

Prospects for Stabilizing the Boom

I. Introduction

- A. Here 4 years ago on subject "Postwar Price Problem - Inflation of Deflation?" Doubted that we would have this choice because inflation would lead to deflation.
- B. Have had and still have inflation.
- C. Inflationary forces have been strong enough to ride through series of adjustments and deflationary debt retirement.
- D. Can we make piecemeal adjustments so as to level off the boom and maintain full employment?
  1. This is our goal. Mass unemployment is unacceptable.
  2. Prospects are not bright in view of inflation we have already had but the sooner corrective action is taken the less serious will be the adjustment required.

II. Why do we have inflation?

- A. War and war financing
- B. Postwar
  1. No peace
  2. Foreign relief and recovery demands
  3. Reconversion
  4. Conflict between economic stability and other objectives
    - a. Premature removal of inflation controls
    - b. Veteran aid programs
    - c. Farm support programs
    - d. Tax reduction
    - e. Easy financing of housing
    - f. Pegging of Government bond market

- C. In summary - we have used tools appropriate for a depression to deal with a restocking and preparedness boom.

III. Prospects for piecemeal adjustments are not good.

- A. Historical record; our economy has always been subject to recurring booms and depressions.
- B. Possible sources of future difficulties;
  - 1. The test is one that looks to the future, not to the past.
    - a. By initiating a general downturn
    - b. Aggravating a decline
  - 2. High military expenditures which may decline.
  - 3. Large export demand which cannot be maintained indefinitely.
  - 4. Business inventories have been largely re-built.
  - 5. ~~Bumper~~crops. Present level of important crops is almost certainly excessive on basis of prospective long-term foreign and domestic requirements.
  - 6. Backlog demands for capital goods and consumer goods are being increasingly satisfied.
  - 7. The rate of expenditures for producers' durable equipment is exceptionally high and is being stimulated by
    - a. Easy and large profits
    - b. Cheap and readily available credit
    - c. Rising prices and opportunities for inventory profits
  - 8. Exceptionally high demand and prices for houses.
    - a. Prices and costs are high relative to incomes of mass of buyers
    - b. Mortgage debt is increasing sharply and being incurred at very high prices
  - 9. Private debt generally is increasing. This will become particularly important after the downturn when it will be liquidated.

10. Fixed income groups are being squeezed and real wages of many are declining.
  11. Liquid asset position is becoming less favorable:
    - a. Gradual shift toward higher income groups
    - b. Purchasing power of liquid assets has been sharply reduced by high and rising prices.
- C. Piecemeal adjustment assumes an unlikely sequence of events:
1. Difficulties must present themselves one at a time
  2. To maintain income, a decline in one form of expenditures must be offset by rise in another.
    - a. Actually, expenditures are inter-related and have cumulative income and expenditure effects.
    - b. In this specific postwar situation, piecemeal adjustment assumes that when the heavy, war-induced backlog of demands has been satisfied, normal demands arising out of current incomes will increase enough to compensate for the reductions in backlog demands.
    - c. Only Government can take compensatory action on a large scale.
- D. In view of our past experience, it seems unlikely that we shall satisfy enough of these conditions to achieve stabilization. This is especially likely if we permit inflationary forces to continue unchecked.

#### IV. Immediate prospects

- A. In spite of the developing maladjustments the situation is more favorable for corrective action now without drastic consequences than it will be later.
  1. Important sources of strength are still present
    - a. Some backlog demands remain
    - b. The volume of liquid assets is large and widely distributed
    - c. Distribution of income is still favorable judged by past standards
    - d. Foreign demands are still large
    - e. The private debt structure is not seriously impaired
    - f. Wild speculative excesses have not developed on a large scale

2. For these reasons, we can afford to accept restraints and the risk of a recession in attempting to correct the maladjustments.
  - a. Underlying forces are such as to make the risk at this time one of recession, not severe depression.
  - b. If required, compensatory action of a moderate sort will probably be enough to reestablish high activity and production levels.
- B. If we wait and do not apply restraints, we run great risks of
  1. Accentuated over-investment in important areas.
  2. Creating an untenable debt structure that requires drastic and protracted liquidation
  3. A still higher and more inflexible cost structure.
- C. In summary, if we permit inflation to continue until a depression comes, we shall then face extremely serious problems of liquidation, bankruptcy, and unemployment. These problems may require heroic Government measures, if they can be solved at all within the framework of the free enterprise system.

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## *Information for the Press*

### THE SURRENDER TO INFLATION

Address by the Honorable Marriner S. Eccles,  
Member, Board of Governors, Federal Reserve System,  
before the 298th Regular Meeting of the National Industrial Conference Board  
delivered on the evening of September 23, 1948, in the Grand Ball Room,  
The Waldorf-Astoria Hotel, New York

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Mr. Chairman, Honored Guests, Ladies and Gentlemen: This organization has been good enough to invite me to appear before them four times prior to this occasion. I must have either created enough controversy or given enough satisfaction to some of my listeners, or I wouldn't have been invited the second time and certainly not invited back upon this fifth occasion!

My situation -- and I have told this story a good many times in appearing before other groups -- is not like the situation one evening when I was talking, off the record, to a group of McGraw-Hill Publishing Company editors. My assistant at that time was sitting next to me, when I asked him if I had not appeared before that group before. He very seriously said to me he was very sure that I had not or I would not have been there that evening. So I am very glad that I have a better reputation with you people than with those who know me best.

I regret that I cannot believe the problem of controlling inflation can be made as mechanistic and as simple as my good friend, Dr. Spahr, seems to think it can. I should like to remind you that curing the 20's, and I think up until the time of the Bank Holiday, the situation was a good deal like the situation to which Dr. Spahr refers. We did have a redeemable currency, that is, redeemable in terms of gold. We lost a good deal of gold because of that redemption privilege, but it didn't stop the deflation. Neither did it give to the debtors, certainly, a dollar of unchanging value. The man who had to pay his debts in 1932 found out the dollar at that time had grown in its purchasing power, just as the creditor today has found out the dollar has been contracted in its purchasing power.

Redeemable currency has not given to this country, or any country, a medium of purchasing power of unchanging value. I don't want to take up the time I have to debate this question. I think it is, for all practical purposes, academic. There will be nothing done about accepting Dr. Spahr's program.

The rest of the world, of course, would like the price of gold to be in-

creased in order to get more for the gold they send us.

This is the primary market in the world for gold. The rest of the world wants American goods. To the extent that they cannot get the credits or grants to make up the deficiency of their balance of payment situation, they are, of course, willing to part with their gold.

Inflation is a very unfortunate situation for any country to have to contend with, because of the great injustice it does to a great many people, particularly the creditor, and the people who put their savings into obligations which are payable in a specified amount of dollars, in what we call debt forms, that is, people who buy insurance, who have annuities, and so forth.

However, deflation, as I think we will all remember if we will look back to the period of '31, '32, '33 and '34, is likewise a very unpleasant situation. What we really want is a degree of economic stability that will bring about fairness to all of the various income groups.

Speaking of the problem we have to contend with at the present time, which is the problem of inflation -- I think inflation now means deflation later, unfortunately -- we should recognize what inflation is and why we happen to be in our present particular predicament. I would like to speak a few moments on the causes, that is, what inflation is and what its causes are -- you know, I think, pretty largely its effects -- and how we might deal with it.

Inflation is a condition in which the means of payment in the hands of people -- by "people," I mean all elements of the population -- exceeds the available supply of goods and services. You may have an available supply of purchasing power in excess of the supply of goods and services, but it may not be spent; it may not be put into velocity. So you have two factors to consider in connection with your money system. You must first consider its volume and then its velocity, the use to which it is put.

When we started our defense program and we later got into the war, we found that we had such a backlog of labor, goods of all kinds, capacity, that for some little time inflation was no problem. As a matter of fact, in 1940-41 a little inflation was healthy, because we hadn't recovered fully from the deflation and we still had a great many unemployed people. However, the war proceeded and we soon found that nearly half of our resources were devoted to the prosecution of the war.

The government was not able to pay for any such cost out of its current income. In spite of the heavy wartime taxes and in spite of the great savings drives which were made to bring back into the Treasury some of the income created by public expenditures, there was a very large residual amount of expenditure which had to be financed. The only place the government could turn was to the banking system. That is where the expansion of the money supply came from.

I agree, Mr. Prentis, that our military is not an economical establishment. We possibly could have spent a good deal less. However, I don't know how we could have paid for the war, without large borrowing from the banking system, unless the tax burden had been far greater, or unless the public would have been willing to save far more.

We ended the war with a huge backlog of demand. After five years, we all know there was a great shortage in consumer durable goods as well as in capital goods. We ended the war with a supply of money which had increased through bank financing by about three times. That, mind you, is entirely aside from the volume of

government securities which were the equivalent of cash held by the public.

It was quite evident then that this backlog demand could not be met immediately. There was, first of all, the normal current demand. To that was added the accumulated backlog demand, supported by a volume of purchasing power which was widely spread and held in the hands of individuals as well as businesses. With all controls taken off inflation was inevitable. The miracle is that we didn't have more inflation than we have had, because it was impossible to cure the causes of inflation by increased production overnight, as it were, and it was impossible to contract suddenly or rapidly the large supply of money that had been created.

We made the very great error of removing all wartime controls too soon. In that connection, I want to quote from a statement I made before this body four years ago:

"Nobody can foretell" -- that is in the fall of 1944 -- "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 shortage of certain foods 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 I might have added capital goods -- "and in liquid assets in the hands of the public.

"Because of the uncertainties of a transition period, price, rationing and fiscal controls should be kept intact until industry has resumed civilian production on a large enough scale adequate to meet the 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. The millions of people who own these savings and these shares in the national debt should be encouraged to retain them. If spent when there are shortages of goods, the effect would, of course, be highly inflationary. Even after the transition to peacetime production, however, it would be far better if consumption were sustained out of current income rather than by drawing upon savings. Moreover, it is better to have our national debt widely owned by the great mass of our people than concentrated in the hands of relatively few."

We didn't get very much inflation during the war. It was possibly less than in most any other country. The reason for that was the complete harness and controls which were put into effect, including allocations, building permits, price control, rationing, export licenses, wage controls, and excess profit taxes. They all fit together in a necessary harness of control. When part of them was taken off, it finally became necessary to take them all off.

Price control was inadequate and ineffective after allocations, rationing, wage controls, excess profit taxes and other component controls were removed.

All that was done very promptly after the war ended. It was done upon the demands of the Administration then in power. They responded to the public pressures. The minority in Congress did not raise any opposition or objection.

What has happened to that supply of money? In the first place, the supply of goods and services has not yet caught up to it, because it has been expanded further. I would say that a great deal of it has been activated, whereas during the war it was not in active use. It was lying idle in banks. The owners of those funds were not spending them. The expansion in our production has possibly gone up on an

average of from a third to 100 per cent. Taking production as a whole, I would say it has increased as much as three-quarters. You can see it has not yet approached the supply of money.

During the period since the war and up until June 30th of this year, the government was able to reverse in part the inflationary process of deficit financing by the application of the budgetary surplus to the liquidation of the public debt held by the banking system. That has equalled more than 14 billion dollars. Aside from that, there was a very substantial reduction in the total volume of deposits out of the very large Treasury balances which were held in the banks as a result of the 8th War Loan Drive. At the beginning of 1946, the government had around 25 billion dollars of balances.

Those were deposits that were not activated. They were deposits that were entirely unnecessary, as the 8th War Loan was unnecessary. Therefore, the government in 1946 used those balances to pay on its public debt, and thus very substantially reduced the public debt out of those balances, which never got into the spending stream.

Aside from that, in the last fiscal year, the one ending June 30th, and the fiscal year before, there were substantial budgetary surpluses. The government, through those surpluses, was contracting the supply of money by paying off bank-held debt, thus reversing the process by which the supply of money was expanded during the war. That has been helpful.

However, the banks practically nullified the effect of that contraction -- and I mean the commercial banks -- because they have loaned an amount of money about equal to the amount that was contracted by the budgetary surplus. That has been unfortunate. It is unfortunate that bank credit has expanded, because the deflationary effects of the budgetary surplus has been, as I said, offset by the bank credit expansion. Accordingly, there is no decline in the total supply of money except the decline that took place when the government applied the large unused balances it had after the war to payment on the public debt.

At the present time we are in this situation: The budgetary surplus has disappeared because of tax reductions, and expansion both in the foreign aid program, and also in military expenditures. The top of an inflation is the wrong time to have the budget either unbalanced or just in balance. There should be a budgetary surplus to use as an anti-inflationary weapon. It is the most effective single weapon there is.

Speaking of the monetary situation, the Federal Reserve has been criticized for not increasing long-term interest rates, and thus curbing the increase in the supply of money. We must remember that with a public debt of 250 billion -- sixty per cent of the entire debt; all other debts are about 40 per cent -- it is quite a problem to manage the public debt, especially when you consider that 50 billion of it falls due within the next twelve months, another 50 billion within the next five years, and 58 billion is composed of E, F, and G securities, demand obligations.

When you start down the road of increasing the long-term rate, you must be willing, it seems to me, to go all the way necessary to accomplish the purpose of increasing savings, because they are deficient in relation to investment demand. You must use the high rate to decrease investment demand, so that you will get less pressure upon the capital goods market, and you will get more money in savings from the people.

The question is: How far do you have to go to bring that about? Should you go to a 4 per cent rate to induce savings, or to discourage new investment? That



would mean that the long-term 2-1/2 bonds would drop to about 72, and all other long-term fixed obligations would drop in proportion. The refunding of the public debt would have to be done, of course, at such a rate as would assure its successful refunding. Certainly, there would not be an immediate adequate supply of savings to take care of 50 billion refunding. The refunding would have to be done at a higher rate than that being paid to present holders. The short-term debt would have to be financed largely by the banks and corporations.

That is a road I would hesitate very much to start down. You can be very sure that, by adopting what is known as the traditional central banking control, you could stop the expansion of the means of payment. There is no question about it. You could deny the banks Federal Reserve funds, which is the basis for their credit expansion.

We are confronted with a dilemma today. So long as you support the government bond market, you find it impossible to control either the banks or the insurance companies, or anyone else who wants to sell bonds. The Federal Reserve is the ultimate market, and by its purchase of securities it creates deposits and reserves in the banking system.

The insurance companies are castigating the banks, and the banks the insurance companies. Certainly, the insurance companies should not be selling their long-term government securities at this time. Those securities were purchased out of the savings of the American public which were put into insurance during the war, and it was spent by the government for war purposes when those bonds were bought, and the government is not in a position to collect enough taxes to pay off those bonds.

So when the insurance companies sell their bonds on balance, they are spending again the money that has already been spent in the prosecution of the war. The expenditure that is made by the insurance companies when they sell their bonds is not out of current savings; it is in addition to current savings. It is inflationary. That is likewise true of anyone else who sells bonds under these conditions.

Unless there is sufficient demand on the part of buyers to offset the sale by sellers, the residual amount goes into the Federal Reserve System. Up to date, it has not been serious.

When these bonds are sold and the Federal Reserve buys them, the banking system gets deposits on the one side of the ledger and excess reserves on the other side of the ledger. The banks are able thereby to expand credit six times. I won't explain that; accept my word for it. The Reserve System did not want additional powers to control bank credit expansion. All we wanted was a partial substitution for the powers we were unable to use, the traditional powers, unless we withdrew from the support of the government market and let that market find its own level, with all the dire consequences, and particularly is that true today when the foreign situation is what it is.

Do we want the American public to lose confidence in government securities? What would a decline of 10, 15, or 20 points in government securities held in your financial institutions mean? What would it mean in your ability to finance another deficit if we should be confronted again with that problem?

All that the Federal Reserve sought was a partial substitution for the traditional powers which we could not use because of the size of the public debt, and because of the exigencies of the situation with which we were confronted. The traditional powers were designed in 1913 to deal with a condition which existed then, but certainly does not exist in the world of today.

Did we get them? We did not. Most of the bankers were anxious to have us give them a ready market for their securities without depreciation, but they were as unwilling to have us control the further expansion of the means of payment as labor was to have the government exercise control over wages. Everyone wanted to have complete freedom in a world in which you cannot have complete freedom, in a world which requires, in your own interest, in your own protection, certain restraints.

It seems to me we are in a dilemma. There are a lot of soft spots developing in the economy. Prices and wages have reached the point where they have created disequilibrium. Many people have been priced out of the market. They are spending their savings and they are using credit, and that is tending to sustain the inflation.

We are getting caught up in many fields. The large agricultural crops, the increase in production in many directions, have tended to catch up with the inflationary pressures. It is unfortunate that the inflation has gone so far; and the farther it goes the more difficult the adjustment, and the less cushion we will have under it. Many of the things we have been doing were things that should have been designed for a deflationary period.

Some of the public expenditures, by city, county and state, should have been reserved for a cushion under a deflationary period. Some of the easy bank credits should have been reserved for a later period, particularly easy housing credit. Likewise, the tax reductions should have been reserved for a period of deflation. Had it been possible to hold down the foreign aid, that would have been something desirable for a period of deflation; and, of course, that is true of military expenditures.

Unfortunately, in the past two years we have been trying to catch up on housing, on capital expansion, on consumer durable goods, right at the same time when we have had a huge foreign aid program, and now an expanding military program. The longer it goes, the less cushion you will have under your deflationary process. It is too bad so much has been done at the high inflationary prices as a basis of credit.

It is desirable that the inflation be stopped. It is desirable that further bank credit be curbed. It is desirable that the insurance companies and other holders of governments retain them. It is desirable that all public expenditures, city, county and state, be contracted so far as it is possible to do so. It is likewise desirable that we do not give encouragement to easy mortgage credit for housing at these prices and get little people in debt. It is desirable that farm support prices be reduced. It is desirable that production to the fullest extent possible be maintained.

You get at the causes of the inflation by more production in the fields where there are shortages, and by contracting the supply of purchasing power, first through budgetary surpluses, and then through either a contraction of credit or, at least, an attempt to prevent a further expansion of credit.

Unless inflation is sustained and intensified through expanding military expenditures, or further expanding foreign aid -- certainly, if we can establish a basis of peace, and that is essential -- then, without question, we will be facing the dilemma of deflation. Because the inflation has gone as far as it has, it will give us considerable trouble -- it will give us less trouble the sooner readjustment comes, by reason of the fact that there would still be some backlog demands, and a considerable cushion that can be used to temper the deflation.