INFLATIONARY DANGERS AND THE BUDGETARY SITUATION

Summary of Statement Before the House Ways and Means Committee,
Executive Session, October 29, 1943,
By M. S. Eccles, Chairman,
Board of Governors of the Federal Reserve System.

The Federal Government budget figures for fiscal year 1943-44, according to the latest official published estimates, are as follows:

		(Billions of dollars)
Expenditures (including net outlays to Government corporations and agencies)		
War activities	100	
Interest on debt	3	
Other	6	
Total		109
Receipts		
Individual income taxes	18	
Corporate income and excess profits	14	
Other (net)	7	
Total		39
Deficit		70
Decline in Treasury Balance		- 1
Increase in public debt		69

Assuming continuance of the war on the present scale and no change in taxes the 1944-45 budget may be roughly of this same order of magnitude.

This huge amount of expenditures adds tremendously to individual incomes, while the goods being produced are for war purposes and cannot be purchased with these incomes. This is an inherent and unavoidable result of war, and the reason why wars are generally accompanied or followed by inflation. The only way to be sure that inflation will be avoided is to balance Government expenditures by taxes. But it is a practical impossibility to increase taxes as rapidly as expenditures. So far our taxes equal little more than a third of our expenditures, and it should be the aim of public policy to make them gradually approach nearer to the level of expenditures. We should certainly be in a position to balance the budget and possibly retire debt in the immediate postwar period, if necessary, to avert an inflation.

The attached chart shows the trend of individual incomes, personal taxes, consumer expenditures, and savings for recent years with projections into 1944, based on estimates presented to the Committee by the Treasury. These figures show that incomes have increased much more than taxes and that unless additional taxes are imposed, a continued increase in this margin seems likely. The situation for the fiscal year 1943-44 is indicated by the following estimates, given in round numbers:

Individual incomes will be about	$150	billion
Personal taxes	20	"
Goods and services available for purchase by civilians	90	"
Balance available for savings or for bidding up prices	40	"

If this $40 Billion is all saved, there should be no inflation this year.

But, to this 40 billions of necessary savings should be added about 34 billions saved last year, 16 billions the year before, and another 40 or 50 billions that may be saved next year and possibly the year after, should war expenditures and taxes continue at around present levels.

Most of these savings are being accumulated in liquid forms -- currency, bank deposits, and war savings bonds -- and are readily available for spending. Holdings of currency, bank deposits, and U. S. Government Securities by individuals now total close to $90 billion, or about twice as much as in prewar years. At present rate of expansion they may be considerably more than 150 billions at the end of the war. In addition, businesses hold 50 or 60 billions of liquid assets -- 3 or 4 times the prewar level.

These funds represent a potential of buying power that could be added at any time to current income and thus create a demand for goods and services vastly in excess of current production.

The figures indicate that currently people are saving a large part of their incomes; but the record also shows that they are spending more than they should and that this is interfering with the effective prosecution of the war:

> Consumer expenditures have been larger than earlier estimates had indicated they would be -- 90 billions compared with estimates of about 80 billions -- this is due in part to higher prices and in part to increased production.
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> This means that scarce facilities and manpower, needed for war purposes, have been used to maintain consumer living standards at above prewar levels.
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> Price control programs are running into great difficulties in keeping prices and wages from rising, and some increases are occurring.
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> While these figures are necessarily estimates, they reflect conditions in a broad way and can be used safely as guides to policies. They present in simple symbols the reasoning that should form the basis of policy decisions.

Suppose they should be wrong? What are the possible errors?

> Government war expenditures have been running at a rate of 7½ billion dollars a month, compared with a budget estimate of 8½ billions, but it was expected that expenditures in the earlier months would be less than in later months, and some further increase is scheduled.

Any reduction in expenditures, therefore, will depend upon revisions of schedules, and this is a matter on which there is no published information.

Receipts are running close to schedule; it is yet too early to judge the full effect of the tax legislation of last summer; but it is not likely that final results will vary from estimates by more than one or two billion dollars.

But suppose, to take an extreme example, the deficit should be as much as 10 billion dollars less than current estimates, what effect would this have on the estimates and how should this affect tax policy?

Reduction of such an amount in war expenditures might have the effect of reducing national income or permitting an increase in the production of civilian goods; in either event, the balance available for saving would probably be reduced from around 40 billions to around 30 billions.

This would still be tremendous, especially on top of all the savings that have been accumulated.

While, in view of other controls and influences, the necessary amount might be saved during the war, it would add to the store of trouble for the future. The existence of such balances will make possible extreme fluctuations in economic conditions in the postwar period.

Tax legislation has at no time since the beginning of the defense program in 1940 been adequate to forestall inflationary dangers inherent in the war program.

No amount of curtailment of expenditures, short of seriously restricting the conduct of the war, can remove the necessity for a considerable further increase in taxes, if inflationary dangers are to be avoided now and in the future.

The potential dangers in the present budget situation are unmistakable; the way to reduce these dangers is clear. I believe the people are willing to follow that road. This will mean personal sacrifices, but far less than would result from inflation now or later.

In this connection, the following, from a letter written by an Army Sergeant in West Africa, is significant. The letter was sent to President Coffey of the University of Minnesota, who is Chairman of the Federal Reserve Bank of Minneapolis. It strikingly indicates the kind of leadership that men in the armed services are expecting from those charged with responsibilities for protecting the home front:

"Never before has the need been so great for men of vision and ideals to exert a guiding force in building our economy.

"Right now the monetary and price situation is probably the greatest problem facing us. Victory is inevitable, but dark clouds of inflation still loom ominously on the horizon of peace. Ralph Robey points out in a recent issue of 'Newsweek' that the excess purchasing power which we are piling up during the war will continue to affect our economic structure after the war. He disproves the theory that this excess will be drained off in the purchase of consumption goods after the war, since every dollar of production means another dollar of buying power in and of itself.

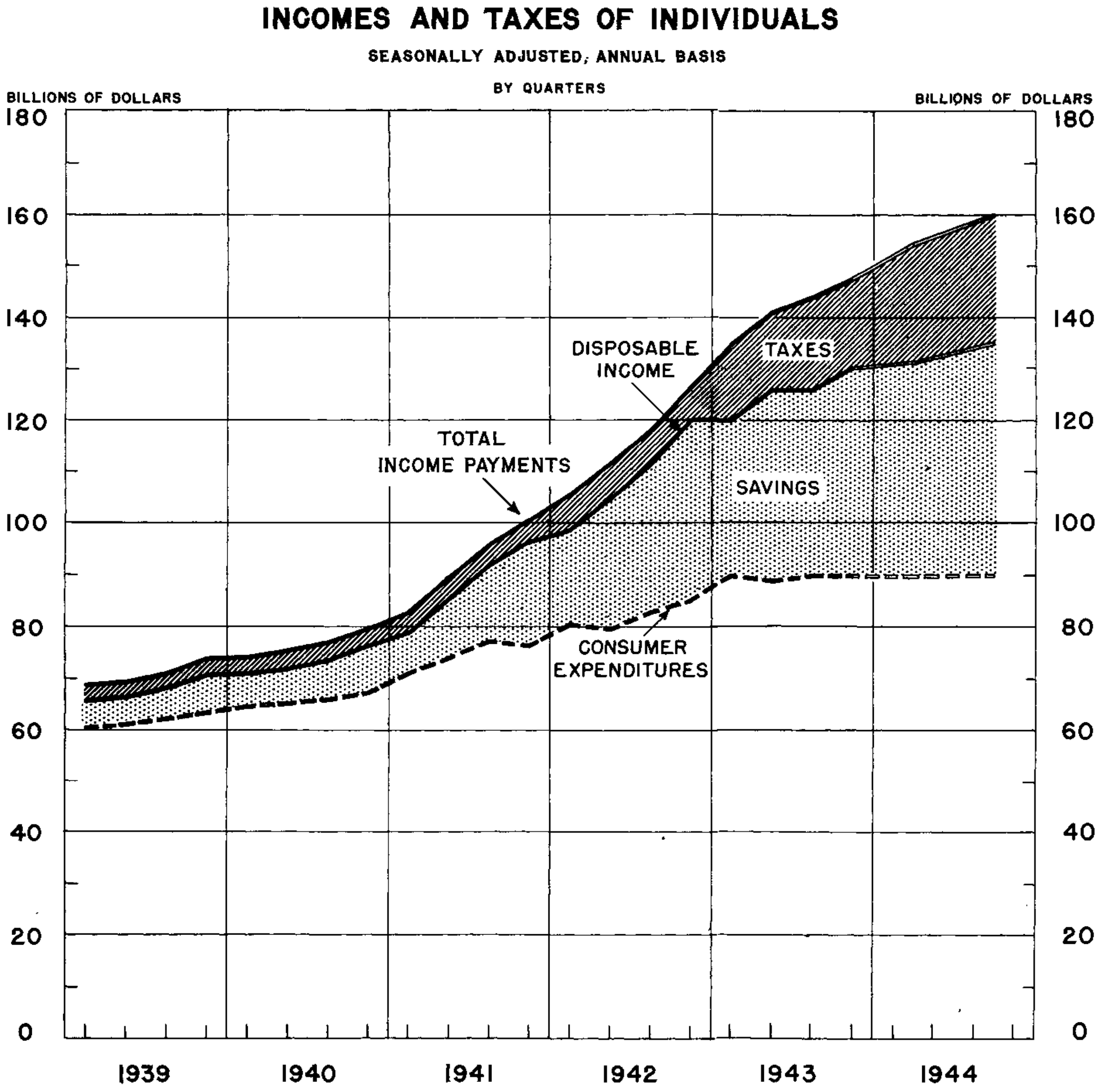
"You well know the results of inflation. But this time there will be even greater cause for discontent and unrest. This time we will have some ten million men and women from the military services who will form a formidable group if their plans are shattered by inflation.

"You might be surprised at the number of men who are making plans already for their return to civilian life. Publicly they may not say much about it, but I have talked to innumerable men who are saving all of the money they possibly can for the time that they get back. Some are married or plan to be married and they are putting money into a house, a farm, or furniture. But this is rare. The majority are saving their money - counting it carefully - and dreaming of the comforts that it is going to buy.

"But the point is that they are dreaming of these things in terms of pre-war prices. We in the Army are not vitally affected by prices. Those of us in foreign service chalk up differences against the country in which we happen to do our small amount of buying. Those of us in the States buy little anyway. Certainly we read about the price of furniture advancing 100% or some other price index going up 50%. But it doesn't strike home the way it would if we looked at a radio that we almost bought before the war for twenty-five dollars and now find that we have to pay fifty dollars for it.

"After the war that is the experience that each and every one of us in the Army is going to have. We have saved our money - denied ourselves many pleasures, and we are dreaming of a down payment on a house, of new clothes, marriage, etc. But our air castles will fall with a very discomforting thud when we find that we can buy only half, or a third, or some smaller fraction of the commodities we had planned. That is when the protesting murmurs of ten million hearts will swell to a crashing crescendo of condemnation against our government. The results may well be catastrophic.

"That is the possibility; but none of us over here believe that it will actually occur. We have confidence that men of knowledge and judgment who are in positions of influence * * * will solve this problem for us. Our confidence is unlimited; you cannot afford to fail."


INCOMES AND TAXES OF INDIVIDUALS
SEASONALLY ADJUSTED, ANNUAL BASIS
BY QUARTERS
BILLIONS OF DOLLARS
BILLIONS OF DOLLARS
TAXES
DISPOSABLE INCOME
TOTAL INCOME PAYMENTS
SAVINGS
CONSUMER EXPENDITURES
180
160
140
120
100
80
60
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1939
1940
1941
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1944