

IV. Levels of Activity and Adjustments Needed in 1948

IN spite of some disappointments on the supply side and serious inflationary distortions on the demand side during 1947, we enter 1948 on a high tide of economic activity and with prospects for another prosperous year if we handle our economic affairs wisely and firmly. The Employment Act calls upon the President at the opening of each year not merely to review current trends but also to state what levels of employment, production, and purchasing power during the ensuing year are needed to carry out the policy declared in the act and to recommend measures by which these objectives may be attained. These two requirements will be met in this section.

We face in the months and years immediately ahead a test of whether we have the foresight and courage to safeguard our economy against a return to the devastating sequence of boom and depression. If we are to complete safely the transition from a war economy to a stable peacetime economy and clear the way for the great progress which lies within our reach, we must, promptly, take vigorous measures to check the course of inflation which now has the economy in its grip.

NEEDED LEVELS OF EMPLOYMENT, PRODUCTION, AND PURCHASING POWER

Employment objective

The American economy is now operating at a level of employment which may be regarded as a practical maximum. It is estimated that the labor force will increase by about 700,000 persons during 1948. If we provide them as well as the present labor force with opportunities to work, this would mean an average civilian employment of almost 59 million for the coming year.

Production objective

This labor force will have at its disposal expanded and improved capital equipment and there should in general be a better flow of raw materials. During the past year, business expended 23 billion dollars for plant and

equipment, approximately one-half of which represents a net addition in excess of wear and tear and obsolescence. Since there are still some shortages of materials, particularly in metals, some of the new plant and equipment may begin operating at the expense of somewhat less production in older plants.

It should be our objective to open up most of these bottlenecks in the course of 1948, with the use of new capacity to produce materials and components which are now scarce. Assuming that new capital equipment and other efficiency factors raise nonagricultural productivity somewhat more than 2 percent, our objective should be to increase the output of goods and services in this sector of the economy to a level somewhat more than 3 percent above 1947.

For farm production, the Department of Agriculture has announced production goals for this year which call for an increase of 3 percent in the acreage of crops. Reduced feed supplies, however, will inevitably cause some decrease in the output of livestock and livestock products. Balancing this against a possible increase in crop production, it appears doubtful that total agricultural production this year can surpass that of 1947.

For the economy as a whole, an increase of total output by about 3 percent above 1947 is a feasible objective. To reach this objective will require skillful management, the maintenance of good labor-management relations, and some improvements in the geographical distribution of labor.

Purchasing power objective

Our purchasing power objective for 1948 should be to effect the economic adjustments which are necessary to afford adequate protection against increasing inflation. The view has been expressed that the only cure for inflation and the only means of providing maximum real purchasing power is more production. Certainly the continuation of full employment and the removal of impediments to maximum production will provide the surest long-run remedy for scarcity prices and the exploitation of monopolistic situations. But we cannot increase industrial and agricultural production enough within the next few months to catch up fully with market demands or to surmount the inflationary dangers of the coming year.

Weather will be a major determining factor in our farm output. The reduction in the corn crop of 1947 has required drastic revision of livestock producers' operations and makes it certain that supplies of meat, poultry, and dairy products will be less abundant in 1948 than in 1947.

On the industrial side also, the inability to re-equip producers and to fill pipe lines, while simultaneously turning out enough consumers' goods for all

the demands of a fully employed population and providing needed foreign aid, will result in some relative shortages during 1948. The basic shortages in coke, in steel, and other metals, in petroleum and petroleum transport facilities, and in railway cars and motive power will not fully be made up during 1948.

This leads to the conclusion that, even were our employment and production goals for 1948 fully realized, this would not of itself meet our purchasing-power objective nor substantially dispel the need for other affirmative anti-inflation measures. More than this, we face the danger that the continuance of maximum employment and production will be impossible unless we achieve the necessary purchasing-power adjustments in the price-wage-profit structure. When a price-wage spiral breeds business uncertainty and impairs confidence, employment and production go down instead of up.

The affirmative measures which I have proposed to the special session of the Congress, and which I shall here reaffirm, are not a substitute for more production, but rather constitute the only assurance of maintaining high and increasing production.

FISCAL POLICY TO COMBAT INFLATION

It is well established that a substantial excess of Government receipts over expenditures is counter-inflationary.

The Federal agencies will have to make cash payments to the public in calendar year 1948 of over 40 billion dollars. This is about 1 billion dollars less than cash payments to the public in calendar year 1947. It includes proposed expenditures under new legislation, mainly foreign aid, of about 3 billion dollars. (These figures and those below represent cash payments and receipts and apply to the calendar year. They differ in both respects from the conventional Federal Budget, as is explained on page 30 and in more detail in appendix A, section II.)

Over 40 percent of the total is required for defense and for veterans. Most of the remainder represents expenditures to carry out the provisions of existing law and to meet the Government's commitments, such as interest payments on the public debt, refund of taxes, loans to foreign governments, social-security payments, and expenditures under previously authorized contracts.

On the basis of receipts from present taxes and of expected payments, the excess of receipts over expenditures for calendar year 1948 will be substantial. With inflationary pressures a major threat to the stability of the American economy, no action should be taken now to reduce this excess.

But while waging war against inflation, we should not neglect the casual-

ties. Certain tax changes now will help those millions of families whose disposable incomes have lagged more and more behind the increased cost of living during the past year and a half.

I therefore propose that the Congress enact legislation extending a cost-of-living tax credit of \$40 for each taxpayer and each dependent.

To offset this decrease in government revenues, corporate taxes should be increased sufficiently to yield an equivalent amount. Corporations were given early relief after the war in very substantial amount through repeal of the excess profits tax. While present corporate income taxes are very high by all prewar standards, they have permitted both high business activity and an unexampled addition to capital investment. An increase in corporate taxes would not cause production to fall below the highest output that available materials, capacity, and labor will permit. It would, however, have an anti-inflationary effect which would wholly or in large degree offset the inflationary influence of the reduction in individual income taxes.

Any net change one way or the other in the effect of these tax revisions upon inflation is outweighed by the manifest equity of the revisions proposed. In any event, these equitable adjustments will not interfere with success in our anti-inflationary efforts if the other anti-inflationary measures which I shall now discuss are promptly adopted and vigorously applied.

THE REGULATION OF CREDIT

In the process of inflation, one of the most potentially dangerous sources of excessive demand is the expansion of credit. This applies to consumer credit, commercial credit, real estate credit, and credit on securities.

I again recommend that the power of the Board of Governors of the Federal Reserve System to regulate consumer credit be restored. Even under the controls which existed, and which expired only on November 1, 1947, the volume of instalment consumer credit outstanding had increased from 4 billion dollars on January 1, 1947, to 5.5 billion dollars on November 1. Since the lapse of control, and due only partly to seasonal influences, the rate of increase has moved sharply ahead. A further rapid expansion at this time can only contribute to inflationary price increases. (See appendix B, table VII.)

Also dangerous is the mounting volume of mortgage debt, urban and rural. The longer-run interest of the people requires careful consideration of the present financing policies of both private and governmental agencies.

More dangerous than the expansion of consumer credit is the over-rapid expansion of commercial loans by banks. During the first half of 1947, commercial credit expanded only moderately, but during the second half it rose at an annual rate of almost 10 billion dollars, a much more than

seasonal increase. This increase coincided with the upsurge of inflationary developments.

The increase of bank credit was both a result and a further source of inflationary pressure. The increase in bank loans reflected a growing demand for funds that arose from a variety of sources. In adapting their operations to a rising cost and price structure, business firms needed a larger volume of credit for working capital, and borrowed additional amounts to maintain and expand expenditures on plant and equipment. Farmers increased their borrowing to purchase real estate and to acquire farm machinery and finance other capital improvements. Increased consumer buying of durable goods, payments for the purchase and modernization of homes, and outlays to meet current living expenses were financed in part by expanded bank loans.

When demand from other sources is already pressing against the price structure, the injection of large amounts of bank-created funds to support business, real estate, and consumer expenditures necessarily contributes to further inflation. The impact of this additional supply of money is felt first, of course, in those markets in which the borrowers are direct participants. But as the funds are used by the borrowers to purchase the goods and services they want, they become part of an enlarged general income stream. As other temporary sources of demand decline, the expansion of bank credit could potentially keep the inflationary trend rising and interfere with the gradual transition to a stable situation. Among the strategic points at which to curb the inflation movement, none is potentially more powerful than the restriction of bank credit.

The control of bank credit is not a simple task, nor is it free from dangers. Unwisely exercised, it could overplay its role and precipitate an undue liquidation of credit and a lowering of economic activity. Furthermore, the problem is complicated by the relation of credit to the administration of the public debt. Limitation of the amount of commercial lending would probably be accompanied by higher interest rates. Except as special devices may be introduced which can partially insulate the public debt, two unfortunate developments might take place: a decline in the value of Government bonds held by the public, and an increase in the cost of servicing the debt as refunding takes place. But these difficulties can be surmounted through the wise exercise of restraints upon excessive bank credit.

In view of their central relation to the control of inflation, current proposals for credit control, especially those which have been presented by the Board of Governors of the Federal Reserve System for the increase of bank reserve requirements, should be given close study by the Congress, and legislation should be enacted of a sufficiently comprehensive character to make available all the powers that may be needed.

Within the last fortnight the leaders of our commercial banking system have taken positive organized action to secure the curtailment of inflationary expansion of bank credit by their members. I commend this far-sighted action. If they succeed in this voluntary effort, they will be curtailing credit at the points where it is most likely to exercise inflationary influence and further general action might not be required.

As part of our program for restraining excessive credit expansion, the Federal bank supervisory agencies have already announced policies designed to confine extension of private bank credit to legitimate production requirements. The credit standards of the Government lending agencies have also been reviewed with the objective of checking inflationary influences from this source. It is essential that the major Government credit agencies in making direct loans and in guaranteeing private loans shall pursue policies consistent with a national anti-inflationary policy.

THE NEED FOR SELECTIVE CONTROLS

While the credit controls and budget policies discussed above are essential instruments for halting the inflationary trend, there have arisen specific situations which, in all probability, cannot be dealt with adequately by these measures.

The most important of these special situations is the shortage of grains and the related mounting price of food. In the case of meat, for example, the shortage will almost certainly be greater next spring. The use of credit and budgetary controls to the point where they could halt the rise of meat prices would probably cause widespread unemployment. Depriving people of their livelihood in order to cause a decline in the cost of food is obviously not an acceptable alternative. Nor is it an acceptable alternative to let mounting prices ration the short supply at the expense of millions of families of modest income.

In meeting this situation, consumer rationing of selected commodities would not only relieve the demand pressure, but would also provide for a more equitable distribution of the available supply. There should also exist limited powers of price control to be used for combating rising prices at those points where they bear most disastrously upon the cost of living. I have already recommended to the Congress that such powers be authorized. It is also necessary to authorize, and to use if necessary on a selective basis, price control of a few vital industrial products that are in short supply, since we have had ample demonstration that these areas of shortage are also a focal point of spreading inflation.

There should also be set up powers for dealing with the distribution of basic industrial and agricultural products where scarcity threatens to

impede production or raise prices unduly. These should not subject business firms to a detailed plan of operation prescribed by the control agency, but merely provide a check on such distribution of scarce supplies as is found to be impeding domestic production, defeating the purposes of the foreign aid program, or working inequities as between legitimate users of the scarce commodity.

In areas where price control might be employed, its workability might be impaired by excessive wage increases. I therefore repeat my recommendation to the Congress that authority should be granted to prevent wage increases where such action is necessary to maintain any price ceiling that may be established. This is a power which should be restricted in its use, and might not need to be used at all. Its existence would not supersede the general practice of fixing wages by voluntary agreement, nor would it relieve labor of any of the responsibility it now bears for moderation in wage demands to help curb inflationary pressures.

I also repeat my recommendation that rent control be continued and strengthened. Nothing could be more disastrous to the standard of living of millions of people, or better calculated to initiate another spiral of wages and prices, than the continuation of the sharp increases in rents now under way. This is particularly true because relaxation of rent control could not effect a rapid increase in the supply of housing.

The measure enacted by the Congress toward the end of its recent session extended the Export Control Act, and also extended the authority to allocate transportation facilities and equipment. In addition, it authorized measures to increase the production of food in non-European foreign countries and to encourage conservation practices in this country. While these steps are desirable, they constitute only a small part of an effective anti-inflation program.

The same measure also provided for voluntary agreements among businessmen, relating to the allocation of transportation facilities and scarce commodities and relating also to the regulation of speculative trading on commodity exchanges. While I have stressed many times that certain types of appropriate voluntary action are important, the experience reviewed in this Report, and the facts which it sets forth, demonstrate conclusively that governmental action along the lines that I have recommended is absolutely essential.

THE NEED FOR VOLUNTARY RESTRAINT

The need for some government controls does not lessen the need for voluntary restraint. Only with the voluntary cooperation of the American people can any controls be made to work effectively, and the more effective voluntary restraint becomes, the less will controls be needed.

I have already urged consumers to restrict their purchases of scarce products. The Federal Government is deferring many public works projects and following procurement policies designed to minimize their effect upon price increases. I urge State and local governments to do likewise. Businessmen should defer expansion that does not immediately augment production. They should also strive to maintain inventories at the lowest efficient working levels.

The campaign to sell savings bonds will be intensified. Voluntary savings of all types should be encouraged. The new bond buyers and millions of loyal Americans who enabled their country to finance the war are assured that the power which their Government possesses to maintain the value of their bonds will be exercised wherever necessary.

Most important of all, businessmen should hold the line against price increases and reduce prices wherever they can, foregoing a quick and dangerous excessive profit in favor of long-run stability. And labor should be moderate in its wage demands, mindful of recent experience which demonstrates the impossibility of registering real gains in an inflationary spiral.

I cannot too strongly emphasize that every self-imposed voluntary restraint, in the making of purchases, in the setting of prices, and in the demand for wages, contributes to the restoration of economic stability and prolonged prosperity. But to the extent that the result is not achieved by these means, it is essential that proper agencies of Government be given and that they use powers to restore the balance.

When an inflation is in progress, there is no way of predicting when it will break of its own accord. One can only be certain that, if permitted to run its own course, it will break with destructive force. How serious or prolonged such a situation would be in the current instance cannot be foretold. Whatever its character, if a depression occurs, it will be far more costly in human welfare and will involve the Government in far more pervasive intervention in the economic life of the country than the measures which are necessary to prevent it. I therefore urge that the Congress consider with the utmost speed the nature of the problem which we have to meet and adopt the measures that are appropriate to its solution.