

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

April 20, 1943

To - Mr. Krost  
From - Mr. Thurston

The Chairman asked me to pass along the attached to you with a view to extracting from you and your able associates any suggestions you might have as to the way in which he might present this discussion. Something probably should be added on the need for balance between savings and investments.

He doesn't need a speech written, but would like to have any material you feel would be pertinent and appropriate to illuminate these questions. In other words, a series of notes, if you could prepare some, such as you would be inclined to use yourself if you were going to head up this discussion group.

E.T.  
*[Handwritten signature]*

Attachment

1/11/43  
April 29, 1943

NY Economists  
4/30

Notes for Talk Before New York Economist Group

1. The problems of post-war economic planning fall into two sharply demarcated groups. The first group of problems relates to an earlier period when major difficulties will center around deficiencies in supply. The second group of problems belongs to a latter period when the major difficulties will be connected with deficiency of demand.

2. The period of difficulties in supply will strongly resemble the period of the war itself. Its main characteristics will be shortages of consumer goods and of capacity to produce consumer goods, coupled with an excessive volume of liquid funds in the hands of the public. There will be tremendous backlogs of deferred demand. The public will want to replace its worn-out or old-fashioned automobiles and household goods. There will be a shortage of housing. If the war lasts as long as the end of 1945, the public's demand for durable goods will be supplemented by demands to replenish worn-out stocks of clothing. During this period the continuance of price control will be an absolute necessity, if we are to avoid the disastrous inflation and deflation of 1919, 1920 and 1921. In this period, three years were wasted in a general scramble for paper gains and in finding a relatively stable level of prices at which business could be done after the boom was over, while little real progress was made toward reaching a permanent and stable pattern of peacetime production and employment.

each

3. Continuance of price control and gradual removal of rationing as goods become available to meet consumers' demands will be a necessity of the period immediately following a substantial curtailment in Government expenditures. This period may be a period of peace or, as now seems more likely, it may be the period following the termination of the European war. The prospects for a satisfactory economic adjustment will be brighter if the war does end in two stages. If that happens the curtailment of Government expenditure, and their replacement by normal civilian expenditure, will be a smoother and more gradual process than if the curtailment of Government expenditure takes place in one sharp movement. The object of economic policy during this period should be to avoid the juxtaposition of a boom in business inventories, induced by the expectation of rising prices, with the inevitable upsurge of consumer demand. If the public has confidence in the stability of cost of living its buying, as well as business buying, is likely to be more orderly. We could look forward to this period with less apprehension if we had built up a system of adequate controls of consumer purchasing power.

4. We have been late in developing such controls. Even if we should succeed, some time in the course of the present year, in establishing a system of compulsory saving with careful provision made for release of the funds as they are needed to sustain demand in the postwar period, a good deal of uncontrolled purchasing power has already been built up. The volume of demand deposits and currency already exceeds \$75 billion, nearly twice the December 1939 level, and if the war lasts until the end of 1945 the level is likely to reach from \$145 to \$175 billion, depending on our success in selling securities outside the banks. In addition to these liquid funds there are now about \$19 billion of savings bonds outstanding, cashable upon demand or upon short notice. This volume is likely to increase to over \$50 billion by the end of 1945. The magnitude of these figures would be somewhat diminished by a more nearly adequate fiscal policy, which ought to be developed and which we may hope to see developed as the war progresses. It is clear, however, that the most that can be expected from increased taxation and compulsory savings programs is a slowing up of the rate of increase in these additions to the public's liquid funds.

5. This period during which consumer spending will continue to press against inadequate supplies of civilian goods involves two dangers. There is the immediate danger that a major price inflation will develop as it did after the last war. There will inevitably be a considerable amount of public disillusionment and discontent with the practical workings of price control and of rationing. And there will inevitably be pressures to get rid of these unpopular wartime measures too soon. Compensatory fiscal policy will require that tax rates during this period be kept as high as possible, that the Government run as large a surplus as possible, and that the surplus should be devoted to reducing the short-term Government obligations in the hands of the Reserve Banks and the commercial banks. Such action will do something to reduce our abundant money supply.

6. Basically, however, the inflationary situation which will exist during this period can only be remedied by eliminating its cause: the shortage of consumer goods. To this end, everything possible should be done to facilitate the quickest possible conversion of industry from war production back to the manufacture of civilian products.

7. But there is danger not only that this period may be a period of inflation but also that the atmosphere of a false prosperity generated by it may lead to the neglect of the measures necessary to deal with the problems of deficiency of demand. These will come into the foreground when business and the consuming public have made good war-time shortages in plant and equipment and in durable goods. We will then

be confronted with the problem of finding investment outlets for a volume of saving which far exceeds anything that we have known in the past under peacetime conditions. If our efforts to deal with the problem of inflation during the war period itself are reasonably successful, we shall probably emerge from the war with a national income somewhere in the range from \$150 to \$175 billion. If they are not, the figure will be very considerably higher. There can be a considerable decline in national income with the conclusion of peace, or with the end of the post-war period of inflationary pressure, without leading to mass unemployment, since many married women and elderly persons now at work and earning an income will want to withdraw from the labor market voluntarily and many workers now receiving high wages for long hours of work will be willing and even anxious to return to jobs paying less money for shorter hours. The problem is how to avoid making the decline in the national income too large and too sudden.

8. If we set our sights at attempting to prevent the level of income from falling below the approximately \$120 billion which prevailed in 1942, we must anticipate the necessity for finding investment outlets for saving of magnitude of from \$25 to \$30 billion. Unless a very considerable part of this sum is to be absorbed by deficit spending, private industry will be called upon to make an altogether unprecedented volume of capital outlays. To assure that such capital outlays will be adequate to maintain the high level of output which we now know our economy to be capable of producing, it will probably be necessary to consider a whole group of measures to stimulate business expenditure. In my opinion, these ought to include reduction in present high level of taxes on income from business equity capital. We may find it necessary to establish some new forms of incentive taxation to insure that business earnings will either be returned to stockholders or actually spent on goods and services.

9. Another method of approach to the problem which I regard as supplementary to, rather than competitive with, measures to stimulate business spending, consists of the gradual development of the tax structure as a whole in a direction designed to equalize the distribution of income and thus to diminish the volume of saving that will be forthcoming at any given level of income. The funds thus obtained by the Government should be used for the development of a program of social services, which should not only go far to eliminate from our economy the most serious forms of economic distress, but should also give business a new and larger market for the goods which it is potentially capable of producing.

April 21, 1943.

To - Mr. Krost  
From - Mr. Thurston

Since sending you the memorandum yesterday about the date the Chairman has with the New York economists, he talked to Murray Shields by telephone and asked that the date be changed from May 7 to April 30, and this has now been arranged for the 30th.

E.T.