



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON

OFFICE OF THE CHAIRMAN

January 19, 1951.

Dear Mr. President:

I am enclosing the memorandum which you asked me to send to you, the subject of which we discussed this morning.

I have already discussed it with Charlie Wilson.

Respectfully yours,

A handwritten signature in cursive script, appearing to read "Tom".

Thomas B. McCabe.

The President  
The White House

Enclosure

January 18, 1951.

M E M O R A N D U M

TO: The President

SUBJECT: Necessity for dealing  
with the causes of  
inflation.

FROM: Mr. McCabe

In the past six months we have given top priority -- and rightly so -- to a reassessment of our international position, and to the development of a comprehensive military program. We have given urgent consideration to procurement problems and production problems. Now that these programs are launched, the next order of business must be to work out a comprehensive program for maintaining the integrity of the dollar. Inflation is our Number One unresolved problem today.

The strong upsurge of prices over the past several months dramatizes the potency of current -- let alone future -- inflationary forces.

If it is in order to contemplate such heroic measures as a complete freeze of wages and prices across the board, is it not equally in order, and essential for the long-run, to initiate simultaneously emergency action on the fiscal and credit fronts? For example, I suggest that you might ask John Snyder to explore the practicability of an emergency tax measure -- one that would jolt the country and stop this inflation psychology in its tracks. More drastic action on selective credit controls (Regulations W and X, and margin requirements) plus emergency restrictions on loan portfolios of insurance companies, banks and other lenders would help to curb inflationary credit expansion. To be enacted quickly, these measures might have to be

crude and should be temporary. But they would provide time to work out a more carefully evaluated program.

No dam of wage and price controls alone can be expected to withstand pressures of the magnitude that are in sight. Increased income resulting from defense spending will be far in excess of goods available for civilian purchase. The outstanding volume of bank and other credit is more than enough to finance the entire economy even at forced draft. Fully as important is the current movement to convert liquid assets into land, equities, and commodities, the so-called "hedge against inflation." This movement is well under way and is gaining momentum. It feeds on itself. It will accelerate with any further rise in the inflationary spiral and will accentuate the spiral. The volume of liquid assets already outstanding is out of all proportion to the needs of the economy.

Inflation is not inevitable.

I suggest the Defense Mobilization Board immediately concentrate on a study of all problems of inflation control. The study should be just as comprehensive as that given to the requirements of military mobilization. The problem is much more complicated and much more urgent than it was at the beginning of World War II. I doubt very much whether it will be solved by minor adjustments in fiscal policy, in debt management policy, or in monetary and credit policy. We need a complete reappraisal of what is involved in credit and financial mobilization for a fullscale defense effort. I think it would be fatal to repeat the mistakes of World War II financing. As you so clearly and correctly pointed

out last Fall, "During World War II we borrowed too much and did not tax ourselves enough. We must not run our present defense effort on that kind of financial basis." You and the Treasury have already taken an heroic stand in this emergency to press for a "pay-as-we-go" tax program, and the suggestions made here are for the purpose of strengthening your hands.

We cannot forget that the American economy was subjected to a major inflation in spite of the harness of direct controls applied during the last war. That program broke down rapidly when hostilities ceased. As soon as the harness was removed the pent-up demand of the swollen money supply, which resulted from the war financing methods, broke loose in a tremendous inflationary tide.

Active consideration is being given to building a dam of general price and wage controls in the hope that they will stem these forces. I am profoundly convinced that such a dam alone -- and at this time -- will not suffice. It should be part and parcel of a broadscale carefully integrated program not only of direct restraints on spending but also fiscal and credit measures to lock up demand. Otherwise it may actually compound the problem by precipitating widespread hoarding as the freeze on automobile prices has already done. A general freeze on prices and wages creates an illusion of anti-inflation security. By itself it does not deal with the fundamental cause, namely, a volume of money demand arising out of increasing incomes, credit expansion, and out of liquidation of assets that is greatly excessive in relation to goods available for sale. The inflationary flood which threatens to engulf us must be stemmed at the source.

D.P. Lee.

THE WHITE HOUSE

WASHINGTON

January 24, 1951.

Memorandum for:                   Honorable Charles E. Wilson  
From:                                The President

I am enclosing a memorandum from Tom McCabe. I understand he has already discussed this subject with you.

This memorandum seems to me to be basically sound and in line with what we are trying to do. I believe your organization is the proper place for getting the interested departments and agencies together to consider such matters as this.

I believe that the Council of Economic Advisers can be of particular help to you in considering these matters, and I hope that you are calling on them regularly. I also believe that there may be some agencies of the Government not represented on your Board who have particular interest in some of these questions -- as, for example, Ray Foley in the housing field.

Enclosure.