfalls and administrative difficulties. It cannot be discussed briefly and simply. I have stated the guiding principle and I have requested the Secretary of the Treasury to reconsider in the light of new developments the tax program

which we submitted last January. At that time we figured on increasing general taxes by \$7 billion and social security taxes by \$2 billion. I believe now that, in order to avoid greater hardships later on, we shall have to increase this by another \$5 billion.

In addition we may have to collect perhaps 5 per cent of all incomes at the source and give the people in return a non-transferable Government war bond that cannot be redeemed until after the war. This would help to reduce the demand for civilian goods and would divert the money to Government use; and at the same time people would be building up nest eggs to be available after the war. At that time we shall all be greatly in need of re-equipment. There also will be need for finding employment for plants and men released from war service. The release of a dammed up demand in the form of Universal Savings bonds will be helpful then.

Aside from taxes and universal saving, the Government must also make every effort to meet the part of their expenditures that must be borrowed by selling bonds to corporations and individuals, not to banks. Each family and business should plan voluntarily to set aside the most (in addition to the above) that it can possibly spare for the purchase of United States bonds. The situation requires that everyone of us work out for himself the greatest reduction that he can make in his current expenditures in order to do his bit to make the program work.

It would be both wise and helpful for everyone to use this time of larger income to pay off debts. Much of that must be left to the people to decide for themselves, but the Government can encourage the reduction of

debt by tightening its control on instalment and other consumer credit, by reducing the amount that can be borrowed on land and buildings and by asking the banks to be extremely cautious in extending credit for purposes not connected with the war effort. I am asking the Government lending and supervisory agencies to act in accordance with this policy in so far as their existing powers permit and to let me know if they require additional powers. I shall then request the Congress to grant such powers as may be necessary.

In addition to all this, in order to prevent a runaway situation getting out of control, we must resort further to direct regulation. We must hold the fort at all costs while legislative and administrative reinforcements are being rushed through. We must freeze all prices directly at a fair level. This must include all commodities, agricultural and industrial. It also must cover rents. Plans for fair action have been worked out, most of them can be put into effect without further legislation, some will require action by Congress. I am asking the Price Administrator and the Secretary of Agriculture to take all the necessary steps to put the plan into immediate operation. In the case of scarce commodities, price fixing must be accompanied by rationing so as to assure that everyone will get his fair share of the available supply.

With profits limited and the cost of living frozen -- we must ask labor also to be content with its present earnings, except where they are below a minimum level that is necessary for health and vigor. I am asking that all wages, with these exceptions, be frozen as of some recent date, that time and one-half pay for work in excess of 40 hours a week be

retained, and that double pay be granted only in cases of a seventh consecutive day or work, whether it be a Sunday or a week day.

Before closing, I want to ask you whether you have ever thought of the fact that the only time we can pay for the war is now? It is now that we have to make the sacrifices. We cannot fight with planes that have not yet been ^{built} made or man them with pilots who have not yet been trained; we cannot shoot shells to be cast next month out of gund to be assembled next year; we cannot load or sail ships that are still in the shipyard. In physical goods and in mental anguish we must pay for the war as it proceeds.

Financially also the Government must pay for a war from day to day. Whether it raises the funds in taxes, or by borrowing, or by creating money, in any case, it pays for the war currently. It does, however, make a great deal of difference to the people what methods of raising the money are used and in what way. The difference is in how sacrifices are distributed during the war and in how income is distributed after the war. There is not time to discuss this in detail this evening, but I want to repeat that we must give up now all the things that cannot be produced for civilian use -- because they are needed for the war on the firing line. I want to say also that the more we can pay for out of taxes equitably levied and the less we pay through advances in the cost of living -- the more justly the burden and sacrifice will be distributed during the war and the less difficult will be reconstruction after the war. It is to do all we can in this direction that our program has been designed.

If all of us will help to carry out this program, which distributes as fairly as may be the burden of this war, then we shall be as strong on the domestic front as we must be overseas, then we shall send out to our boys the tidings that all is well at home, then we shall be able to contemplate the world after our victory with confidence that we have not fought in vain. We shall have preserved the dignity of man from the onslaught of barbaric powers overseas and from the effects of economic disaster at home.