2. Objects of Action

IN MY testimony before the Senate Finance Committee in February 1933, I had contrasted our willingness to go into debt to support a war with our reluctance to do so to revive our economy. I had argued that in time of emergency the government never lacked the means by which it could finance its efforts; that we could readily support a national debt of at least $50 billion without strain, providing this debt-creation stimulated a noninflationary and parallel increase in the national income.

At the time these arguments were advanced, they shocked those who heard them. Yet as the events of World War II were to prove, if there was an error in what I said it was on the side of understatement.

When Roosevelt took office, our public debt stood at $22 billion. This represented the unpaid costs of the First World War and the deficits accumulated despite the Hoover Administration's budget-balancing efforts. Between Inauguration Day 1933 and the eve of Pearl Harbor our national debt rose to about $48 billion. Thus the total increase during this period of eight years and eight months averaged around $3 billion a year.

As against this, in one year of actual war we increased the public debt by $50 billion, a sum exceeding the deficit compiled by the nation in the preceding twenty-five years. By V-J day our war expenditures of approximately $380 billion left us with a public debt of $280 billion, or nearly six times what it was on the eve of Pearl Harbor.

Yet at no time was there any doubt that money would be forthcoming to wage war. The promise Henry Morgenthau made to General Marshall was honored in full. Our military

leaders shaped their plans free from worry that they would lack money to pay for them. Moreover, while the war debt was built up, there was no change in the interest rates paid by the government on its various types of securities. Contrary to the prophecies voiced in February 1933 that an increase in the national debt would force our government securities into a fatal drop in value, the fluctuations that occurred were minor even though the national debt increased six times.

I am not implying that rising debt reflected limitless confidence in the public credit. The results achieved were due to the types and methods of Treasury financing, which required the Federal Reserve to maintain and support a fixed pattern of rates. The significance of this fact is not limited to past events; it has equal significance for those of today. Specifically, when we went into the war, the public debt was equal to about one fourth of the entire debt in the country. By the end of 1945 it was nearly two thirds. Under these circumstances, public debt has become the dog, and private debt the tail. That is, public debt has become the dominant factor in our economy, and this in turn makes inevitable the conscious control and management of the money market.

In the war years the maximization of war output was our supreme aim. Financing that output was a secondary consideration. Nevertheless, what was secondary was extremely important, since war has its own needs for economic stability.

From my observation post it seemed that billions of dollars, particularly during the last year of the war, were spent needlessly. While these dollars could have been spared for better purposes, the problem of maintaining economic balance in the war years was compounded of more complex things. It was a problem shaped by facts directly contrary to those with which we dealt in the preceding depression years.

In the fall of 1935, for instance, when the specter of inflation was raised as part of an attack on the government's spending program, I had asked how we could have inflation when mil-

lions of men were unemployed and when facilities of all kinds were everywhere idle. Inflation, as I understood the term, was a condition where the effective demand for goods and services exceeded the supply, and prices were driven up.

The definition of inflation that I offered in 1935 was disparaged as being "academic." But when this very definition described the character of our wartime economy—when government expenditures put purchasing power in the hands of the public much faster than goods were available for the public to buy—many of those who in the depression years talked the loudest about inflationary dangers were the most reluctant to do anything about them when they really developed. The failure to curb the upward spiral of prices required that more and more money be raised with which to pay for the war. And this in turn brought on a greater increase in the national debt than there would have been had inflation been prevented.

Those of us, then, on the financial front of the war effort had this object in view: to raise the money that was needed, but at the same time to raise it in a way that would minimize the economic instability inherent in waging global war. This being our goal, the choice of means to reach it were the following, stated in their order of preference:

First, we wanted to raise by current taxation as much money as was possible. In this way the government would transfer the purchasing power from the public to itself and thus increase its own purchasing power while reducing that of the public. Stated differently, it would transfer goods and services from the public, which could no longer pay for them, to the government, which had to have them and could pay for them.

There were, of course, grave institutional and political blocks that made it hard to raise taxes with a speed that matched our mounting war expenditures. Nevertheless, I was among those who felt we should and could have paid more of the costs of the war out of taxes.

The Administration, the Treasury, and Congress were all shy

in stating the economic facts of life to the nation. They all feared the political repercussions of a tax program that suited the needs of the hour. Many people wanted to wage a comfortable war; they wanted guns and butter, and there was a reluctance in government circles to do anything to disturb this sanguine view of how a global war could be waged. Moreover, even when some of us presented the case for stiffer taxes in terms of its effect as an inflation control measure, we were met with incredulous stares. The reaction is not hard to understand. We entered the war years with a hangover of depression psychology. For the period of eight or nine years before the war, it had been money and not goods that was in short supply; in that period we never seemed to have enough money to buy all the things that were available and that we wanted. The momentum of this belief was carried forward to the war years, and Americans found it hard to believe that in war it was goods, not money, that would be in short supply.

Nor was the tenacity with which we clung to the belief that we could never have more money than goods very far from the truth at the beginning of the war. The enormous surplus of labor, factories, and raw materials that existed in the depression years gave us great leeway to increase production in 1940 and 1941.

Despite the huge deficits accumulated in those years, no real inflationary pressures, reflecting a full use of the nation's productive plant, began to be felt until 1942. Up to that time the slack in our economic structure seemed by itself to offer security against inflation.

It may be of passing interest to relate that Roosevelt's insight into the nation's belief that we could only suffer a shortage of money and not goods entered into the strands of thought that led to Lend-Lease. He disclosed this to me in the course of a White House dinner on December 18, 1940, the day after the press conference at which he announced the Lend-Lease plan. At that press conference he had said:

Now, what I am trying to do is eliminate the dollar sign. That is something brand new in the thoughts of everybody in this room, I think—get rid of the silly, foolish, old dollar sign.

Well, let me give you an illustration. Suppose my neighbor's home catches fire, and I have a length of garden hose. . . .

At the White House dinner the next night Roosevelt leaned over in my direction and said:

"Marriner, how did you like the idea of Lend-Lease in the papers this morning?"

"I'm sorry to say that I only had time to read the headlines and didn't study it," I replied, "but I'd certainly like to hear about it."

"Well," said the President, "I had a little free time to think when I was on my cruise to the West Indies. And this idea just occurred to me while sunning myself. I knew the British were at the bottom of the barrel for cash. They had to get some direct help from us, or the Nazis would win the war. I also knew that with the isolationist sentiment in the country, the desire to keep neutral would be the ground for a blast of opposition if I proposed a direct loan to a country that had not paid back what it borrowed from us during the last war.

"But I think people can better understand what happens in international trade. You sell goods to the world and you must take goods back in payment. Well, everyone knows we have a lot of surplus goods which we don't need and can't use, but most people feel there is a shortage of dollars. If we made a dollar loan to the British, it would seem to our people that we were giving the British money of which we were short, instead of goods which were in surplus. But it's different if we lend them goods which we don't want and get goods of theirs sometime in the future. Of course, even if we give them goods, they must be paid for in dollars. But by presenting this problem as an exchange of goods which they now greatly need for goods to be returned to us at some future date, it takes it out of the field of

an international dollar loan and places it in the field of lending and leasing things with your neighbor."

So much for this digression. I return to the preferred means for keeping the economy on an even keel in wartime.

Next in the order of preference, we felt that the part of the war cost that could not be financed through taxation should be financed by nonbank investors. That is, it should be financed by inducing the public to save as much as possible out of their current income and invest that saving in government securities. This would withdraw the money from the spending stream and reduce the public's purchasing power, and thus the inflationary pressures. Moreover, in so far as it was nonbank sources from which the money was borrowed, to that degree the securities offered by the government would not enter into the money and credit-expansion mechanism that follows when banks lend to the government—or, for that matter, to anybody.

The Reserve System recognized that an expanding and complex war economy called for some expansion in monetary supplies, and that some buying of government securities by banks was necessary to meet these needs. With this in view, we supplied banks with the reserve funds they needed from time to time to purchase the securities that were offered to them. But for reasons I'll state in a moment, our intended policy of vigorously controlling any unwarranted bank-credit expansion was frustrated.

The Treasury, for its part, agreed with the general objective that the purchase of government securities should be made in the first instance and in the main by nonbank investors. They further agreed that bank buying of government securities should be limited in volume. In pursuit of these two ideas, the Treasury made new issues of long-term securities ineligible for purchase by banks. It also launched special drives to promote sales of these securities (especially savings bonds) to nonbank investors. But, unfortunately, the subsequent procedures adopted by

the Treasury encouraged rather than discouraged bank purchases of securities. To that degree they frustrated the very objective to which the Treasury was committed.

A third general principle of war finance agreed upon by the Treasury and the Federal Reserve called for an assurance of relatively stable prices and yields for government securities. This was a radical departure from all previous war-finance experience. It was a difficult policy to maintain. It caused serious problems during the war years. It is one of the root causes of our postwar inflation problems. But it should be said that the difficulties which arose were due less to the principle itself than to the way it was applied.

The initial reasons for adopting the policy were these:

First: To encourage (in a war of indeterminate length) the prompt buying of securities by investors who might otherwise wait for lower prices and higher rates.

Second: To assure a strong and steady market for outstanding securities and to reduce speculative fluctuations in anticipation of possible changes in interest rates during a period of large deficit financing.

Third: To keep down the costs of carrying the war debt and thereby limit the growth in earnings by banks and other investors from their holdings of the public debt. Since a tremendous increase in the amount of securities offered by the government could be expected, and, further, since war expenditures and Federal Reserve operations created the money available to banks and other investors for the purchase of these securities, it would have been wrong for the government to pay increasing rates of interest for the use of these funds it helped create.

As a final tool of wartime finance, we agreed that rationing and a number of direct price controls should be used to dampen down inflation and hold it in check.

But this last was to be only a supplementary source of strength.

Unfortunately, as things turned out, a weak fiscal policy—plus laggard buying of government securities by nonbank investors—plus Treasury policies that induced excessive security-buying by banks produced a situation in which the direct controls were rushed to the fore to save an economy torn by too much money and too few goods. If serious inflation was curbed during the war years—and our performance was better in the Second World War than in the First—we owe the fact to the rationing system and direct controls that were used. It took their precipitate removal at the end of the war to reveal the deeper layers of economic instability that wrong policies in the field of war finance helped to produce. In other words, it became evident that when the fiscal, monetary, and credit policy was inadequate and thus encouraged a great expansion in the supply of bank deposits and currency, direct controls only postponed and did not prevent inflation.

It is not within my power to record all the intricate decisions made on the economic front of the war. But within the scope of my experience, there were three general spheres of activity in which I was involved, the highlights of which I present in succeeding pages. I ask the reader to bear in mind that though the sections that follow bear different headings, they were all aspects of the central problem of trying to maintain economic balance in the war years by reducing or holding back inflationary pressures, the problem being the very opposite of the one we faced in the depression years.