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Settlement of Cancelled War Contracts

Edward H. Foley

TREASURY DEPARTMENT

Washington

The following address by Under Secretary Edward H. Foley, Jr., before the American Institute of Accountants, Grand Ball Room, Palmer House, Chicago, Illinois, <u>is scheduled for delivery at 11:15 A. M., C.D.T., Thursday September 23, 1948, and is for release at that time.</u>

During the recent war, and particularly in the immediate post-war period in connection with the settlement of cancelled war contracts, I had an opportunity to work closely with many of the members of the American Institute of Accountants, some of whom are present today. Your President George D. Bailey, your Vice-President J. Harold Stewart, Paul Grady, George O. May, John McEachern and Coleman Andrews, to mention only a few whose names come most readily to mind, all performed patriotic yeoman services on behalf of the Government in connection with the swift solution of some of the most complicated and baffling problems ever to confound accountants and lawyers. Every lawyer who was privileged to work with them was impressed with their competence, skill and cooperation. And that's a lot for a lawyer to say about an accountant. The Government owes them much for their sacrifices and help.

I was delighted when George Bailey and Hal Stewart invited me to come here today, not only because it affords me an opportunity to renew acquaintances, but also because it provides an occasion to tell you about some of our problems in the Treasury and bespeak your help in solving them.

One of the principal responsibilities of the Treasury is the management of the public debt. The very size of the public debt is in itself a real challenge -- 253 billion dollars is a tremendous sum. While you should not be over-whelmed by the magnitude of the public debt, nonetheless you cannot prudently underestimate its far-reaching effect upon the national economy.

The public debt today makes up about 55 percent of all of the debt in the United States. Federal obligations are the principal investments of millions of individuals, and of thousands of banks, other financial institutions and corporations. Individuals directly own 67 billion dollars of Federal securities. In addition, they have an indirect stake in the larger portion of the public debt owned by banks, insurance companies and other financial institutions which hold their savings and deposits and underwrite their policies. Federal securities constitute about 55 percent of the earning assets of commercial banks, about 40 percent of the assets of insurance companies, and about 60 percent of the assets of mutual savings banks. The Treasury, therefore, has a responsibility for what happens to its obligations such as no private financial organization could have.

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In the Treasury we work constantly at the problems of public debt management and we try to mold our debt-management objectives to the needs of the country as the fiscal and economic conditions change from day to day. Each decision must be weighed carefully in the light of its swift and chain-like ramifications.

Before telling you how we are attempting to shape -- and have shaped -- our fiscal policy to the needs of the economy, I should like first to review briefly our economic situation.

The United States is enjoying a prosperity never before equaled in peacetime. It is a prosperity so great in its proportions that hardly anyone would have dared forecast it three years ago. The reconversion slump, which so many persons then were so certain we could not avoid, simply has not materialized.

In July, employment reached an all-time record of nearly 62 million jobs. Most of you will recall that only three years ago a goal of 60 million jobs for the peacetime economy was considered over-optimistic. Unemployment has fluctuated between 1-3/4 and 2-3/4 million since VJ-Day. This represents pretty close to maximum employment in a dynamic economy such as ours, where you always find workers who are changing from one job to another or are looking for new and better job opportunities.

According to the figures compiled by the Federal Reserve Board, industrial production early this year reached a peacetime record of 194 percent of the 1935-39 average -- far above any level reached in the prewar years.

This prosperity is distributed broadly throughout the economy. All sectors share in it. Wages and salaries, farm income, and business profits have all reached new peak levels.

The standard of living of the American people, measured in terms of goods and services, is higher than ever before.

This record prosperity is in sharp contrast to the situation which existed at a similar period after the end of World War I. Many of you will recall that by the end of 1921 this country had already experienced, and was just beginning to recover from a severe postwar recession. Early in 1921, industrial production had reached a level one-third below the postwar peak. Wholesale prices -- as measured by the Bureau of Labor Statistics index -- had dropped nearly 45 percent from their 1920 peak.

Our present prosperity is not, however, without a very serious danger. This danger is the persistent upward pressure on prices which has existed throughout most of the postwar period. Wholesale prices have risen almost without interruption since shortly after VJ-Day. They rose 12 percent in the 12-month period ending last July -- the latest month for which figures are available. Consumer prices have followed a similar course; the rise in the same 12-month period amounting to 10 percent, according to the Bureau of Labor Statistics Consumer Price Index. Both of these indexes reached all-time highs this summer.

It was to deal with this serious problem of inflationary pressures that President Truman called Congress into special session last November and again last July. He laid before Congress a comprehensive anti-inflation program, which Congress chose not to enact. I will not go into the details of that program or why President Truman considered that it was essential to have all of it. I merely want to point out that the program contained specific measures for remedying specific instances of excessively high prices, which cannot be reached by the general anti-inflationary weapons at the disposal of the Administration today.

Fiscal policy can be employed against inflation, for example, by cutting down the total purchasing power of the economy. It is not, however, a suitable weapon for bringing under control the price of any one specific item which is seriously out of line. It could be used for this purpose only at the risk of a drastic deflation in the entire economy. In the main, fiscal policy can deal only with general excesses or deficiencies of purchasing power.

Before I began to talk about the way we have tried to direct our policies toward combating inflationary pressures, I wanted to make that clear.

In the field of fiscal policy, a surplus of Government receipts over expenditures -- which can be used for debt retirement -- is the most effective instrument. The fact that the Federal Government has been able to operate at a substantial surplus during the past two years has been a factor of significant anti-inflationary importance.

As you know, the public debt reached a peak of 280 billion dollars in February 1946, just after the close of the Victory Loan. At the same time, the Treasury cash balance, swollen by the proceeds of the Loan, also was at its record level. Because Federal expenditures were then being cut more rapidly than had at first seemed possible, we no longer needed a Treasury cash balance as large as had been required to meet the contingencies of the preceding war years.

Consequently, a debt pay-off program was inaugurated on March 1, 1946. This program, carried on over the last 2-1/2 years, has brought the debt down to the present level of a little under 253 billion dollars.

From March 1 to the close of 1946, the debt was reduced 20 billion dollars through the application of cash balance funds. By this time, the cash left over from the Victory Loan had been expended, so that subsequent debt reduction had to come from a budget surplus. During 1947 and the first four months of 1948, by the use of the budget surplus, we were able to cut the debt by over 7 billion dollars. Two-thirds of this reduction was concentrated in the first four months of 1948.

The money for this concentrated program in the early months of the current calendar year came from a budget surplus of approximately 6 billion dollars accumulated in the first quarter of the year. The rest of the surplus was used to build up the cash balance -- partially to meet expenditures in the latter part of the year when current expenditures exceed current receipts. Some of the remainder, however, is still available for debt reduction -- for example, a bond maturity of 451 million dollars was paid off only last week.

While the total debt is now down 27 billion dollars from its peak, it is significant to point out that the debt held by the commercial banking system is 30 billion dollars less than it was at the peak two and one-half years ago. And the volume of securities owned by individuals and other nonbank investors is larger than it was in February 1946. This transfer of Government securities from banks to nonbank investors was a direct consequence of the public debt management policies of the Treasury. These policies have contributed to the fight against inflation, and will be continued as long as they are appropriate.

Unfortunately, however, the Federal Government no longer has a budget surplus; with the battle against inflation not yet won we have lost our most powerful fiscal weapon. As a result of the combined impact of increased expenditures for foreign aid and National defense, brought about by the tense international situation, and decreased tax revenues, brought about by an ill-timed tax reduction, the Federal Government will this year have an operating deficit estimated by the President at approximately 1-1/2 billion dollars, as contrasted with an operating surplus of nearly 8-1/2 billion dollars last year.

You will note that I say operating deficit and operating surplus. In seeking for a Government surplus we must be sure that we have a real surplus, and not one that appears only on paper. We should be careful that we do not get mixed up by our bookkeeping. I don't have to tell you accountants that the Government should keep its records so that a CPA could certify to them without putting embarrassing qualifications in his certificate. What I have in mind, of course, is the law passed by the last Congress which directed that 3 billion dollars spent during this fiscal year for the Economic Cooperation Program be treated for the purpose of reporting Government expenditures as if it had been spent in the preceding fiscal year. Keeping the books that way does not make it so. This bookkeeping operation, directed by the Congress, does not change the timing of the impact of the economy of a single dollar of Government receipts or expenditures. This transaction is irrelevant as far as the problem of inflation is concerned. You accountants are in a better position to realize that than any other group in the country.

The Federal Government has, of course, other — but less effective — anti-inflationary fiscal instruments, and is using them to the greatest possible extent. For example, the Treasury, during the past year, has increased substantially the interest rates which it pays on short-term Government securities. This, of course, results in higher interest rates on private borrowing and, so, has a restraining effect on such borrowing. The Federal Reserve System has followed with increased rediscount rates; and has recently announced increases in reserve requirements against demand and time deposits of all member banks, pursuant to the new authority granted by Congress last August.

In addition, the Government has asked private bankers to reexamine their lending policies, with a view to cutting down lending which does not result in an increase in the production of goods and services. The American Bankers Association carried out a special program to cooperate with the Government in this respect; and I should like to take this occasion to repeat the thanks which Secretary Snyder has already expressed for the Association's cooperation.

The task is far from complete, however; and, as Secretary Snyder and President Dodge of the American Bankers Association each commented in an exchange of correspondence last July, now that the Federal Government is no longer able to operate at a surplus, a heavy and added responsibility is placed upon the banks to re-intensify their efforts to reduce nonessential lending. When one bastion is put out of action, the remaining bastion must double its fire. The bankers of the country, I am happy to say, are accepting the challenge in this spirit.

In your capacity as professional accountants you can be very helpful in this connection. By counseling your clients not to borrow money for purposes which do not increase production, you can join the ranks of those actively engaged against the forces of inflation. You know better than any other group in the community the dangers of over-extension — over-extension of credit, over-extension of inventories, and over-extension of plant and equipment. By carrying to your clients a message both of optimism and conservatism, you can make your influence felt in the battle against high prices. Both are needed, for it is only by maintaining a balance between the two that we can avoid the boom-and-bust cycle characteristic of so much of our past history.

So much for fiscal policy. Now I want to talk briefly about another matter on which the Treasury would like to have your help and cooperation. As I indicated, for the full fiscal year 1949, we will not be able to effect a net reduction in the debt. We will, however, be able to continue in some degree our anti-inflationary policy of cutting down the amount of bank-held debt. But the only funds available for this purpose will be the cash receipts from trust funds and the receipts from the sales of savings bonds. It is, therefore, highly important that a maximum effort should be devoted to the sale of savings bonds to nonbank holders.

The heart of the Savings Bonds Program, as you know, is the payroll savings plan. It is in firms like those with which you come in daily contact that the payroll savings plan can be the most effective. During the war, business and industrial firms throughout the country cooperated whole-heartedly in promoting participation in this plan. At its peak, about 27 million people were purchasing bonds through payroll deductions. After the war, there was a substantial decline in the number of participants in the payroll savings plan which was, of course, to be expected. No need in peacetime can equal the need of actual war, nor can any peacetime appeal be as effective as the patriotic one which was made during the war, when most purchasers of bonds had sons, husbands, fathers and loved ones on the fighting fronts.

The low point of participation in the payroll savings plan was reached about a year ago, and the trend has been upward since. This upward trend has been due, in large part, to the cooperation and activity of business executives throughout the country. Hundreds of companies have reestablished the plan, or have revitalized it; and important increases in participation are reported everywhere. We hope in your capacity as financial advisers and consultants to business, that you will look upon the plan from the viewpoint of its economic and financial benefits to the employer, the employee, and the country as a whole, and disregard the small cost involved in its operation. As you know, each dollar of debt which is transferred from the banks to the general public cuts down the money supply and relieves the pressure upon prices. That is why emphasis on that phase of our anti-inflation program is more important now than ever before.

You can help greatly in our fight against inflation by using your influence with your clients to see that the payroll savings plan is put into effect in those companies which do not now have it and is maintained and strengthened in those companies where it is now in operation, to the end that it be made available to every worker in the country who wants to participate in it. That's good for management because it benefits from the effects of a more stable economy. It's good for the worker who saves a portion of his earnings against the day when they are really needed. And it's good for you and me and the country as a whole because it puts the brakes on inflation and brings down living costs.

I have enjoyed talking to you about these problems which we, as citizens, hold in common. In asking for your cooperation and assistance in our struggle to cut down inflationary pressures, I know I am appealing to a sympathetic and responsive organization whose members have never turned away when there was a legitimate public service to be performed. No other group has a greater understanding of Government and its financial problems. I know we in the Treasury can count on you.

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