

December 1, 1941

Mr. Chairman:

Here are some thoughts. If you agree with them - you may wish to use some of them in New York this week.

  
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*Material for  
Speech in NY  
12/4/41*

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We have talked about inflation for more than a year. When we started talking about it, it was not yet generally recognized that we are going to have an inflationary danger. The causes of inflation, its dangers and consequences are so familiar that I do not need to discuss them with you. You also know what needs to be done to avoid it.

It is curious how certain words or phrases become the bearers of a large amount of thinking, planning and controversy. In recent years in the field of economics those words or phrases more often than not have originated with Keynes. Just now the word of the hour in economics is "gap". As you know, the gap is the difference between the amount of money spent for defense and entering into the income stream and the amount of goods available for civilian consumption. I recognize the gap, recognize the evils that may flow from it and have done what I can to propose methods of bridging it.

But I want to take a day off from that gap today and call your attention to the fact that there is another gap and one that is vastly more important than the financial gap. This gap is the difference between the amount of goods that we need to produce in order to prosecute effectively what still is known under the alias of defense and the amount that we are actually producing. It is infinitely more important to do everything in the world to increase our output to the necessary level than it is to avoid any financial or economic difficulties.

As a realist I cannot help knowing that in a democratic country with the kind of machinery we have for adopting tax measures, Treasury financing methods, price controls, priorities and rationing we are not going to be able to fill the financial gap that Keynes talks about and that we are going to have a certain amount of inflation.

We are not going to have a run-away inflation, unless we are extraordinarily stupid, but we are going to have a moderate amount of inflation, unless we turn out to be more willing to act promptly, vigorously and even ruthlessly than there is any reason to believe that we are. Therefore, I think that it is time to do a little thinking about the extent of the inflation that we are likely to have and what we ought to do in view of that fact. I should not want to say what I am saying to every group, but you are trained people and you will not misunderstand me when I say that I expect some inflation and that I am trying tonight to explore what our course of action should be in the light of the fact that we are going to have it. This in no way means any relaxation in our efforts to prevent inflation. It only means that our thinking and exploration must not stop at that point.

In making some guess as to the minimum amount of inflation that we are going to have, we have not much to go on, except that there have been estimates that we need to raise between 5 and 8 more billions of dollars from taxation in the next year in order to prevent inflation. I am afraid that we are not going to raise that much or the major part of

it. Consequently, we are likely to have, say, perhaps 4 or 5 billions of inflationary dollars next year. On a national income of 100 or 105 billions a year, that many inflationary dollars are not going to be fatal, provided they are not allowed to get out of hand. This cannot, however, go on year after year without disastrous results.

If prices will not increase by more than 10 or 20 per cent, we will not have very serious consequences to contemplate. It may even be said that if we get to the point where the consumption of the lower income groups must be reduced, a rise in prices may be as easy a way of accomplishing this as any other method that we are likely to adopt. A housewife always has to struggle to make prices at the store and her allowance come together. A moderate rise in prices will only accentuate and somewhat modify that struggle, but it will still stay within her hands and such resentment as she will have will be against the storekeeper or the profiteer. If, on the other hand, her allowance were reduced because her husband needed the money to pay taxes, then her resentment would be against him and against the Government, which may have more serious social consequences. Furthermore, she would not have the assurance that prices would go down or would fail to rise because of the fact that her allowance has been cut. And even if they were, she would not know it. So, I believe that a certain rise in prices may be not only the inevitable but also the most acceptable way of reducing consumption in an economy constituted as ours is. Of course, I know that inflation has the effect of a regressive tax, and I would not be tolerant of even a moderate inflation, unless we had enough progressive taxes to make the upper income groups bear their fair share.

I want to make it clear that I do not mean that we must be defeatists and give up the struggle. On the contrary, I mean that we must see to it that such inflation as does occur does not get out of hand, that it remains within the boundaries of reducing consumption, rather than making serious inroads on people's savings and insurance policies and wiping out the economic status of the middle class, as inflation has done in other countries. What, then, must we do if we decide for the sake of the argument that we will have a moderate inflation?

First of all, we must prevent it from becoming immoderate and that means that we must prevent the development of speculation. It is through speculation in commodities and securities and real estate that a real dangerous inflation gets hold of a country. To prevent speculation we must, in addition to those fiscal and regulatory measures which we have already mentioned, increase our control over bank credit. Speculation cannot get very far if it cannot be done on credit. We must, therefore, be in a position to control credit expansion. Whether that is done through control of reserves or otherwise is a separate point. It is my own opinion that the reserve control is not only more democratic, but is also more effective than a direct control of the uses to which credit is put. We have now certain selective controls in limited fields that can be used effectively, if necessary. We have the power to control margin requirements if speculation should develop in securities, and we have the power to curb instalment credit further, if necessary. I think that in addition to that we ought to be in a position to control bank speculation for a variety of things, including inventories and commodity

accumulation, as well as for unnecessary non-defense purposes in general. If we do that, we will be reasonably sure of keeping our inflation in a tame condition and not permit it to become a wild and unruly element.

In the second place, we must not permit such inflation as we have consented to tolerate to interfere in any way with the constant flow of funds into the Treasury for purposes of financing the war. We must not allow the long-time rate of interest to rise materially and we must see to it that an ample amount of funds is always available to meet the Government's requirements. That is a job which involves the use of our best judgment about the nature of the securities to be issued and the methods of selling them, and it involves along with that close cooperation between the Treasury and central banking authorities in the maintenance of a level of rates that may be determined upon as the proper basis for financing the defense effort. Our problem of finance is not an unduly difficult one. The nation's income is so large, the resources of the country are so great that there will be no serious obstacle to raising all the funds that the Government needs, but it is clearly to the advantage of the country to see to it that this is done as smoothly and on as good terms as will be consistent with the maintenance of our creditor-debtor economy.

In the third place, and that is perhaps the most important and the most difficult phase about inflation, is that we must plan ahead to see what we will do when the war is over and Government outlays for armaments diminish. The question will be whether we should permit the price

level then to fall back to some pre-war basis, or shall endeavor to maintain it at the point that it will have reached. I say that, if price advances are kept within moderate bounds, our best post-war policy would be to keep prices at the point they have reached rather than to let them decline. Price declines are very hard on an economy, they accumulate distress on the way down and make it more difficult to meet the other problems with which we will be confronted.

It is not possible to over-emphasize the importance for America to be prosperous after the war. It is crucial for this country not to permit the development of unemployment or under-employment. It will be poor consolation to the people who have gone through the hardships of defense and war to face after it is over the same depression and discouragement which was upon them for nearly a decade in the Thirties. We must plan to keep activity at a level that will provide employment substantially to all our workers. Failure to do that may lead to more serious consequences than we like to contemplate.

It is important for us to be prosperous not merely because of our domestic needs, but also because of the indirect effects that a depression in this country would have on the chances of world reconstruction. The only hope for a reasonably successful reconstruction lies in the maintenance of ability for America to buy a large amount of goods abroad and to spend a lot of money both in traveling and in remittances abroad. The rest of the world will be in an exhausted condition; it will be in need of everything we have to sell. The only way we can hope to keep it afloat is

by being prepared to buy large amounts of raw materials, luxuries and other things that will provide dollar exchange for the purchase of the goods that will be needed.

We cannot finance a stable recovery of the world on credit, although some of that may be necessary in the early stages. Beyond that international loans develop into trouble -- they cannot be repaid and they cause a lot of hard feelings as well as a lot of distress to investors or to tax payers, as the case may be.

We must make it our business to keep our economy going full tilt after the war because that is the only way that we will really preserve those institutions for which the war is being fought and the only hope for the reestablishment of anything like stable economic conditions and, therefore, stable political conditions throughout the world.