

LUNCHEON TALK BEFORE THE TEXAS CONGRESSIONAL DELEGATION
BY MARRINER S. ECCLES ON "INFLATION", OCTOBER 28, 1942.

Talking about the inflation problem means telling the story of a big job that isn't being done as well as it ought to be. Between this morning and the close of business this afternoon, the Federal Government spent about 200 million dollars. Ninety-two per cent of this was spent for war purposes. Today we spent sixteen times as much as the Canadians spent, three and a half times as much as the English spent. No one really knows how much Russia and Germany are spending, but it is a fair guess that we are spending as much as those two mighty nations combined, although we have less than one-half of their combined population.

We are spending money on a scale that shows that we intend to win this war, but I am sorry to say that we are raising that money in a way that will hinder us rather than help us in winning it.

Fighting a modern war means that the civilian population must do without. We sometimes talk as if it was the Government here in Washington that was asking the people to do without. If the Government had done a better job of organizing the economic side of our war effort, the sacrifices we shall have to make might have been a little smaller. But, basically, these sacrifices were not decided on in Washington. The sacrifices the American people are now beginning to make were imposed on them by decisions made in Berlin, Rome, and Tokyo. How big they will be and how long they will have to last will be decided not in Washington, but on the battlefields of Europe, Asia, and Africa.

In the coming year the gross product of our economic system -- everything turned out by our farms, mines, and factories including services -- will amount to some \$175 billion, a figure considerably higher than ever before in our national history. But out of this vast flow of goods the Government will take no less than \$90 billion for war purposes. Part of what is left over will be needed for repairing and replacing our capital equipment and for the irreducible minimum of non-military governmental functions. The goods and services remaining for sale to civilian consumers, valued at prevailing prices, will amount to no more than \$70 billion. That is -- the value of all the goods that can be sold to our people. That is all the money we ought to give the public to spend on these goods. If the people spend more than that amount on these goods, their spending will not bring them any more goods, but only the same goods at higher prices. The cost of living will continue to rise and we will be pushed faster and faster along the road to inflation, a road that we have already begun to travel.

It is a shocking fact that next year we propose to give the public, not just the \$70 billion that they need to buy these goods at prevailing prices, but very much more than this. After paying their taxes, the public will have available to spend on these goods, not \$10,000,000,000 more than these goods are worth, not \$20,000,000,000 more than they are worth, but \$60,000,000,000 more than they are worth.

We can expect the public to save part of this vast excess of purchasing power. If we continue to encourage people to pay their debts, to buy savings bonds, and to save in other ways, we can expect them to save about one-half of this sum. But the pressure of the other half, in the absence of stronger measures to deal with the situation than now seem to be contemplated, will drive prices up by at least one-third of their present level and probably by a good deal more than this.

It is no answer to say "but we have fixed prices. They cannot rise further because the Government has said so." The Government can fix prices but it cannot guarantee housewives that goods will continue to be available for sale at the prices it has fixed. We are beginning to see that this is so in the case of coffee. We see that it is so in the case of meat and before many more weeks have passed, we will see that it is so for many other things.

We are going a step further. We are rationing these scarce goods. We are making an effort to see that however small supplies may be, they are fairly distributed. That is one way of dealing with the problem. The more fundamental way of dealing with it, and a way more consistent with the framework of our American institutions, is to reduce this vast excess of purchasing power by a really adequate program of taxation and compulsory saving.

Congress has done a magnificent job in enacting the Revenue Act of 1942. That Act takes us a long way in the right direction. I am sorry that I must say, however, that it is just not on the right scale to deal with the gigantic problems of war finance that are confronting us. To do the financial job that needs to be done, the huge total of \$8.5 billion in taxes and compulsory saving provided by the Revenue Act of 1942 should have been just about three times as big.

In what I have said so far, I have emphasized the fiscal aspects of the inflation problem. There is another aspect -- a monetary aspect. In the current fiscal year, the Treasury will have to borrow about \$60 billion. Of that amount about \$40 billion will have to be borrowed from the banks. In the next fiscal year -- beginning only eight months from now -- the figures will be even bigger and the story about the part borrowed from the banks will be even worse. When we sell these huge amounts of Government securities to the banks, we increase their deposits. Their deposits are the checkbook money that our people will try to spend on our diminishing volume of civilian goods and services. The volume of things the people can buy is getting smaller and smaller; the amount of money that they can spend on those things is getting bigger and bigger. It does not make economic sense.

Besides the explosive effect on prices of this increasing volume of money, it involves the most serious dangers for the future soundness of our banking structure. These deposits are coming into existence as a part

of the process of war finance, but they will remain as a constant threat to economic stability and to our banking structure even after peace comes. Moreover, the presence of these securities in the portfolios of our banks imposes upon the Reserve system an unavoidable obligation to prevent a fall in the prices of those securities and the resulting disaster to our banking structure. This obligation seriously interferes with the exercise of the instruments of credit policy which the System might otherwise use to check a post-war inflationary situation. The powers with which the Reserve System has at its disposal to deal with this situation are entirely inadequate. No central banking powers could be adequate to deal with this situation on the scale on which it is now developing. Our only effective remedy is to tax more and borrow less and to see that our borrowing represents the savings of the people and not the result of bank credit creation.

This is the problem as I see it. It is not a small scale problem, it has enormous dimensions. It is not a problem that will develop some time in the remote future; it is a problem that began to develop before we entered the war and is spreading and growing worse as we sit here today.

What can be done about it? I believe that our financial policies are developing in the right direction, but we are not moving in that direction fast enough. We have made and are continuing to make three major mistakes in our financial policies. We have leaned too heavily on voluntary savings; we have not placed sufficient restrictions on mass growth of purchasing power; and we have borrowed too heavily from the banks. Large-scale borrowing from the banks ought to be a last resort when a nation can no longer tax and can no longer borrow from its people. Instead of that, we have used it as our primary source of funds, in a period when we are still far from the limits of our taxable capacity and far from having exhausted the public's ability to save and to lend to the Government. Voluntary savings have their place in war finance, but it is not the place which we have mistakenly assigned it. Our voluntary savings program has two great defects. The savings that have been lent to the Government under this program are not stable. Savings bonds can be converted into cash at no loss to the holder and that cash can be added to the vast flood of cash that threatens to overwhelm us. This is a danger that we shall have to face not only during the war but afterward, when the danger of inflation may be even more serious than at the peak of our war effort. In the second place, voluntary savings under our present program are just not big enough to do the job. Voluntary savings should be continued, but only as a supplement to an adequate program of compulsory savings. Voluntary savings should be used as an outlet for the funds of our citizens whose economic circumstances, or whose patriotism makes it possible for them to lend the Government even more than the share assigned to them under a compulsory plan.

In the restrictions it places on mass purchasing power, the Revenue Act just enacted goes in the right direction but again it does not go far enough. The 24 per cent rate placed on income subject to income tax under the Act (5 per cent Victory tax, 6 per cent normal tax, 13 per cent initial surtax) is still not high enough. The whole of the 24 per cent, or

the whole of any higher rate, ought to be collected at the source instead of merely the 5 per cent that represents the Victory tax.

We need stronger measures along these lines. They ought to be strong enough to make a significant reduction in the Government requirements for funds to be supplied by the banks, perhaps strong enough to cut those requirements in half.

In the fiscal field, as in other fields, we have been guilty of unjustified optimism. The policies now being pursued are leading us toward disaster. It is my hope and belief that these policies can be changed before it is too late.

**INCOME TAX AND COMPULSORY SAVING LIABILITY
IN
UNITED STATES, UNITED KINGDOM, AND CANADA**

(Married, two dependents)

October 28, '42

Net income before exemptions	United States		United Kingdom		Canada	
	Total	Refund	Total	Refund	Total	Refund
\$2,000	\$106	\$35	\$304	\$114	\$275	\$138
5,000	861	109	1,655	225	1,747	600
20,000	7,220	475	11,020	260	11,336	1,091
100,000	69,086	1,200	83,900	260	80,307	1,091

**ESTIMATES OF GROSS PRODUCT AND NATIONAL INCOME
(Billions of Current Dollars)**

October 28, '42

Calendar Years	Gross Product	Depreciation and depletion	Business Taxes	National Income
1941	120	7	18	95
1942	150	12	22	116
1943	175	15	22	138