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SAVING IN THE DEFENSE ECONOMY

Abatement of inflationary pressures since March has accompanied and been accompanied by a return to more normal savings patterns on the part of the American people. In contrast to the excited markets of last summer, when inflationary pressures were rampant despite the low level of defense expenditures, many markets in recent months have tended to be sluggish even though defense expenditures have been mounting rapidly. Several factors have contributed to this contrast. One of the most important is the fact that consumers, after the earlier period of scare buying, have returned to more traditional patterns of thrift.

This illustrates the key role of saving and thrift in the maintenance of the value of the dollar in this country during the defense build-up ahead. Avoidance of inflation over the long run depends essentially on a three-pronged approach—pay-as-we-go on defense expenditures, credit restraint, and saving. A high level of current saving and retention of past savings by individuals, together with careful conservation of these funds for essential uses, are as necessary in an adequate program of inflation restraint as anti-inflationary Government fiscal, credit, and other policies.

The United States Treasury is currently conducting a nationwide Defense Bond Drive to stimulate interest in individual thrift and to promote the use of regular bond purchase plans for systematic saving. In announcing the details of the Drive, the Secretary stated, "The Drive will directly aid financial preparedness for defense, and it offers an answer to the question so many people have been asking, 'What can I do to help in this emergency?' . . . The answer is that every individual can start his own thrift program, and the period of the Defense Bond Drive is an excellent time to begin such programs. . ."

THE PLACE OF SAVING AS AN ANTI-INFLATIONARY WEAPON

Avoidance of inflationary pressures in the current defense period can be accomplished only by restricting nondefense demand for goods and services sufficiently to bring it into line with the volume of goods and services available after defense requirements have been met. Basically, this must be done by restricting or immobilizing purchasing power for nondefense buying. Direct controls, such as price and wage controls, can also be useful in smoothing the transition to a defense economy and as a backstop against a rapid inflationary run-up, especially in areas where defense demands hit particularly heavily.

Measures for curbing the total volume of spending for nondefense purposes include primarily restrictive fiscal action, credit controls, and promotion of permanent saving and their conservation for essential purposes. Each is important and necessary to a suc-

cessful program for preventing inflation in this defense period.

On the fiscal side, the United States Government ended the first full year of the Korean effort with a large cash surplus. The Treasury collected in tax revenues and other cash receipts 7.6 billion dollars more than it paid out for goods and services and for other purposes. This surplus arose in part from higher tax payments due to the sharp expansion of incomes, which reflected both increases in output and employment and the inflation of prices after Korea. The surplus also reflected, however, two timely and substantial increases in tax rates as well as curtailment of Government programs not closely related to defense. The budget outlook for the present fiscal year, however, is less favorable. If Government outlays are to be matched by receipts as defense outlays expand, substantial further tax increases will be necessary.

Credit restraints curb private demand for goods and services by limiting additions to current buying power from credit expansion. The program of credit restraint that has been developed during the defense period rests on three kinds of measures. General credit instruments — open market operations, changes in reserve requirements, and changes in the Federal Reserve discount rate — have been used to curtail the total volume of credit available. Selective credit measures, which are designed to discourage borrowers in particular credit areas, have been applied to restrict loans for buying consumer durable goods and new houses and for purchasing or carrying securities. Voluntary credit restraints have been developed through a program in which all major lending groups are cooperating voluntarily to curtail lending for nonessential purposes.

Avoidance of further inflationary pressures during the current defense period will depend on the will of the people to save and to retain savings already accumulated as well as on a vigorous program of fiscal and credit restraint. The need for funds to finance the defense build-up will not be confined to the requirements of the Treasury. For some time to come there will have to be large expenditures for private plant and equipment for defense purposes. These outlays will have to be financed in part by borrowing or by raising equity capital, since internal sources of business funds — retained earnings and depreciation allowances—will not be fully adequate. In addition there will be a demand for investment funds for a variety of nondefense purposes.

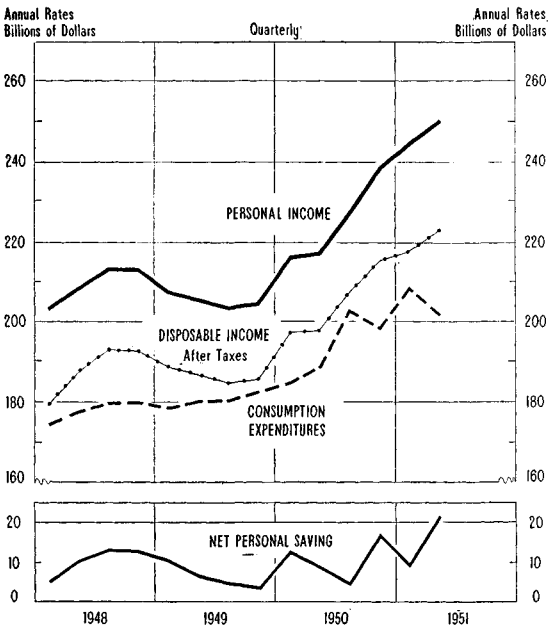
Prevention of inflation will thus require a willingness of the people to save and careful conservation of the savings that are available. If genuine savings are not supplied and used to finance the investment essential to establish security, then this investment will have to be financed to a disproportionate degree by resort to the credit facilities of the banking system, which would lead to an undue expansion of the total money supply. This process would result in a rise in prices faster than in incomes of the bulk of consumers, who would be forced to restrict their consumption. A balance between saving and investment demands would thus be achieved through the "vicious spiral of inflation" rather than through voluntary saving by individuals and the curtailment of investment programs to those most essential to the public welfare.

Changes in Total Personal Saving

Statistically, the dollar amount of current personal saving is measured by the excess of current personal income after taxes over current expenditures for consumer goods and

services. As thus measured, personal saving amounted to about 12 billion dollars in 1950. Saving was at an annual rate of less than 5 billion dollars during the third quarter, however, and following an increase in the late months of the year dropped sharply again in the first quarter of 1951, as is shown in the chart. The sharp fluctuations in total personal saving since mid-1950 have reflected primarily waves of scare buying as many consumers drew on past savings or increased

PERSONAL INCOME, CONSUMPTION, AND SAVING



Department of Commerce quarterly estimates, adjusted for seasonal variation. Latest figures shown are for second quarter 1951.

their instalment indebtedness in the several months following the outbreak of hostilities in Korea and to some extent again in early 1951 after the intervention in Korea by the Chinese. In the second quarter of 1951 personal saving rose to the high annual rate of 21 billion dollars. This increase reflected a further growth in disposable income of individuals and a sharp curtailment in spending for consumer goods.

An increase in the dollar amount of personal saving is not in itself necessarily anti-inflationary. The effect depends on what forms the savings take, as is discussed below.

Anti-inflationary Significance of Various Forms and Uses of Savings

Savings can be held or used in many different ways. They may be invested in capital assets, either directly such as in housing or personal business enterprise, or indirectly such as through the market for corporate securities. Savings may be held in the form of accumulated cash balances in demand deposit accounts or as currency holdings. They may be channeled into savings institutions through increased ownership of dollar claims such as savings deposits or shares, or through the building of equities in pension funds, annuities, or life insurance. Savings may also be kept in savings bonds or other kinds of Government securities. Each of these major kinds of savings has a different significance from the standpoint of inflation restraint.

Personal saving invested directly in capital assets may have little anti-inflationary value and may actually contribute to inflationary pressures, especially in the short run. New housing construction and inventory accumulation by noncorporate businesses and farmers, for example, are included in the personal saving total, and these may at times have an inflationary impact. On the other hand, savings of businessmen or farmers that are used to buy equipment needed to expand output of essential goods and services, or savings used to buy corporate securities issued to finance such investment, are likely eventually to have anti-inflationary value.

Accumulations by individuals of currency or demand deposits over a particular period may represent genuine personal savings, or

they may be additions to holdings of cash working balances called for by an expansion in incomes and economic activity. They are thus a form of personal saving of uncertain economic significance. Such funds may actually be in the process of active current use, passing from one holder to another, thus increasing inflationary pressures. Or they may be held awaiting disbursal, heightening the threat of immediate inflationary pressures. If the funds are held idle, however, and if they do not cause their holders to spend more freely out of future income or past savings, such accumulations are at least temporarily anti-inflationary. It was the experience of World War II and the postwar period, however, that accumulations of funds in the form of demand deposits and currency tend to return to the active money stream when attractive spending opportunities arise and may become highly inflationary. Although genuine savings held in this form are anti-inflationary in the short run, they may complicate the problem of avoiding inflation over a sustained period of time.

Savings placed in savings accounts at commercial and mutual savings banks, savings and loan shares, pension funds, annuities, and life insurance tend to be more permanent additions to the supply of long-term capital. Savings used to repay outstanding debts to these institutions likewise add to the current supply of loanable funds. It is important, however, that these savings be conserved by the savings institutions to give first priority to essential uses. This is the objective of the cooperative effort of major lending groups under the Voluntary Credit Restraint Program.

Savings bonds or other Government securities purchased by individuals are a form of saving with special anti-inflationary value. If the Government defense budget is kept on a pay-as-we-go basis, such funds would be available to the Treasury for retiring short-term debt held by the banking system and particularly by the Federal Reserve Banks. Replacement of that debt by savings bonds is a debt management move that is anti-inflationary in that it operates to contract the money supply and to restrain lending by commercial banks. Should there be a Government deficit, its inflationary effect could be substantially offset to the extent that it was financed out of genuine long-term savings.

Recent Savings Trends

Recently there has been an increase in certain forms of savings with potential anti-inflation significance. Time deposits at commercial and mutual savings banks were expanded 700 million dollars in the second quarter of 1951, as is shown in the table. This growth, which was larger than that of the corresponding period of other recent years, followed a 9-month period of net withdrawals or small increases. There was a further increase in savings deposits during July.

Saving in Selected Forms

[Changes in amount outstanding, in millions of dollars]

Period	Total, selected savings forms	Time deposits		Savings and loan shares
		Commercial banks	Mutual savings banks	
1949—1st Q.	+933	+196	+313	+424
2nd Q.	+933	+292	+232	+409
3rd Q.	+164	−192	+168	+188
4th Q.	+644	+46	+173	+425
1950—1st Q.	+1,228	+354	+427	+447
2nd Q.	+933	+219	+223	+491
3rd Q.	−546	−519	−23	−4
4th Q.	+777	+114	+110	+553
1951—1st Q.	+282	−114	+90	+306
2nd Q.	+1,321	+400	+300	+621
Nine months ending:				
March 1950	+2,036	+208	+768	+1,060
March 1951	+513	−519	+177	+855

Note.—Accumulation of interest is included as new savings. Estimates for changes in time deposits in 1951 are preliminary.

Savings and loan shares have also expanded sharply in recent months. This savings form, which has grown rapidly in importance in the last few years, showed net withdrawals only in July of last year. Growth in the first quarter of 1951 was at a slackened rate, however, reflecting heavy withdrawals in January presumably in connection with the scare buying of consumer goods in that period. In the second quarter of this year shares increased by a record amount.

Contractual saving through pension plans and with life insurance companies has been maintained at a high level and has even increased somewhat since mid-1950. In 1950 saving by individuals through life insurance and annuities was 4.3 billion dollars, and saving through private pension funds probably amounted to about 2 billion. There is also a large volume of loanable funds becoming available currently to savings institutions through contractual repayment of mortgage and other debt by individuals. The large institutional investors as a group have been investing more in mortgages and corporate securities than they have been receiving currently and have sold Government securities. In recent months, however, such sales of Government securities have been substantially curtailed.

Savings Outlook

Prospects are good that saving in anti-inflationary forms will continue at a high level, at least if a strong inflationary trend does not develop. Usual savings patterns are being re-established following the spending sprees after the outbreak of hostilities in Korea and the intervention by the Chinese communists in the Korean fighting. Many of those who interrupted their current saving programs or used accumulated savings to buy greatly in advance of their needs may regret that action in the light of subsequent market developments. They have seen that markets can move two ways as prices of many consumer goods have reacted downward in recent months. Supplies of certain articles that were expected to become scarce have actually expanded so much as to glut the market temporarily. Confidence that the value of the dollar can be maintained has strengthened. Whether inflation is avoided in the future will depend on the adequacy of saving and on the administration of those funds by savings institutions, as well as on the adequacy of the effort for avoiding, or at least limiting, Government deficit financing, and on the success in curbing credit expansion.

Defense Bond Drive

A Defense Bond Drive is now under way. Volunteers from labor, management, agriculture, finance, education, and other sectors of American life are joining to urge increased participation in this aspect of the defense program. The immediate focus of the Drive is on encouraging regular and systematic purchases of Defense Bonds through the Payroll Savings Plan or the Bond-A-Month Plan. Its broader purposes, however, are to extend the distribution of public debt ownership and to mobilize the power of individual thrift and saving behind the national defense effort.