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BY

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THE POSTWAR PRICE PROBLEM - INFLATION OR DEFLATION

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Dr. Jordan, Members and Guests of the Conference Board:

This will be the fourth time you have done me the honor to ask me to be a speaker at one of your sessions. I had supposed that the first time would be my last. My best friends tell me that I do not have the most important qualification of a public speaker, namely, the faculty of saying what audiences like to hear. So it is a great consolation to know that even though you may not have liked some of the things I felt ought to be said, you have invited me again and again and again.

Postwar is still some time in the future. We have come a long way on the battlefronts, but the obstacles still to be overcome are grim and formidable. Here at home we must continue to provide our armed forces and our allies with equipment and supplies in undiminished volume. That is our first job. We must not be diverted from it. Nevertheless, if we are to win the peace as well as the war, we must know where we are going when war no longer is the driving force of the economy.

In less than four years this Nation has accomplished a miracle of production. At the same time we have had a remarkable degree of economic stability. All of us have seen the miracle happen -- many of you helped greatly to bring it about -- although at times some have lost sight of it in criticism of details. The problems have been and still are staggering. Nevertheless, under Government direction, program after program has been put through successfully. The vast cooperative achievement of our people -- industry, labor, agriculture, and all other groups -- was only possible because of Government organization of united effort, Government planning, Government financing, and Government settlement of countless conflicts of interest on the economic front. Within this framework, the accomplishments of industry have been tremendous. The over-all results have been magnificent.

There have been withdrawn for armed service well over 11 million men and women in the most productive age groups. At the same time we have increased the total output of our country to 75 per cent above 1939 levels. We are supplying goods and services in support of the war effort at a rate of about 85 billion dollars a year. At the same time, output for civilian use is valued at about 110 billions. Nearly one-fourth of our food production is going to our armed forces and our allies. Per capita civilian consumption of food is well above the prewar level. While fighting the greatest war in history, the country has succeeded in raising the standard of living for the population as a whole above the level of any peacetime year. Moreover, we have created many new industries or greatly expanded existing ones -- for example, magnesium, synthetic rubber, shipbuilding and aircraft. We are producing planes at the astounding rate of 100,000 a year. Before the war we imported nearly all our rubber. Our annual production of rubber now exceeds our imports of rubber before the war. This production record has been achieved by a net increase of about 6 million or less than 15 per cent in civilian employment, combined with a substantial increase in hours of work and more intensive effort,

I mention these facts because they so vividly reveal the magnitude of our postwar job if we are to continue to keep our productive resources fully employed. Having experienced an output of goods and services of nearly 200 billion dollars during the war, the people of this country will not be satisfied with a peacetime output of 125 to 150 billions. Having experienced several years of full employment, the people will not tolerate mass unemployment. They will not accept the explanations, so often heard in the past, that "we cannot afford it", or that it is economically unsound for the Government to intervene, or that we must have faith in eventual rescue through "natural forces".

The question before this Conference is, "Postwar Price Problem - Inflation or Deflation?". The question so stated implies that we have a choice between one or the other. But if we have inflation, we shall certainly have deflation following it. Thus we may be faced with having both. However, if we avoid inflation, we shall still face the danger of deflation. If, in the period of transition from war to peace, we fail to maintain wartime price controls and rationing until civilian goods become available in adequate quantities, an inflationary situation may well develop. If, later on, we fail to raise the flow of consumers' expenditures greatly above prewar levels, deflation will be inevitable. The danger of inflation in the transition period can surely be met. The danger of deflation presents a vastly more difficult problem. To solve it, will be the main challenge to our postwar economy.

Nobody can foretell how strong inflationary pressures will be during the transition from war to peace. Inflation pressures include the pent-up demand for consumers durable goods and housing; continued shortages of certain food and clothing items; the huge volume of liquid assets in the hands of the public; a potentially large foreign demand; and, finally, the people's desire to return to normal and to get rid of wartime controls once victory is won. The longer the war lasts, the greater the danger of inflation will be because of the cumulative increase in pent-up demand for civilian goods and in liquid assets in the hands of the public.

However, at the same time there will be deflationary pressures working in the opposite direction. There will be large reductions in war expenditures creating unemployment in war industries. Demobilized war veterans will be added to the civilian labor force. There will be large stock piles of many raw materials. Uncertainty about future employment will deter many people from drawing on their savings or spending as much as they otherwise would out of their current income. Similar uncertainty will delay business expenditures. Many other factors in the situation, as the war ends, will add to the mixture of inflationary and deflationary forces.

Because of the uncertainties of the transition period, price and fiscal controls should be kept intact until industry has resumed civilian

production on a scale adequate to meet demand. Only thereby can the consumer be assured that he will not lose by postponing purchases and that the purchasing value of his savings will be protected. This is vital because of the huge volume of liquid savings accumulated in the hands of the public as a result of war financing. If these savings are used prematurely through fear of impending price increases, they would be a destructive inflationary force.

Unless the program for the transition period is carefully planned and carried out, the long-run economic problems of the country will be vastly more difficult to meet. Just as the difficulties of the 1930's were due to the failure of the policies of the 1920's, so will our postwar situation be determined largely by the job we do in the transition period.

For example, we may expand our industrial plant too greatly and in the wrong directions in an effort to satisfy too quickly the huge backlog of demands. These demands will include not only the large pent-up need for consumers durable goods, capital goods and public works, but also for large foreign demands. Instead of meeting these demands at once, prudent policy calls for satisfying them in a more gradual and orderly manner so that when these accumulated forces are expended, there will not be a sharp and sudden drop with serious deflationary consequences. It is better to ration, control prices, restrain credit expansion, and delay deferrable public works or foreign loans in this period than to have an unsustainable over-extension. It is most important during this transition period, while we have the sustaining power of backlog demands, to adopt policies designed to lay the groundwork for the higher standards of living we must have later on. These policies should include, among other things, a Social Security program covering all of our people and providing adequate benefits; a modified tax structure; maintenance of low rates of interest to encourage new investment, including housing; and the planning of Federal, State and local public works to be undertaken when the need to provide additional employment develops. It is at this time, when the backlog of deferred need has been largely met and we must rely upon current demand, that we shall face the most difficult test of our ability to prevent deflation and mass unemployment.

On the average this year about 52 million civilians are employed. In addition, more than 11 millions are in the armed forces, making a total of more than 63 millions, or nearly one-half of our total population. After the war, a substantial number of people attracted to the labor force during the war will retire or return to school or housework. A rich country such as ours can afford to give its young people adequate education and to provide retirement for its older people. But even after making full allowance for probable withdrawals from the labor force, it is evident that more people will be available for work in peacetime activities than are now employed.

What does this mean in terms of production in the postwar years? It has been conservatively estimated that in order to have reasonably full employment in the second year after victory, we will need to produce goods and services amounting to 170 billion dollars at 1943 prices. As the labor force and efficiency increase, this figure will have to be revised upward.

Yet, even a 170-billion-dollar total reflects a volume of output vastly above that of 1939. In order to visualize what 170 billion dollars of expenditures means, let's divide as follows: 110 billion dollars in consumers goods and services, 25 billion dollars in plant, equipment, housing and other new investments, and 35 billion dollars in goods and services supplied by Federal, State and local governments.

Allowing for price advances since 1939, these figures mean, for example, that as compared with 1939 we will need to have 40 per cent more in consumers goods and services, nearly twice as much in plant, equipment, housing and other new investment, and double the total of public expenditures.

These are challenging figures. They are significant not because they are in any sense a forecast. They are significant because they indicate the general magnitude of the job that lies ahead of us. It is apparent that we must aim high; that we can never go back. If we were to return to 1939 levels of production, from 15 to 20 millions of our postwar labor force would be without jobs, an intolerable situation. Many of those without jobs would be veterans of this war.

We should be able to agree in substantial measure on a relatively simple statement of what our postwar economic problem will be once we are beyond the difficult period of reconversion and the backlog of needs accumulated during the war has been satisfied. The over-all economic problem may be defined in this way: In order for 56 million workers to have jobs, enough money must be spent to buy the output of 56 million workers. Production large enough to employ substantially all workers is possible only if the total income which is received is either spent on consumers goods and services or is saved and goes into new investment directly or indirectly. Savings which are invested are returned to the stream of expenditures and thus continue to give employment. Savings that are held idle or used to bid up prices of existing assets do not. If the flow of income back into the expenditure stream is interrupted, demand becomes insufficient to take off the market what is produced at full employment. As a result, production, income and employment inevitably decline. To assure a sufficient flow of expenditures is, first of all, the responsibility of the people and businesses who receive income and who decide how to use it. But there are millions of income recipients and millions of businesses in our country, and there is no assurance that a sufficient amount of expenditures will come forth in a steady stream. If the purchases and investments of the people are not sufficient to buy the goods and services provided by full employment, then cumulative deflation and unemployment will develop unless the Government steps in and provides a sufficient volume of total expenditures.

The larger the unused savings, the larger must Government expenditures be to overcome the deficiency in private spending and investment. The Government has two ways of channeling idle savings back into the income stream, that is, either through taxation or through borrowing. As between the two, I believe that taxation must carry the main burden. I would be most hesitant to see further additions to the public debt after the war. In this respect, the post-

war picture will differ greatly from that in the early 1930's when the economy had undergone a drastic deflation and large Government deficits were not only unavoidable, but it was desirable to replenish a contracted money supply. An entirely different situation will exist after this war. Upon the termination of the war, the total volume of currency, bank deposits and Government securities, which are the equivalent of cash, will be far more than adequate as a basis for the purchasing power needed to provide full employment.

A more direct approach than deficit financing should be found in order to maintain necessary expenditures. Since we cannot afford, in the postwar economy, to have widespread unemployment, it will be essential, if all other methods of providing employment fail, to have the Government underwrite employment through borrowing the unspent savings of the people and returning them to the income stream. However, this should be a last recourse. A much more satisfactory approach would be to bring about the necessary increase in the flow of expenditures by other means, for example, by an extension of the Social Security program and by appropriate tax policies that would induce more spending and reduce idle savings.

A high level of consumers' expenditures is the basic requirement for postwar prosperity. The consumer is the real employer. If he receives adequate income, business has a buyer for its products, and having a buyer for its products, it has jobs for the workers. If the consumer does not buy, the markets for the output of business shrink and total income and employment fall off.

Much can be done to increase consumption through a much broader Social Security system. The Government should underwrite and guarantee a national minimum of income, education, health and old-age security for all citizens. By so doing, the Government can place a floor of purchasing power under the economy. This in turn will place a floor under the market for the goods and services of business, industry, and agriculture. Decent minimum levels of income will themselves help to achieve and maintain full employment. Our productive capacity is so great that such minimum standards will not be a strain nor will they impose a dead level of uniformity. Ample room will be left for most people to raise their incomes far above these minimum levels. Postwar social security benefits should not be based upon further additions to the payroll tax, but should be paid for out of the general budget, because a tax on payrolls is a tax on consumption and, therefore, undesirable when more consumption is needed.

The Federal budget is not likely to be less than 25 billion dollars a year after the war, or about three times the prewar level of 1939. If we succeed in maintaining full employment, however, a budget of this size, in order to be balanced, will not require tax rates to be three times as high as before the war because the income base will be far larger. The higher the national income, the easier it will be to pay for the costs of Government. It is doubly important, therefore, to recognize the close relationship between the way in which our taxes are collected and the flow of income from which they are drawn. Our postwar tax system should be designed to induce a high level of consumers' expenditures. Accordingly, the first requirement should be a drastic reduction

in excise taxes because they tax consumption and thus undermine the markets for business. Secondly, personal income taxes upon the lower income group should be reduced by increasing exemptions.

There is no lack of need for everything that we can produce. There are still a great many people in this country whose standard of living is shamefully inadequate. The basic problem is to see that the necessary purchasing power flows into the hands of those who will use it to increase their standard of living. An adequate Social Security program as well as assured employment will do much to induce the spending of current income and thus increase the standard of living.

A high level of consumers' expenditures is not possible without a large volume of wage and salary income. If our economy is to operate at full capacity, average wage and salary incomes must be high enough at normal hours of work to give the people sufficient purchasing power to take the product off the market. Again the significance of this for the postwar adjustment is evident. When, after the war, hours return to normal and overtime pay is discontinued, total wage and salary income will decline sharply. If we are to avoid sharply declining prices and loss of markets which discourage production and business expansion, a gradual upward adjustment will be necessary in the wages and salaries of the great mass of comparatively lower paid workers.

Increases in productivity should be passed on to the public largely in the form of higher wages and salaries and should not be added to profits. In those industries in which productivity is increasing much faster than average, prices should be reduced in order to reach larger mass markets. Throughout, prices should be set on the basis of narrow margins per unit of output.

Once a high level of consumer expenditure is assured, the foundation for investment expenditures of business will be laid. Investment expenditures are made in anticipation of consumer demands and are not likely to be made unless business is assured in advance of an adequate market. We hear much about the reluctance of business men to take risks and engage in new ventures because of lack of confidence. However, business confidence is an effect and not a cause. It will exist if there are markets to look forward to; it will not exist if markets are lacking.

To assure adequate total purchasing power, it is necessary for business to disburse the funds which it receives from the buyers of its product. Corporate profits that are not used for capital expansion should be passed on to the workers or the owners, and thus returned to the expenditure stream. Depreciation and depletion reserves which accumulate as idle balances similarly constitute a drain on the expenditure stream. Currency, deposits and Government securities held by businesses other than banks and insurance companies have increased from about 24 billions in 1941 to the unprecedented total of 66 billion dollars. They should not continue to increase after the war because, as I have emphasized, business receipts must be respent currently to help sustain full production and employment.

There is much discussion today in favor of reducing corporate taxation after the war. To the extent that this reflects a recognition that taxes are an instrument of economic control, I welcome the discussion because I have long contended that fiscal policy is the most important single instrument through which the Government may influence economic conditions. I believe, however, that much of the current discussion is in the realm of wishful thinking because the revenue objective is set entirely too low. Also, I believe that removal of various excise taxes and a reduction of income taxes on the lower income groups should come first. Once this has been done and revenue needs permit, I would favor a reduction in the corporation income tax. The rate might be lowered to 25 or 30 per cent and the corporation permitted to take out of its taxable income that part of its profits which it distributes as dividends. This would remove double taxation of dividends and be an inducement for corporations to distribute their earnings. Some provision could be made to allow small corporations to retain needed funds without tax penalty. The excess profits tax with its carry-over and carry-back provisions should be retained for some time after the war at a reduced rate of around 65 per cent. High profits that will be earned in that period are traceable to backlog demands and are thus in the nature of war profits.

As a further encouragement to small business enterprise, provision should also be made for substantial tax benefits. This would stimulate investment in small and independent enterprises. It would be the most effective way to make equity capital available to them and be of far greater help than to provide too much easy credit. Encouragement of small enterprise is essential not only for economic reasons, but to vitalize our democratic institutions and help keep alive the spirit of American enterprise.

Our economic problems must be worked out at home. There has been, in recent discussion, too much reliance on the stimulus to our domestic prosperity which may result from world trade. International cooperation is essential and international agreements, such as those planned at Bretton Woods, are desirable. Yet, we must not forget that the level of postwar employment in the United States will depend primarily upon the existence of domestic markets for our products. Our first responsibility is full employment at home and achieving it is the most powerful contribution we can make to a prosperous world economy.

In the period ahead, we should keep constantly in mind that this is a 200-billion-dollar a year country. We all know by now that we cannot gain by fighting over shares of a small total output. In 1932 when many millions were unemployed, corporations as a whole lost nearly 3-1/2 billions and net current income of farm operators amounted to less than 2 billions. In 1943 with full employment, corporations, after tax liabilities of about 15 billions, had net incomes of nearly 9 billion dollars, an all-time high. Similarly, net current income of farm operators amounted to more than 12 billions, likewise an all-time high. There is no profit in goods that are not produced. On the other hand, we all gain from a larger total output.

I have sought to outline tonight the principal economic factors in prospect and the approach to the solution of our postwar problems which I believe promises the best hope of success. Such suggestions as I have made are, of course, only a part of a comprehensive long-run program for full employment. The objectives of such a program may be summed up as follows:

To maintain full and stable national production, income and employment to the maximum possible extent through encouraging the expansion of private enterprise.

To guarantee minimum standards of health, education, and personal security for all members of the community.

To provide for a steadily rising standard of living for the Nation as a whole by development of our economic resources and by improving the efficiency with which they are used.

To promote a high level of world prosperity and world trade in cooperation with other nations.

There will not be much disagreement today among thoughtful people, regardless of political faith or economic background, on these goals of national economic policy. Modern governments, including our own, have long since assumed a primary responsibility for the economic guidance and progress of their peoples. A highly developed nation like our own, with demonstrated capacity for providing a standard of living for all of the people far higher than anything we have ever known, can well afford to provide a national minimum of income, education, health and old-age security for all of the population. It cannot afford to do less.

Such a guarantee is not the impractical dream of the social reformer. It is essential for our national economic security and for protection of what we call our free enterprise system. It will go far to protect our economy against slumps. It will stimulate mass consumption, widen the markets for private enterprise, and thus open the way for new investment. It is absolutely necessary for the preservation of this democracy and this economic system of ours. Only defeatists today in the face of the war record will say that the goals of full employment are impossible of attainment under our economic system and form of government.

Eleven millions of the youth of this Nation now serving in the armed forces are not likely to believe that we cannot afford in peace as in war to provide jobs for able and willing workers. They are well aware of all of the talk about postwar planning, and if they are impatient with it now because they think it shows an unawareness of all of the bitter fighting that remains to be done, they will be far less tolerant if, when they come home, they find the planning and the talk about free enterprise and fully employment are only a mirage.

How many will never come home, how many will return maimed for life -- we do not yet know. We do know that it is these 11 millions who are risking and losing everything to save this system of ours. We do know that the good intentions of a few years ago about taking the profit out of war look rather like a mockery today. We do know that these 11 millions have not shared in the veritable war boom which has enriched the homefront. They have given up homes, jobs, businesses, and life itself. Those who have stayed at home, safe and protected, have been provided with a higher over-all standard of living than the Nation has ever before enjoyed. They have accumulated the greatest volume of savings in our history. Farmers, workers, corporations, business men have on the whole higher salaries and wages, more profits, more savings and fewer debts than ever before. Most of this has come out of an expanding, already mountainous, national debt.

The stay-at-homes -- you and I -- own the shares in that debt. We will get the interest and be paid the principal on that debt when we want it. The 11 millions -- those who survive -- will have to help shoulder that mountain of debt of which we stay-at-homes are the principal owners. They may be quite willing to do so if they have adequate jobs and economic security. You and I should have imagination enough to realize what would happen if we on the homefront, who have profited so much and risked so little -- while they have risked so much and profited so little -- if those who have the economic power or the political power in this country accept the defeatism still expressed by some to the effect that the country cannot afford the goal of full employment because the dictates of so-called "sound finance" stand in the way. I cannot imagine more unsound finance or a plainer proof that we do not at heart believe in our system or in our democracy.

Those who have overcome the most terrible of obstacles to win this war are not defeatists. If we at home fail them, they will rightly take command and throw the defeatists out of public and private places of power and responsibility -- and I, for one, would be all for helping them to do it. It need not happen that way.