Committee For Constitutional Government

Incorporated Under the Laws of the District of Columbia

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Hon. Marriner S. Eccles
Federal Reserve Board
Washington, D. C.

Dear Mr. Eccles:

As usual, you were taking a scholarly and logical position when you advised Congress that over-all price control was unnecessary and should not be imposed on the economy. Whether those who are responsible for such controls really believe that the right way to regulate the temperature in a house is to deal with the thermometer rather than the furnace, I do not know. Probably they are merely criticizing the ignorance of the public concerning the forces responsible for price changes. Of course, as you say, price controls merely lead to black markets and racketeering, profiteering and tax evasion.

When you advocated lengthening the standard working week during wartime, you were certainly on firm ground, for more production is needed to win the war. I believe, also, that there can be no doubt of the correctness of your assertion that "inflation is far more costly to the Government than increases in the interest rate".

It is sincerely to be hoped that Congress will take seriously and act favorably upon your sage advice.

Very sincerely yours,

Willford I King

Chairman

WIK:mg

Mr. Eccles

THE MENACE OF INFLATION AND HOW TO AVOID IT

by WILLFORD I. KING

Economics—Professor Emeritus, New York University

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ARE WE NOW SUFFERING FROM INFLATION?

Official Government figures show that, between January and November, 1950, the average of wholesale prices rose 13%, retail food prices climbed 7%, and stock prices moved up 18%. These advances have given rise to a widespread belief that inflation is in full swing. Is this assumption correct?

Before answering this question, it is well to call to mind what the term "inflation" really means. It is defined by the Committee on Economic Accord—a group of some 150 leading economists—as follows:

"Inflation is a change in the volume of circulating medium tending to reduce the value of the monetary unit." Our *circulating medium* consists of the combined supply of pocketbook money and demand deposits in banks. Other things being equal, when the volume of circulating medium increases relatively faster than does the physical volume of trade, the value of the dollar shrinks—or, in other words, the price level rises—and this result has been brought about by *inflation.* Was this the explanation of the price advances occurring in 1950?

Contrary to general opinion, the answer to this question is a decided negative. Official Government figures appearing in the United States *Survey of Current Business* show, indeed, that the amount of pocketbook money in circulation on December 16, 1950 was slightly *less* than the corresponding amount on December 24, 1949, and that the increase between the same two dates in the volume of demand bank deposits was only 7%; while, from December, 1949, to October, 1950, the physical volume of industrial output advanced 23%, and is still climbing. Since the increase in our supply of circulating medium did not even keep pace with the growth in the physical volume of production, it is clear that 1950 was by no means a year characterized by *inflation.*

WHY THERE WAS NO INFLATION IN 1950

That such was the case must be credited in large measure to the well-directed efforts of the Federal Reserve Board acting in cooperation with the Secretary of the Treasury, for, throughout that year, there was a marked tendency on the part of both individuals and business men to borrow freely. Despite restrictions imposed by the Federal Reserve authorities, consumer credit expanded by more than three billions of dollars, and total bank loans grew by an even larger amount. However, the Federal authorities offset a major part of this expansion by reducing Government indebtedness to the commercial banks. But, despite this restraining action, prices kept climbing throughout 1950. Why?

WHY PRICES ROSE IN 1950

A common answer to the above question is: "War demands are extremely urgent. Furthermore, war makes goods scarce in proportion to money. Hence, of course, prices rise." Those giving this answer overlook two facts:

1. As long as government meets its expenses by taxation, total civilian demand will decline by the same number of dollars that governmental demand increases. Therefore, unless government pays for its purchases with newly created money or bank deposits, *total* demand will be unaffected, and there will be no tendency for the price level to rise.
2. Work and materials expended in war activity generate about as much money turnover as do work and materials going for civilian needs.

The true explanation of why prices rose in 1950 is found in the fact that inflation is not the only force which can produce a rise in the price level. Another factor which also may affect prices materially is the *velocity* with which money and money substitutes circulate. Reference to the United States *Survey of Current Business* shows that, in the twelve months ending in October, 1950, the rate of turnover of the average demand-deposit dollar increased by about 13%—a percentage *exceeding* the advance during the same period in the prices of material goods. It appears, therefore, that the real villain in the recent price drama has been growth in the *velocity of circulation*—and not *inflation.*

VELOCITY OF CIRCULATION AND THE BUSINESS CYCLE

The year 1950 was in the rising phase of the business cycle. Past financial history indicates that, in that part of the typical cycle, trade is unusually active, and the rate of money turnover is abnormally high. But, when optimism fades, and trade declines, money movement becomes relatively sluggish —in other words, velocity slows down. The typical short business cycle has an average wave length of 3.35 years, or approximately 40 months. It last hit bottom about July, 1949.

We might, therefore, expect the next crest to be around March, 1951. Hence, under normal conditions, the year 1952 would be characterized by declining trade, shrinking bank loans and demand deposits, slower turnover of the circulating medium, and a falling price level. Under such circumstances, people would be concerned about *deflation* and unemployment—not about *inflation.* Is there, then, any real justification at the present time for worrying about inflation? The answer is a decided "Yes." Why? Because we are at war.

WHY INFLATION NOW LOOMS

Wars are terribly expensive, and past experience shows that, in our own nation as well as abroad, politicians have not dared to levy taxes sufficient to balance wartime budgets. They have blithely voted stupendous appropriations, and then cast upon the Treasury officials the burden of finding the money to pay the bills. These officials, being put in a quandary, have, commonly, either printed paper money or borrowed from the banks, and both methods alike inflate the supply of circulating medium and reduce the value of the money unit. When carried to the extreme, as it was, for example, in Germany and China, such inflation is likely to result in the collapse of the government responsible. When held down to moderate proportions, as was the case in our own country in the War of 1812, the Civil War, World War I, and World War II, the effect is to rob the thrifty members of the population of a large fraction of the total value of their holdings of cash, bank deposits, notes, bonds, annuities, and insurance, including social security accumulations. The inflation resulting from World War II confiscated approximately half of all such savings. Of course, such robbery discourages thrift and tends to prevent the accumulation of the capital needed if industry is to expand and prosperity forge ahead.

EFFECT, UNDER 1951 INCOME-TAX LAW, WHICH DOUBLING THE PRICE LEVEL AND INCOMES WOULD HAVE UPON TAX RATES OF TYPICAL FAMILIES

If Your Present Net Income (after deductions but before exemptions) is	Then Your Net Income After Inflation would be	Your Present Tax is	Your Tax After Inflation would be	Per Cent of Your Income Taken by Income Tax	
				Now	After Inflation
$ 2,000	$ 4,000	$ 0	$ 320	0.0	8.0
3,000	6,000	120	720	4.0	12.0
4,000	8,000	320	1,152	8.0	14.4
5,000	10,000	520	1,592	10.4	15.9
6,000	12,000	720	2,096	12.0	17.5
7,000	14,000	932	2,636	13.3	18.8
8,000	16,000	1,152	3,200	14.4	20.0
9,000	18,000	1,372	3,800	15.2	21.1
10,000	20,000	1,592	4,464	15.9	22.3
12,000	24,000	2,096	5,888	17.5	24.5
14,000	28,000	2,636	7,488	18.8	26.7
16,000	32,000	3,200	9,272	20.0	29.0
20,000	40,000	4,464	13,248	25.7	33.1
32,000	64,000	9,272	27,432	29.0	42.9
64,000	128,000	27,432	73,008	42.9	57.0
128,000	256,000	73,008	182,344	57.0	71.2
256,000	512,000	182,344	413,376	71.2	80.7

LABOR MONOPOLISTS SEEK PROTECTION AGAINST INFLATION

Today, the leaders of our powerful labor monopolies, anticipating a repetition of the unsound fiscal policy accompanying World War II, are striving vigorously to protect their members against the expected vicissitudes by securing wage contracts providing for hourly rates of pay varying in proportion to the movements of the consumers' price index. If they are politically strong enough to enforce these contracts, their *real* wage rates will remain constant despite rising prices of the things they buy. But how will employers and corporation stockholders fare?

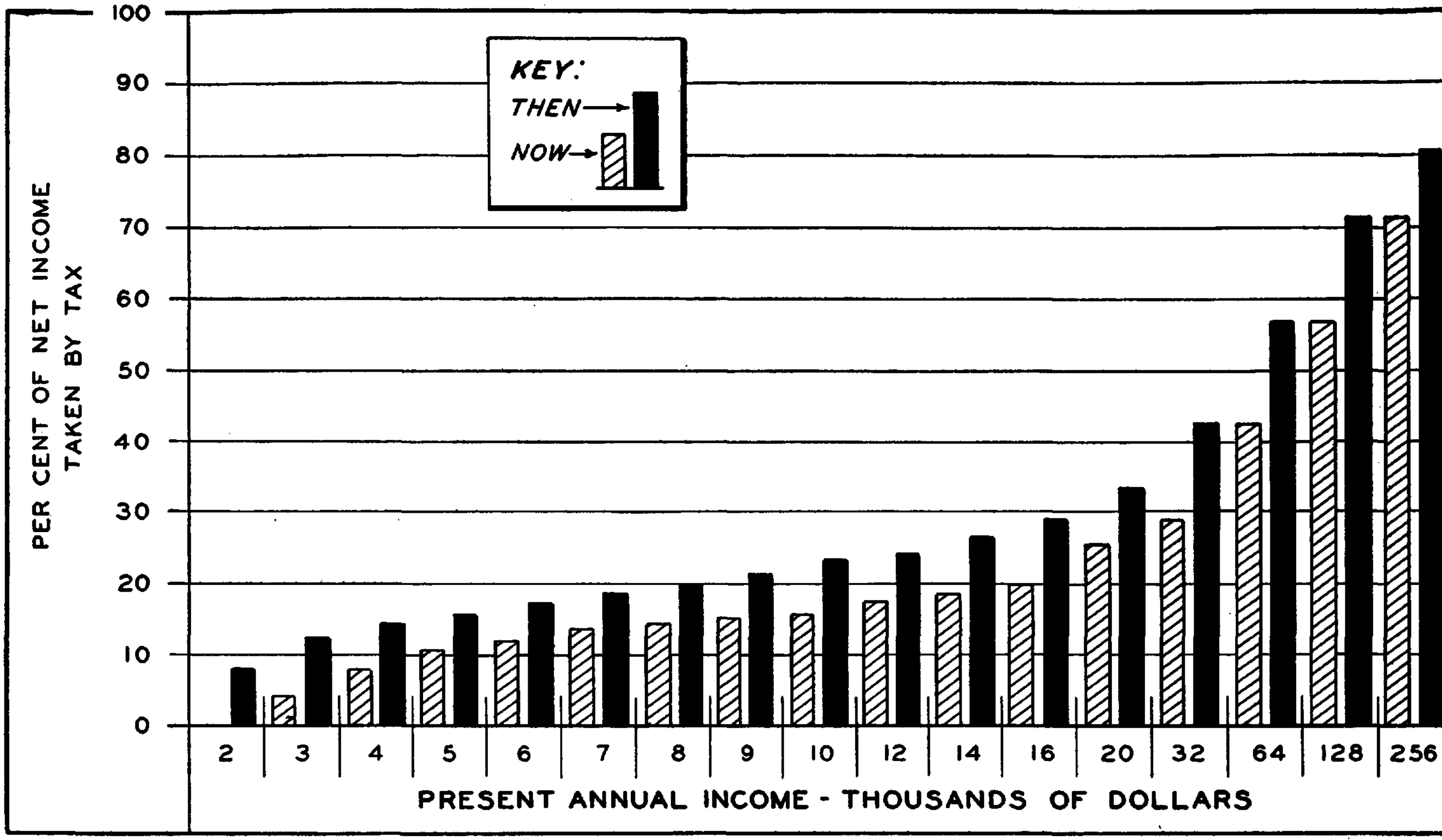
HOW WILL INFLATION AFFECT BUSINESSMEN AND STOCKHOLDERS?

Present indications are that, if inflation goes on at a rate comparable with that prevailing during World War II, business men and stockholders will be confronted with the following conditions:

1. Bureaucrats will strive vigorously to keep down the prices of finished industrial products and goods sold at retail.
2. Rising wage rates and other expenses will eat into profits.
3. If a concern happens to land some lucrative war orders, any profits resulting will be "renegotiated."
4. If, by unusual efficiency, a concern increases its profit margin, some Government official will cut the selling prices of the products.
5. Governmental interference with the free market will reduce sales volume and so lower profits.
6. Despite the efforts of the bureaucrats, the price level will gradually move up. This may generate fictitious "excess profits." Any such will be heavily taxed.
7. Such dividends as are paid to the stockholders will have no "cost of living adjustment" attached to them. If the price level doubles, every dollar of divi-

WHAT WILL A DOUBLING OF THE PRICE LEVEL CAUSED BY INFLATION DO TO YOUR INCOME-TAX RATE

(ASSUMING THE PRESENT LAW IS NOT CHANGED)



dends will be halved in purchasing power.

8. The present $75.9 billions of working capital now possessed by all corporations combined represents a nominal growth since the beginning of World War II of $43.6 billions. This growth represents part of the $75 billions of earnings which corporations have plowed back into their businesses during the nine years. But, since 1941, prices and wage rates have more than doubled. Hence, the existing $75.9 billions of working capital will now buy little more in the way of labor, materials, plant, and equipment than would the $32.3 billions of working capital possessed at the end of 1941. Inflation has, therefore, nearly nullified nine years of effort on the part of corporate management to build up working capital. If similar inflation accompanies World War III, corporate savings will again be largely wiped out.

FUTILITY OF ATTEMPTS AT PRICE CONTROL

If our circulating medium is as heavily inflated as was the case during World War II, the price level will eventually double, for, as experience during the years 1942 to 1946 amply demonstrated, all efforts of the controllers to keep prices down eventually proved futile. Similar results may be expected in the future, for since the successfully controlled articles are relatively cheap and also hard to get, additions to the consumers' spending power are concentrated on articles either not controlled at all, or "controlled" mainly on paper. In the last-mentioned class, "black markets" develop. The net result is that the rise in the *price level* is just as great as if prices were entirely unregulated. Even if inflation goes so far as to double the price level, the powerful labor monopolies may succeed in raising wage rates as fast as the price level rises, but, if they do, the gains of the labor monopolists will be at the expense of the other citizens.

HOW INFLATION BOOSTS INCOME-TAX RATES

It is practically certain that, in the near future, the necessity of meeting war expenses will be given as a reason for raising income-tax rates. But the increase in these rates shown on the income-tax schedules will by no means reveal the *real* advance in rates brought about by inflation. Suppose, for example, that a man having a wife and two children finds that inflation has doubled his nominal income, but that, because prices have also doubled, his income buys no more than it did at the old price level. He will find that, because the income tax is figured in nominal dollars, his tax rate has risen sharply. The table and chart preceding show what the results will be under the law in force at the beginning of this year if the price level and incomes are both doubled.

INFLATION STEMS FROM ECONOMIC ILLITERACY

But is inflation a *necessary* concomitant of war? The correct answer is a resounding "No!" In reality, inflation stems mainly from the ignorance of the voters concerning the economics of government finance. Were they well informed in this connection, they would see clearly that war cannot be fought with future men or future supplies of any kind; that, hence, someone must, perforce, pay for the war as it goes along; and that none of the burden can be transferred to future generations. They would also realize that *borrowing* by government to meet war expenses merely postpones to the future the settlement of the troublesome question of which class of citizens shall bear the brunt of the fray while it is going on, and who shall pay whom thereafter.

Most legislators and administrators know that inflation actually increases the burdensomeness of war while the conflict is in progress; that it makes war expenses persistently outrun estimates, thus multiplying the difficulties of the nation's fiscal authorities; that it lessens production; and that it is disastrous to the thrifty—the class of citizens primarily responsible for a nation's prosperity. Why then do our legislators not insist on levying taxes sufficient to cover all expenditures and thus avoid the inflation which they know to be very dangerous?

The answer to this query is simple indeed. They are afraid of being voted out of office by irate constituents who resent higher taxes. They believe past experience to show that those who have their savings surreptitiously filched away by inflation are but rarely aware of what is happening, and therefore do not take revenge on the officials responsible. If the masses of voters ever come to understand thoroughly the disastrous effects of inflation, it seems highly probable that they will insist that the Government's budget be balanced *every* year. If they do, their representatives will be glad to levy the taxes necessary for the purpose.

DEFICIT FINANCING THE SOLE CAUSE OF DISASTROUS INFLATION

And it is important to remember that, *with a balanced budget, there will never be any disastrous inflation.* History furnishes no exception to this rule. It is, of course, true that, in times of optimism, individuals and business concerns, by borrowing too freely from the banks, do increase the volume of demand deposits—the most important segment of our circulating medium. But intelligent action by the Federal Reserve Board can be used to check such over-expansion. Moreover, long before such privately-induced inflation reaches a stage which threatens seriously to wreck the value of the nation's currency and produce financial chaos, the business cycle always turns down, and over-borrowing gives way to under-borrowing. Explosive inflation is, therefore, caused solely by deficit financing—and by nothing else.

HOW TO AVOID INFLATION

Clearly the self-interest of every person who holds bank deposits, notes, bonds, annuities or life insurance policies, or who is the prospective or present beneficiary of pensions or social security or other insurance should prompt him to demand in no uncertain terms that his representatives vote taxes sufficient to pay all war expenses as they come along. There is no use blinking the fact that the war cost will be so heavy that it will be burdensome to every family in the nation—no matter how the money is raised.

The method of sound financing which will prove least annoying will be to depend primarily upon excise taxes —levying heavy rates on luxuries, and moderate rates on conveniences—only bare necessities remaining tax free. Under such a system of taxation, those who are willing to subsist on the less costly foods, get along with old clothes, old furniture, and old cars, give up such pleasant but dispensable luxuries as costly entertainment, travel and "keeping up with the Joneses," and economize all along the line, can avoid paying much in the way of war taxes. On the other hand, those who feel able to splurge will contribute accordingly. But, everyone's savings will be safeguarded, and, when the war is over there will be no new war-debt problem to plague future generations. So, let's insist on balancing the Federal budget in 1951 and in every future year!

TO ALL AMERICANS: Inflation is the most immediate and serious menace confronting our country. If not blocked, it will impair the assets of every bank, insurance company, the bank deposits and dollar securities of every business, harming employees, stockholders and citizens in all walks.

Between 1941 and 1950, World War II inflation cut in half the purchasing power of our dollar. If by overspending and deficit financing we now permit further inflation, our 1941—100¢ dollar may be worth only 25¢ or less by 1960. This would again harm most seriously those thrifty individuals whose savings have largely supplied the better tools and technology—$6000 per worker—upon which our high scale of living rests.

Such inflation would again cut in two the value of bank deposits and dollar securities of all business enterprises. It would automatically, without change of our tax laws, increase the tax rates of lower income groups by 40 or 50%.

Lenin said in substance, "We will destroy the free market system of capitalism by printing so many bonds and so much money that the capitalists will choke on them." If we want to preserve constitutional liberty and economic freedom, we must fight now against further inflation as we would to stop a pestilence.

What is needed is education at the grassroots level so that citizens knowing the facts will demand of their representatives in Washington sound financial policies. Price fixing, rationing, bureaucratic controls — all are the products of inflationary price rises. They can be made unnecessary and maximum production preserved if we balance the budget and pay as we go. No war can be fought with tomorrow's guns and airplanes. Only today's production and the accumulation of yesterday can be used to fight a war. The sacrifice of goods and wealth must be made currently as we apply this current production to defense and war purposes. If we tax into the Federal Treasury a corresponding portion of current purchasing power, we limit the demand for civilian goods and enable the government to pay as we go, balance the budget and avoid inflation.

But, as a first step, we must cut out of the Federal budget, as demanded by Senator Harry F. Byrd, $7 billions of non-defense and partly wasteful Federal expenditures. Menaced by communism, our defense needs are too great to permit misuse of taxpayers' money to buy with handouts from the Federal Treasury, the votes of selfish minority pressure groups. For details, ask for free copies of Senator Byrd's SPOTLIGHT #3, *"How to Save Seven Billion Dollars."*

Next, distribute widely this folder by Dr. Willford I. King *"The Menace of Inflation and How to Avoid It"* to your fellow stockholders, fellow employees, editors, clergymen, physicians, and other opinion molding leaders in your community. Urge each to make himself a COMMITTEE OF ONE to carry this message far and wide.

Third: Make inflation a matter of discussion in service clubs and other local meetings. Take a copy of this statement to your banker. Ask him to give what help he can in mobilizing grassroots resistance against inflation in your community. Send for 5 free copies and mail one to your Congressman and to each of your Senators with a letter of comment, expressing your own viewpoint. Buy this folder in bulk, 30 for $1; 50 or more 3¢ each; postpaid anywhere. Note our offer to supply 5 free copies upon their request to all those to whom you distribute this folder. Ask for *"The Menace of Inflation and How to Avoid It."*

You may also obtain one free copy of each of SPOTLIGHT #3, Senator Byrd's *"How to Save Seven Billion Dollars,"*; #4, Dr. King's *"Thrifty Americans, Guard Your Dollars"*; and #6, Dr. King's *"Inflation."* SPOTLIGHT, in bulk quantities, 2¢ each, postpaid anywhere.

COMMITTEE FOR CONSTITUTIONAL GOVERNMENT, INC.

205 East 42nd Street • New York 17, N. Y.

February 13, 1951.

Mr. Willford I. King, Chairman,
Committee for Constitutional Government,
205 East 42nd Street,
New York 17, New York.

Dear Mr. King:

I read your recent letter and your article with a great deal of interest, and appreciate your sending them to me.

The need for higher taxes to reduce spendable incomes and keep the Federal Government on a "pay-as-you-go" basis, and the futility of direct controls as a solution to the basic causes of inflation are matters that warrant continued re-emphasis.

Very truly yours,

M. S. Eccles.

CHS:dm