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FISCAL POLICY IN THE UPSWING

Desirable course of business

It would be highly desirable for consumer demands to increase as rapidly as, but no more rapidly than our ability to increase production, so that production and employment would continue to expand with little, if any, advance in prices. In this way the upturn could be prolonged, people on fixed incomes would not suffer from a rise in the cost of living, inventory and commodity speculation would be avoided, interest rates would remain low, and there would be a better chance of avoiding a subsequent drastic recession.

Difficulties and dangers

There was so much excess plant capacity and unemployed labor of all types and skills from 1934 to 1936 that increased production could quickly respond to increased demands with no advance of prices. This condition has now changed. Although all the excess plant capacity has not yet been absorbed and there is still a large number of unskilled unemployed, within recent months practical plant capacity has been reached in some basic lines and the supply of skilled labor has apparently been pretty well absorbed. The steel industry is operating at practical capacity. If demand in the steel consuming industries expands more rapidly than additional steel capacity can be built, the consequence will be an impetus to price rises, forward buying, duplication of orders, and the emergence of boom psychology, which may readily extend to other industries. Demand to satisfy the enormous volume of capital and housing deficiencies accumulated in the past seven years may be superimposed in too short a time on the demand to satisfy normal growth requirements.

The problem is essentially one of timing. We can produce more steel and copper, given time. We can obtain more skilled building trade workers, given time. The danger is that the demand for goods may increase too rapidly for additional goods to be produced, so that prices will rise rapidly in a sellers' market. If the recent rate of increase in commodity prices should continue it will be almost impossible to prevent an excessive cyclical rise in interest rates and a fall in bond prices. All the predictions of a continuance of low interest rates were based on the assumption of a continuance of an orderly revival. Experience in the past has been that a rising trend of commodity prices has always been accompanied by rising interest rates.

How the danger may be minimized.

At this stage of the business cycle and for the next few years it appears desirable to restrain the rate of increase of consumer demands by widening the difference between consumers' incomes and spending on consumer goods. The most effective way of accomplishing this is through increased taxation. Just as a budgetary deficit results in an increase in consumer spending, so a budgetary surplus, in the present circumstances, would tend to moderate the rate of growth in spending. It would, on the one hand, mean that out of a given increase in incomes less will be spent on consumer goods. This would reduce the pressure on deficient plant capacity in the capital goods industries. It would, on the other hand, mean that through federal debt retirement more money would be available for investment. This would tend to restrain the rise in interest rates and fall in bond prices.

On general social grounds it would be undesirable to impose additional taxes on the low income groups. Through social security taxes, indirect taxes and customs duties, their tax burden is already high. The surtax rates on the highest income brackets appear to be about as high as the traffic will bear. The intermediate income brackets, those from $5,000 to $50,000, could, however, very well stand additional taxes. More tax collections from this group would result in a reduction in consumption without hardship and would, through federal debt retirement, result in an increase in the savings of the nation.

The importance of prompt action

The theory of a compensatory fiscal policy, which has been followed by this Administration, implies higher taxes and debt retirements when the recovery movement has become self-generating and threatens to proceed at too rapid a pace to be sustained. This stage has now been reached. If additional income taxes are imposed in this session of Congress they will not be collected until 1938. If action is delayed until the next session, there will be great pressure against any retroactive levy against 1937 incomes so that it is likely that the tax would not become operative until 1939, which may be much too late to be effective.

It would be foolhardy on our part to count on more than three or four years more of the upward movement. It has already been under way for four years. If the recent price movement should continue, the upswing may come to an end even sooner. If, therefore, additional taxes are not imposed at this time there will be grave danger that the upward movement may become disorderly, commodity prices, the cost of living, and interest rates will rise, and we will enter the next depression having made little progress in reducing the debt built up in the previous one.