Speech delivered before
National Retail Dry Goods Association Convention
Hotel Pennsylvania, New York, N. Y.
January 14, 1942

INFLATION - WHAT NOW?

This is no time, as we all know, for speech making and lengthy discussion. This is a time for serious application and study followed by intelligent and courageous action. We are at war!

We are all aware of the changed situation and need take no time in preliminary argumentation.

Through the long painful depression of the 30's, the cry of "Inflation!" was raised by critics of Government spending. However, it was difficult to take them seriously in view of the vast unused resources available for expanding production. Inflation attacks an economy when its productive capacity is near or close to full utilization; not when it has vast resources of idle men and machines.

In the summer of 1940, after the fall of France had precipitated our vast defense program and the appropriation of billions to finance it, we again heard the cry: "Inflation!" - this time as a battle cry for higher taxes and other counteracting measures. This was no "Wolf, wolf!" by the alarmists of the 30's. It was an informed response to a potential danger that lurked in the new economic outlook. But we had yet to see the forerunners of inflation, and could not immediately adjust our thinking to the possibility of a shortage of production after the long depression years of surpluses.

Today voices again cry, "Inflation!", and today we have real cause to give them our serious attention, for we are pressing our productive capacity to the limit. I need not tell you, from the business frontlines, what the effect of our vast defense program has been. You know better than I the tremendously increased buying power of the American public. You know better than I the increased difficulties of getting many of the goods the public wants and has money to buy, and the effect that increased spending is having on prices.

What have we been doing about this danger of inflation. Have we been doing enough? Are we moving along the right tracks, or ought we to try new and different methods? These are the relevant questions today, and they must be faced resolutely and open-mindedly.

What Have We Done Thus Far?

You all know well what the Government has done thus far in the anti-inflation effort. The problem has been approached gradually on a variety of fronts. Taxes have been increased by an amount which at the time seemed very large but which now looks very small beside the huge appropriations necessary for war. Funds have been borrowed from the public through Defense Savings Bonds in an effort to reduce the volume of funds left for private spending for the limited supply of civilian goods. Some mandatory price ceilings have been established, with many others on an informal basis, and a strengthened price control bill is now on its way to Congress. Reserve requirements have been raised for the banks in an endeavor to reduce their lending power, which rests on their unused reserves. Regulations have been established to restrict instalment credit for the purchase of certain specified articles which are exceptionally scarce relative to the demand for them.

These steps taken by the Government have had a considerable effect, though one that is difficult to measure. They have surely been a factor in holding prices below what they otherwise would have been. But it would be a serious error to suppose that the job is done -- or will be done by anything now in near view -- and that we can sit comfortably back without further drastic action.

The inflation potential ahead is tremendous. According to the estimates in the President's recent budget message, Government expenditures for the fiscal year will probably be around 30 billion dollars, and for the fiscal year beginning in July may approach 60 billion dollars. Against this, present Federal taxes may be expected to bring in perhaps 18 billion dollars in the next fiscal year, so that even a very large increase in taxes will leave a tremendous gap to be filled by borrowing.

Borrowing by the Government is not necessarily inflationary. If it diverts for Government use funds that would otherwise have been spent some other way -- it adds nothing to the total spending stream. But if the borrowing is from banks or draws on accumulated funds that would otherwise have remained idle -- it adds to the spending stream and to inflationary pressure.

In addition to the central inflationary force of Government spending, the banks are in a position to expand greatly their private loans and investments, in view of their existing unused reserves. And inflation, once started, feeds on itself. When the public begins to buy goods in anticipation of price advances there is the beginning of a flight from money into goods, which is the very essence of inflation. Inflation comes with increased spending relative to available goods -- whether the spending is of new funds that are created mainly through purchases of Government securities by the banks, or through the more rapid circulation of existing deposits and currency, is a secondary matter.

To offset these inflationary pressures there is the possible deflationary effect of diversion of resources from civilian to war production. We may hope that all resources thrown out of work by priorities and allocations will be reabsorbed promptly by war industries -- but in fact we know that some delay is inevitable. To the extent that people are temporarily out of work, this will be a deflationary factor. This offset may be of major importance for awhile, but over the longer period the forces pushing upward on prices are far more formidable than these deflationary factors.

What More Do We Need To Do?

We need to do more to stop inflation -- much more! But What?

There are three broad aims in this war period, as I see it.

The first and most important is to get the maximum output of war materials and get it quickly.

The second is to avoid unnecessary disruption of economic life, both now and in the postwar period.

The third is to spread the burden of the war effort as equitably as possible.

Inflation interferes with all three of these objectives. Rapidly rising prices make it more difficult to plan and operate our war effort efficiently. They will aggravate the problem of postwar adjustment, and they are inequitable because they impose uneven and arbitrary burdens on different economic groups, especially a heavier burden on the poor than on the rich.

If inflation is bad -- what then are the alternatives? What can we do that will be better?

In general, if we are to avoid sharp price increases, there are two broad lines of attack on the problem:

1. We may fix price ceilings on many or all goods, and supplement these price ceilings by rationing the commodities whose prices are controlled; or

2. We may adopt an aggressive fiscal policy, supplemented by monetary controls, sufficient to divert from current income enough funds to keep consumers from demanding more goods than are available at present prices.

In practice, I feel sure that we shall have to do a great deal of both.

Price Fixing and Rationing

To the man in the street, the answer to the inflation problem appears simple -- just place a ceiling on those prices which show signs of rapid increases. But this answer does not solve the problem -- it only shifts it. If we fix price ceilings but leave people with increased incomes to spend, then we must find some way of distributing fairly the limited supplies available. Prices can then no longer act as the allocating mechanism. We must take the rationing job over directly.

A recognized obstacle to the price fixing procedure is the great administrative difficulty of imposing, policing, and enforcing price ceilings on the thousands of commodities bought and sold in our markets. Even with only a few prices fixed it is very difficult to check evasion; with ceilings on many or all prices the task would be a most formidable one. No one knows that better than you. Already OPA is hard-pressed for competent personnel -- yet OPA today is only a shadow of what it will have to be if price ceilings spread everywhere.

But less widely recognized than these administrative difficulties is this fact -- price fixing inevitably calls for rationing. If scarce goods are not to go to the man with the long purse, then who will get them? "First come, first served" is not an equitable or a feasible procedure. The Government will have to step in and tell us how much of each thing we shall have -- how many rubber tires, how many wool suits, and so on. If incomes soar and prices are fixed, someone must decide who is to get goods for which there are many bidders. Rationing appears to be the only alternative to a haphazard scramble.

Logically there is much to be said for rationing in war time. Ideally it would be, aside from the ever-present possibility of evasion, the fairest means of allocating the limited supplies of available civilian goods among consumers -- rich and poor alike. But there are many among us who would dislike very much to be told just what and how much of it we could buy. Furthermore, you as retailers are keenly aware of the difficulties of estimating for your own sales areas exactly the relationship between what is available for sale and what people will buy. Imagine the technical problems of deciding just how a great variety of articles should be parcelled out among regions and classes of buyers over the entire country. If ration cards and supplies should not be figured to correspond exactly, late-comers would be turned away or excess supplies be left to spoil. Prices would no longer be the adjusting factor.

Also, not to be discounted is the large need for manpower in a rationing system. Before the end of the last World War, over 25,000 people in England were employed full time in food rationing, and over 20,000 more were contributing some of their time and energy. Yet rationing -- unattractive and difficult as it is -- is clearly the only reasonable alternative if we choose to fight inflation primarily by the price ceiling method.

An Aggressive Fiscal Policy

The other major method of combating inflation is:

An aggressive fiscal policy coupled with monetary controls.

If, by taxes or some other means, enough of current income could be withdrawn each year to hold spending down to the level of goods available at existing prices, there would be no problem of general price rises. Theoretically such a procedure could make direct controls unnecessary, but practically, of course, resort must be had to both ways of approach to the problem.

To the extent that the over-all fiscal approach is adopted, the primary available steps are:

1. Taxes
2. Borrowing of current savings, and
3. Monetary controls.

There can be no doubt that increased taxes are one of the means necessary to ward off inflation. Almost all taxes bite directly into current income, and we must all be prepared for a very great increase in the tax burden. We must bear it cheerfully -- not only because we are prepared to do our share, but also because we must realize that if we are not taxed directly we shall lose more and lose less rationally through a rise in prices.

While taxes appear clearly to be the most effective fiscal attack on inflation care must be taken to distribute them upon an equitable basis -- the governing principle being ability to pay. Timing and nature are two essential elements when taxes are related to a fight against inflation. In other words, certain kinds of taxes imposed too soon or too late may fail of their purpose. This is no time to abandon the progressive principles of taxation. Needless to say, the tax system must also be designed so as to prevent war profiteering.

To the extent that the Government must borrow, the borrowing must be planned so as to derive the maximum possible portion of the funds from current income. If the borrowing reduces current spending from what it otherwise would have been, the result is as anti-inflationary as taxes. If the borrowing comes out of past savings or from newly expanded bank credit, it does not reduce current spending -- on the contrary it increases "money in circulation" and feeds the fires of inflation. Borrowing from the public is by no means a necessarily non-inflationary financing method. It is non-inflationary only when it draws current income or resources that would otherwise be used for civilian purposes.

Broadly speaking, the use of Defense Savings Bonds may help most to absorb current income, and we must all do our part by using a portion of our incomes to buy such bonds. No doubt thus far many bonds have been purchased from accumulated savings. This is better than if these bonds had been purchased by banks, but much less anti-inflationary than additional taxes. To the extent that borrowing does not come out of current income, it cannot be relied upon to replace taxes as an inflation preventive. But to the extent that the Government must borrow rather than tax, borrowing from the public is still much better than selling bonds to the banks. The widespread plea "Buy Defense Savings Bonds" is one well worth heeding. Our Government will have to borrow large sums of money. It is determined, as stated by the President in his Budget Message to Congress, to do so at a low rate of interest, and we may rest assured that any bonds we buy will be fully redeemed by the Treasury in accordance with the conditions of their issue.

Carefully planned tax and borrowing policies could easily be offset to a considerable extent if people borrowed to replace the funds paid in taxes or lent to the Government. Therefore monetary controls are an integral part of an aggressive fiscal policy, although in the war period care must be taken lest monetary controls shut off funds necessary for the defense effort. The specific monetary control about which you know most at the present time is Regulation W, which deals with consumer credit. This regulation restricts the expansion of instalment credit to purchase certain durable goods. It is hoped that it has diminished the demand for some of the goods whose supply is especially restricted by war needs. This regulation reduces the pressure on prices of such commodities by diminishing the creation of additional credit for the purpose of buying them. From a broader point of view, instalment credit once created adds the existing money supply and hence makes more difficult the over-all problem of control. At the moment the Board of Governors is working on future amendments to the Regulation to the end of making it a more workable and effective instrument. Since "Pearl Harbor" and the adoption of an all-out war program the need to tighten its restrictive provisions has, of course, increased markedly.

Finally, on the broader front, there should be more adequate control of bank reserves if monetary policy is fully to supplement fiscal policy. There are still 3 billion dollars of excess reserves held by member banks of the Federal Reserve System. These excess reserves might support an expansion of credit of from 10 to 20 billion dollars. All of this expansion may be needed to provide credit for the Government and for production for war, but care must be taken that it is not used exclusively to bid up prices. The possibilities of credit expansion may be further increased if the large volume of currency now in the hands of the public, chiefly because of increased business activity, should begin to flow back to the banks. For currency in the hands of the public, as you know, has been increasing very rapidly and is now about 11½ billion dollars, the largest amount on record. On the other hand, the present currency drain may continue and thus reduce the amount of available bank credit.

In the face of this uncertainty and of the general inflationary picture, adequate machinery should be available to expand and contract the reserve base of the banks so as to enable them to meet all the demands that may be made upon them by the Government and all the legitimate needs of private enterprise -- without going beyond these needs and contributing to inflation. This is a complex situation, and one of the things that makes the problem particularly difficult is the fact that there are about 15,000 banks scattered throughout the country, of which less than half are members of the Federal Reserve System. Only member banks are subject to the Federal Reserve System reserve requirements and, although the member banks hold the bulk of the country's banking assets and deposits, the non-members constitute an important group. Furthermore, even within the Reserve System reserves are not evenly distributed among the member banks. For example, banks in New York -- the money center -- have recently been losing excess reserves, and at present have a much smaller proportion of the total reserves than is usual. What is needed are ample powers in sufficient time, ample wisdom and abundant courage in their use when conditions require that they be used.

Conclusion

What I have said is intended merely as a review of ways and means of combating inflation. I make no effort to say that the war period ahead will be a pleasant and an easy one -- I only say that no real American will place his own personal interest above the Nation's welfare. And the welfare of the Nation is and will be best served not by protesting vigorously against "too high" taxes or against strict regulation, nor by reaching blindly for every suggested control device. Open-minded consideration of the various possible means of safeguarding the economic front must be followed by careful selection of the most appropriate and effective devices. An intelligent and informed citizenry is now, as always, the bulwark of Democratic government.

This is your country -- and mine.

This is your Government -- and mine.

This is your fight -- and mine.

Victory will be ours!