

FINANCIAL MOBILIZATION

by

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I. THE PROBLEM: GREAT EXPANSION OF DEFENSE EFFORT

Contrast with last large defense effort a decade ago

A. Differences between 1941 and 1951

1. Size and duration of the effort
 - a. 11.6 million men vs. $3\frac{1}{2}$ million
 - b. 40 per cent vs. 16 per cent of GNP
2. Status of the Economy
3. Psychology of deflation/inflation
4. Experience with direct controls
 - Difficult to administer
 - At best they postpone - do not solve - inflation

B. The Economics of Defense

1. The burden arises from decision to defend
NOT from the need to raise the money
2. Government: Defense incl. foreign aid

	Fiscal
	1950 1952
17.6 →	34 → 51.8

Expansion of capacity (investment)

Consumption - especially of durables - must go down
- it doesn't make any difference how much
money we have! The goods will not be available!

II. FINANCIAL MOBILIZATION

A. Current income = current output

BUT current expenditures are not limited by current income

1. Can ↑ by spending past savings
2. Can borrow and spend future income

If some segments spend > Income
other segments must SAVE (spend < Income)

B. An Economists' Program

(Quote p. 54)

"Faced with this long-run inflationary prospect, we recommend that the increase in total spending be continuously curbed in three principal ways, and that these constitute the first line of defense against inflation:

1. Scrutinize carefully all Government expenditures and postpone or eliminate those that are not urgent and essential. Substantial reductions can be achieved only if some programs are cut.
2. Raise tax revenues even faster than defense spending grows so as to achieve and maintain a cash surplus. Merely to balance the budget is not enough. If the inflationary pressure is to be removed, taxes must take out of private money incomes not only as much as Government spending contributes to them but also a part of the increase of private incomes resulting from increased private spending of idle balances and newly borrowed money. Larger taxes must be paid by all of us. Reliance should be placed primarily on increases of personal income taxes on all income in excess of present exemptions. Higher corporate profits taxes, in one form or another, are also imperative. In addition, loopholes in our tax laws should be closed.
3. Restrict the amount of credit available to businesses and individuals for purposes not essential to the defense program. An expanding supply of low-cost credit which swells private spending cannot fail to stimulate inflation when the supply of goods available for private use will be difficult to expand and may even decline.

Selective controls over consumer credit, real-estate credit, and loans on securities are useful for this purpose and should be employed. But we believe that general restriction of the total supply of credit is also necessary. This can be accomplished only by measures that will involve some rise of interest rates.

If general inflationary pressure is not removed by fiscal and credit measures, we face two alternatives: (1) Continued price inflation, or (2) a harness of direct controls over the entire economy which, even if successful in holding down prices and wages for a while, would build up a huge inflationary potential in the form of idle cash balances, Government bonds, and other additions to liquidity. Such accumulated savings would undermine the effectiveness of direct controls and produce open inflation when the direct controls are lifted. Everyone remembers vividly the sharp inflation of 1946-48 when the wartime accumulation of liquid

assets went to work on prices after the removal of direct price and wage controls. "Either of these alternatives is extremely dangerous."

Variety of economists signing: Not necessarily correct but evidence of error should be clear and overwhelming.

I haven't seen such evidence yet.

C. These are difficult times

This is Lincoln's birthday

Lincoln - Second Inaugural Address - 1865

"With malice toward none, with charity for all, with firmness in the right as God gives us to see the right, let us strive on to finish the work we are in ..."

Ol' Mose

"Mose, you better be careful; you may be handing an innocent man!"

I spent 3 days in Washington last week. I can confirm your impression that it is a place where sound travels faster than light.

Reported in press

Everyone wants to get into act.