# THE ECONOMIC SITUATION AT MIDYEAR 1949

A REPORT TO THE PRESIDENT

BY THE

COUNCIL OF ECONOMIC ADVISERS

## LETTER OF TRANSMITTAL

COUNCIL OF ECONOMIC ADVISERS,
*Washington, D. C., July 2, 1949.*

THE PRESIDENT:

SIR: The Council of Economic Advisers herewith submits a report, The Economic Situation at Midyear 1949, in accordance with section 4 (c) (2) of the Employment Act of 1946.

Respectfully,

Edwin G. Nourse
*Chairman.*

Leon H. Keyserling
*Vice Chairman.*

John D. Clark

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## APPENDIXES



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# I. The Course of Economic Adjustment and Its Problems

The United States in 1949 is faced with the problems of a new and strikingly different phase of postwar economic adjustment. We are seeking to liquidate inflation without being overcome by business depression. Our problem is to work out a lower level of prices without a further decline of production and employment, and to effect the transition to more stable conditions conducive to maximum employment and production. In this review of the situation at midyear, the Council of Economic Advisers is undertaking to report on the economic state of the Nation, giving full value to the elements of basic strength but not failing to recognize the realities of current recessionary factors. We find the prospect reassuring.

## THE ECONOMY IN TRANSITION

During the early postwar years the situation was dominated by shortages of goods, tremendous backlogs of deferred consumer demand created by the war, an acute shortage of productive capacity in many lines, the vast accumulation of liquid savings, and the high level of expenditures needed to meet military and foreign requirements. In earlier reports, these various factors were dealt with extensively. It was pointed out that they represented the active elements in the inflationary course which the economy took after wartime controls were removed. So long as these extraordinary factors were maintained in combination, it was possible to continue very high employment and production even without a balanced adjustment between prevailing prices and current incomes. But it was foreseen that, when temporary supports slackened, full prosperity could not be preserved without a wide range of adjustments.

It was not to be expected that all of these adjustments could take place without any temporary slackening of employment and production; that would be too much to expect, given the dynamic quality of our free economy. But there was concern lest these adjustments, if too long delayed, would culminate in a manner which experience had taught us might carry the whole economy downhill rapidly and far. How to limit the inflation and prevent it from running a disastrous course to economic crisis and depression was the central theme of previous reports.

The public and private actions which were taken were not sufficient to prevent a very substantial degree of inflation from developing. More extensive measures of public control and more restrained private behavior would have reduced the difficulties of the inevitable adjustment. But the actions taken have been effective enough to prevent the kind of exaggerated speculative spree which could end only in a disastrous slump. The inflationary tendency has eased off gradually at one point after another, so that we have arrived at the present stage where general inflationary pressures have disappeared without being followed by a collapse of the price structure.

In the first quarter of 1949 some reduction in the level of economic activity was expected on a seasonal basis. But in addition to this seasonal slackening, there was an increase in the number of points at which the catching-up process caused markets to weaken and some reduction of production and employment to appear. After relatively moderate developments of this character in the first quarter, intense interest centered on whether there would be the normal seasonal improvement in the second quarter. This was widely regarded as the test of whether or not the economy was slipping downward.

In the second quarter of the year there was indeed some noticeable improvement in various areas of industry, particularly residential construction, and a seasonal pick-up in agricultural employment. The level of consumer income remained high, there was no general withdrawal from markets, and no contagious development of sharp downward price spirals. On the other hand, after allowance for seasonal factors, the general drift of prices, production, and manufacturing employment was still downward. And, in particular, the market weakness extended to metals and other products which at the beginning of the year were still in a tight demand-supply situation. It is no longer possible to describe the situation as one of mixed inflationary and deflationary forces, as at the beginning of the year. The weakening of markets has become general.

### FACTORS OF UNDERLYING STRENGTH

Many factors augur well for the successful culmination of the readjustment process in early stability followed by renewed growth. Among the most favorable elements is that the readjustment has thus far proceeded gradually without giving rise to panicky reactions. Neither the sharp reaction in farm commodity prices in early 1948 nor the 6 months' downslide last fall and winter proved contagious. The management of inventories has been carried out in a spirit of caution rather than pessimism. Production, which on account of inventory reductions has fallen below the rate of sales in many lines, should before too long come back at least into line with current sales if nothing occurs to create more pessimistic anticipations. Aggressive merchandising efforts have been producing favorable results in many markets. New investment in plant and equipment was higher in

the first quarter of 1949 than a year earlier and is continuing at a high level. Investment plans, as reported by recent surveys, indicate no early let-down of serious proportions, though there is considerable uncertainty about the situation 6 months hence. Housing starts, after reaching a low point in the winter, have moved sharply upward, to a level only just below that of a year ago. Business credit is in general available in ample amount and on favorable terms, and there is no evidence of serious banking pressure on borrowers to liquidate their loans.

The strength of the economy is further fortified by many governmental policies and programs. Federal, State, and local governments have now undertaken many of the urgent public works which were deferred during the war, and expenditures for these purposes will be expanding. The payment of unemployment insurance and other social-security benefits has helped to sustain buying power and the demand for goods. The farm-price-support policy, which was so important in the winter of 1948 and again in early 1949, gives assurance that there will not be a collapse of rural buying such as that which occurred in 1920. The international situation is responsible for an increase in combined Government expenditures for foreign aid and military preparedness, which contribute to the domestic demand for goods and services. Through deposit insurance and other banking and financial measures, the economy is protected to a high degree against financial crisis.

Both reflecting and reenforcing these elements of strength is the fact that disposable income has been well maintained. Gross national product, national income, consumers' disposable income, and consumer expenditures are at or near the levels of a year ago. Furthermore, consumers and business firms have large resources of liquid assets, and there has been no threatening increase of personal and business indebtedness such as that which in earlier periods has created vulnerability. Private debt is low, and both home and farm mortgages are to a large extent on an amortized basis.

Evidence of the sort presented provides a basis for belief that we may have the unique and fortunate experience of liquidating a major inflation without falling into a severe recession.

## ELEMENTS OF UNCERTAINTY

In spite of these elements of strength, the situation is beset with many uncertainties and problems. The most serious fact confronting us is that the decline, which has reached serious proportions in some sectors of the economy, has not yet been reversed.

Nonagricultural employment has declined by nearly 2 million since a year ago, mainly because of a substantial drop in manufacturing employment. Unemployment now stands at 1.7 million above a year ago.

Roughly measured, total production of goods and services in the first six months of 1949, measured in real terms, appears to have been about 1½ percent below the last half of 1948. (See chart 1.) The drop in industrial production has been more striking, the index in June of this year being about 13 percent below the peak level of last autumn. The sharpness of the recent declines in manufacturing is shown by a fall of 10 percent between March and June of the present year.

It is probable that the growing industry practice of paid vacations will augment the drop in the production index during the summer months. The summer unemployment figures will reflect as usual the large number of persons who temporarily enter the labor force.

Total private investment, a key element in the picture, which reached a seasonally adjusted annual rate of more than 43 billion dollars in the fourth quarter of 1948, fell by about 25 percent to a 32-billion-dollar rate in the second quarter of 1949. This represents mainly a change-over from net accumulation of inventories to net liquidation. There has not been a similar decline in the level of investment in new construction and equipment.

Since its peak in August 1948, the wholesale price index has declined by about 9 percent, and since the end of 1948 by about 5 percent. The consumer price index has declined by 3 percent since the same peak month and by 1.3 percent since the end of last year. The decline in personal incomes has been more moderate than might have been expected, being in the first half of 1949 only 2 percent below the second half of 1948.

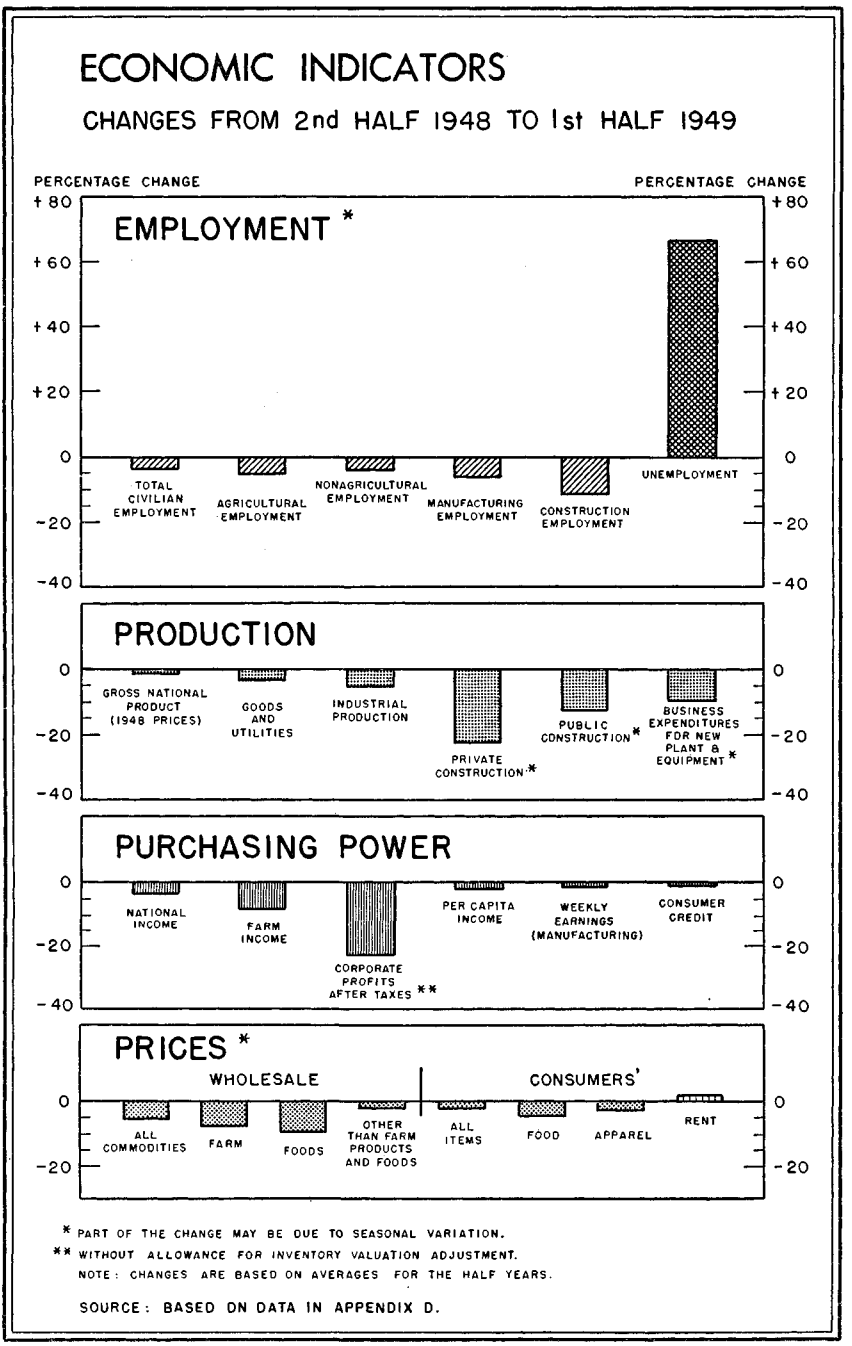
The uneasiness and business hesitation arising from all these circumstances will not be cleared away until actual developments introduce a new note into the business outlook. In the meantime, business sentiment might be so adversely affected that the potential recuperative influences outlined earlier would not come into play. If uncertainty about the future should reach the point of distinct pessimism, orders and inventories might be sharply reduced, production cut back, and investment plans shelved to an extent that would initiate a further spiral of unemployment, loss of consumer income, and decline in consumer demand.

The weight of evidence as we see it does not support so gloomy an outlook. But we may still face an unsatisfactory alternative. While the decline may be halted or even reversed, a satisfactory expansion might not follow. Our real need is for industrial production not only to rebound to the level of present consumption but also for both production and consumption to continue to rise sufficiently to absorb a labor force which is both growing in size and increasing in productivity per man.

### THE PROCESS OF PRICE AND INCOME ADJUSTMENT

Previous Economic Reports have repeatedly pointed out that price levels which were geared to war-created temporary factors of demand and shortages of supply could not be sustained indefinitely. The downward

CHART 1




* PART OF THE CHANGE MAY BE DUE TO SEASONAL VARIATION.

** WITHOUT ALLOWANCE FOR INVENTORY VALUATION ADJUSTMENT.

NOTE: CHANGES ARE BASED ON AVERAGES FOR THE HALF YEARS.

SOURCE: BASED ON DATA IN APPENDIX D.

adjustments now under way are a reflection of the fact that full production can no longer be absorbed by the market at peak price levels.

In its initial stages, the process of downward price readjustment is almost certain to be accompanied by some declines in production and employment. Price declines not only affect the critical relationships among various prices and the size and the distribution of money incomes. They have, in addition, two other important effects: the favorable effect of increasing the purchasing power of the dollar and the unfavorable effect of generating anticipations of further price declines which lead to postponement of buying, thus depressing the levels of production, employment, and incomes.

Fortunately, the process of price adjustment has been in the main orderly. Although in individual cases it has been sharp, it has not been widely characterized by dumping at distress prices. Its orderly character is in large part due to the fact that it has been occurring while consumer demand, though weakened, is still at very high levels, with residential construction and investment in plant and equipment still very high and with government expenditures still rising. In the case of agricultural prices, an additional factor has been the existence of support prices which, while they have not prevented sharp fluctuations in prices, have been effective in limiting the extent of the price fall.

The question arises nonetheless as to the extent to which the price cuts which have been made thus far have helped to stimulate demand. In the case of wholesale prices, the reductions appear to have had little effect in stimulating business demand. For this there are two reasons: (*a*) The initial effect of price cuts when a trend is reversed is to create the expectation of additional price cuts, thus further drying up demand, a tendency which is reinforced by the fact that so many of the price cuts have been so slight in amount thus far; and (*b*) there is the natural desire on the part of business to reduce inventories in a period of slackening demand before reordering on a more normal basis even in those areas where the price declines have been substantial. Though inventories were not out of line with sales, business has been sensitive to the possibility of inventory losses due to price declines. The tendency to liquidate inventories, accompanied by cut-backs of new orders, has brought further downward pressure on prices and production.

In the case of consumer prices, the declines, as pointed out earlier, have been much more limited than in wholesale prices. In individual cases, where large cuts in prices have been made for sales promotion or where new lines at much lower prices have been introduced, consumer response on the whole has been relatively favorable. One of the distinctive features during the war and the postwar inflation was the reduction in the volume of and the actual disappearance of many stripped models and low-priced items of apparel and house furnishings, which had formed so large a part of the sales during prewar years. With the weakening of consumer

demand, there is a growing trend now for manufacturers to reintroduce and emphasize such low-priced items to make products available to consumers at prices which they are able to pay. The relatively favorable showing in these lines indicates that consumers are actively seeking them. Taking consumer prices as a whole, however, the declines that have taken place have not been great enough to encourage consumers to expand their purchases of consumer goods.

The process of price adjustment to date suggests that further price reductions, made promptly to promote volume and not tardily in response to falling sales, are essential. Where and how they are made is also important.

While increasingly active competition has already brought about part of the needed adjustment, there are many fields where the power to "administer" prices is strong and where the practice of price leadership is well-entrenched. It is in these fields that the capacity of businessmen to take the long view and to adopt policies conducive to fundamental and healthy economic readjustment will be put to the test. If, while other prices are falling, they cut production to whatever degree is necessary to maintain their prices, they will impair the effort to maintain economic activity at the highest possible level.

Businessmen generally will not believe that any important group of goods can escape from the forces which are strong enough to compel the current general reduction in the price level, and they will be unsure about the situation until price cuts, which they believe are inevitable, have been made on all important groups of goods, and the results can be observed. Competition will, sooner or later, force some kind of adjustment in these areas, but voluntary and well-calculated price reductions now, with a view to maintaining volume, would be highly preferable to forced and possibly more drastic reductions later on.

A difficult problem of price adjustment is presented by the public-utility services, especially transportation, where competition is not directly effective. Their prices are a substantial element in the cost of production of manufactured goods, and, instead of falling, they are still rising in response to past advances in the cost of materials and labor. Public utility commissions as well as company executives have the special responsibilities of adjusting rates in relation to changed cost and demand conditions, with special emphasis upon the interests of the economy as a whole.

The process of widespread price readjustment is not pleasant nor easy to effect. Weaker firms are overtaken by financial difficulties. Instances of inefficiency in management and low productivity of labor, which tend to be condoned in times of inflation, have to be eliminated. These are necessary conditions for establishing a firm economic base from which a new expansion can be projected.

What price adjustments will prove feasible and helpful must be considered in close connection with wage and other income adjustments.

Price reductions add to real income only if consumers' money incomes are not correspondingly reduced. This leads to special concern for protecting those major sources of income upon which demand so largely rests. The attempt to secure lower prices through wage cutting would clearly be damaging at a time like the present when consumption demand is proving inadequate and business slack is developing. A sound first rule to apply now is that the general level of wage rates should at least be maintained. Beyond that, there is a strong presumption in favor of having money wages move upward over the years to participate in the gains of technological progress and increased productivity. There are difficulties in applying the general principle to specific situations, but this adaptation can be worked out through sound collective bargaining. Particular consideration should be given to those in the lower wage brackets.

With wage negotiations now under way in a considerable number of basic mass-production industries, there is a possibility of an impasse. While a still very high cost of living encourages a determined attitude on the part of labor, the uncertain business situation encourages an equally determined attitude on the part of management. Should industry-wide strikes result, they would not merely reduce the spending ability of the directly affected workers, but would also spread loss of production and income to other areas and thus darken the business outlook. At the present time both employers and workers should strive to work out adjustments which will help to stimulate activity, bearing in mind the need both for holding business costs down and for maintaining consumer purchasing power at high levels.

If wage incomes are maintained, this obviously places a limit upon the extent to which prices can be adjusted downward. There would be no purpose, and much potential damage, in an attempt to get back to some drastically lower price level by wage cutting, since incomes are now geared to prices substantially higher than before the war or immediately after the war. Such an effort would involve a deep and vastly unsettling decline in wages as the accompaniment to a prolonged period of severe depression. From that, practically no one would gain; the economy would lose tragically.

Another example of the necessity of maintaining adequate buying power is to be found in the agricultural situation. The decline in the prices of farm products, which began early last summer, was not arrested until the prices of wheat, corn, tobacco, cotton, and hogs were close to or even below Government support levels. Farm income as a whole has been only moderately affected, because lower prices have been in part offset by high yields. But the prospects of another year of large crop production on top of present carry-overs indicate that the problems of supporting farm prices will be increasingly difficult.

The vulnerability of a small-unit industry whose markets are dominated by exchange and auction methods of sale has led to the development during

the past 20 years of governmental price supports to agriculture. It is now widely recognized that this institutional development has protected the economy against a danger of collapse in a major segment which, on past occasions, has tended to undermine the whole structure. While this institutional development needs still further improvement in the light of experience, there is also need for further reduction of the prices of industrial products bought by farmers.

### THE NEED FOR MAINTAINING THE RATE OF INVESTMENT

The contraction in business investment this year has been due mainly to inventory liquidation, but the completion of many postwar expansion and modernization programs adds an element of uncertainty to the future of investment in plant and equipment. Fortunately, only a moderate curtailment of investment in plant and equipment has occurred, and no severe curtailment is clearly in sight for the remainder of this year. Whether the liquidation of inventories during the first half of 1949 is followed by a more general investment slack next year depends in large degree upon the extent to which investment incentives continue to appear adequate. This, in turn, depends upon the speed with which the price and inventory adjustments result in an upturn in production and the extent to which other recessionary factors are offset by stimulative developments.

The problem of investment is closely connected with the profit question. The maintenance or advance of consumer incomes during a period when price reductions are in process requires business to operate on narrower margins and, for the time being, to take smaller profits. In this connection, businessmen should realize that it is safer to pursue a course of accepting minimum profits or even temporary losses than to conduct a rear-guard action to protect profit per unit. If, in weakening markets, downward price adjustments are resisted, the effect is to reduce production and employment. A lower use of productive capacity and a more precarious structure of prices would be a much more serious deterrent to new investment than a situation in which basic adjustments supported a larger use of capacity.

In at least one respect, moreover, increased pressure on profit margins provides a stimulus to investment. With capacity in many fields now relatively adequate, future investment will stem in larger degree from the competitive urge for modernization and improvement. This motive for investment will be strongest in an atmosphere of active competition, where the maintenance of profit margins is subordinated to maintenance of competitive position as the primary aim of business pricing and investment policies.

The problem of adequate investment cannot, however, be solved simply by making the price adjustments which are appropriate to weakening markets. These adjustments merely provide a sounder foundation from which to start. The actual decision to invest depends on business judg-

ment concerning future markets and possibilities of profitable return. A farseeing realization of the prospects for development is required, and this is peculiarly needed at the present time. If businessmen act in the conviction that employment and the use of capital resources can with our present economic "know-how" be maintained at high levels with only minor dips of a readjustment character, then they will go ahead with investment plans which will be adequate for a growing economy.

The investment plans reported recently, while they show some decline, are still at a high level. They presumably were based upon careful technological and managerial analyses of what is needed for firms to keep abreast of advancing techniques, of changing consumers' tastes and habits, and of the predictable growth of population. While those plans represent the companies' present intentions, they could easily be curtailed if the business outlook should deteriorate, and such curtailment would have the effect of aggravating the downward movement.

Among the foremost purposes of public economic policy must be that of keeping private investment incentives active. This it can do by providing supports which improve the short-run and long-run business outlook and by encouraging those institutional improvements which facilitate the investment process. When such measures are inadequate, Government must take some direct responsibility for stimulating and supplementing private activity.

### PUBLIC AND PRIVATE RESPONSIBILITIES

The task now confronting us is made more challenging because the problem is not simply to prevent a further weakening of the economic situation, but instead to reverse the trend and move toward higher levels of production and employment. We cannot be satisfied with a static economy even if that could be achieved. Mere retention of current levels of production would mean that unemployment would grow from year to year and that we would fail to use our known capacity to lift the living standards of our people. With a growing labor force, increased productivity, new tools, and improved business efficiency, both production and employment must expand if we are to fulfill the conditions of a healthy economy. While the goal for 1949 of a million more jobs and a 4-percent increase in production, set forth as our objective in January, is not now being achieved, the domestic aspirations of our people and the imperatives of world conditions alike require that we regain rapidly the full utilization of our material and human resources.

It is plain from the preceding analysis of current conditions and trends that the direction of further developments cannot be forecast with any certainty. There is a considerable possibility that present adjustments will lead, after some further decline this summer, to an increase in production and employment. But there is still reason for real concern that the present

slack may take a more serious recessionary turn, or not be succeeded by an expansion to satisfactory levels of employment and production. Consequently, it is necessary to approach the situation with positive and constructive measures, rather than to assume that the recuperative factors at work are adequate in themselves.

The Employment Act of 1946 is designed to encourage an economy of free competitive enterprise. Our businessmen, workers, farmers, and consumers create the Nation's wealth, and it is their decisions which will primarily determine whether the economy will move up or down and whether the Government will be required to play a larger or a smaller part. It is eminently desirable in the current situation that each of these groups base its action upon confidence in the long-run future of the American economy and thus contribute to the most favorable outcome. In this Midyear Economic Review, we have sought to highlight those lines of private action which are most needed in this task.

But while we point out the course of private action that our analysis convinces us would be beneficial to the economy, we are quite aware that many individuals feel compelled to act in accordance with what they feel is likely to happen in the short run rather than in accordance with what they would like to see happen over a more extended period. No one can quarrel with this natural rule of self-preservation, but it indicates the need for the cultivation of a general economic environment in which all who participate in the Nation's economic affairs would be justified in following en masse a course which few of them could run the risk of following alone.

It was with this dilemma in mind that the framers of the Employment Act also underscored the role of Government policy to promote through all its resources the objectives of maximum employment, production, and purchasing power. This involves no departure from our national traditions. It is important that Government agencies, both executive and legislative, reexamine and reshape policy in the light of the situations which have been developing during the first half of this year and are in broad outline foreseeable as to the second half. We have learned through bitter experience that a little recession may lead into a big depression before we find the road to renewed prosperity, and this experience dictates the timely and preventive use of public policy to supplement the efforts of private enterprise.

In seeking to define and apply these public policies, we are not writing on a blank page. The mere fact that the Federal Government is currently withdrawing well over 40 billion dollars a year from private-income channels and is disbursing a like or even greater amount into the market and income stream means that the Government is already the most influential single factor in the current operation of the economy. What the legislative representatives and the executive agents of the people decide to do by way of enlarging, contracting, or redirecting these money streams and how they shape by legislative act or administrative policy the institutions through

which workers, traders, and investors conduct their private affairs may sharply affect conditions in the next few months and strongly affect them for the longer pull.

During the years of inflation, the President rigorously held expenditures to the lowest levels consistent with meeting the most pressing of our domestic needs and international requirements. This was for the purpose and had the effect of reducing inflationary pressures. Our analysis has indicated that, with the abatement of inflationary pressures, such Government outlays have operated in the main as a salutary sustaining force, and the slashing of such expenditures at this time would aggravate deflationary trends. On the other hand, an attempt to raise taxes at this time in order to produce a balanced Budget would increase the difficulties of business management in trying to effect cost and price adjustments to sustain volume operations in a weakening market, or would lessen the disposable incomes of consumers, or would have both of these consequences. In the presence of these opposing difficulties, the appearance of a Government deficit will have to be accepted.

In addition to fiscal policy, there is essential need for promotion by Government of conditions under which the generality of businessmen will have the highest attainable confidence about the future course of economic development and therefore make those decisions which will contribute most to a favorable outcome. Similarly, Government policies which support the maintenance and exercise of consumer purchasing power lend strength to the business system and to general public confidence. We have also determined that those unemployed in the process of economic transition, whether they be many or few, are entitled to such protection as our rich economy can reasonably provide, because too much of the cost of such disturbances should not be borne by a particular group. And, finally, without a premature commitment of resources, it is wise to prepare and make ready those programs of Government action which should be available to support economic expansion if the forces of the market alone should fail to provide the needed uplift. The understanding by the community that a far-sighted program has been adopted should in itself be a powerful factor in holding business activity on a high level.

Delay in implementing these principles would prove costly in terms of economic waste and loss of confidence. Action in time through the cooperative efforts of public and private instrumentalities at all levels will demonstrate that we have learned to pursue the twin objectives of economic stabilization and economic welfare under our free and democratic institutions.

# II. Economic Indicators and the Nation's Economic Budget

The adjustment of the economy to a new price level, following the abatement of postwar inflationary forces, proceeded throughout the first half of 1949 without developing a sharp recessionary spiral. At midyear the process of transition is continuing in orderly manner.

## The Course of Employment and Production

*Employment*

In June of this year, total civilian employment stood at 59.6 million; in June of last year, at 61.3 million.

During the first quarter of this year, the monthly average of total civilian employment was about 57.4 million, compared with 57.2 million during the first quarter of last year, an increase of about 200,000. But during the second quarter of this year, the monthly average was 58.7 million, a drop of approximately 700,000 from the average of 59.4 million for the second quarter of last year. The pick-up in employment which occurred in the second quarter of last year has not been equaled this year. Employment, which rose by nearly 4 million from March to June 1948, rose by slightly less than 2 million from March to June 1949. (See chart 2 and appendix table D–7.)

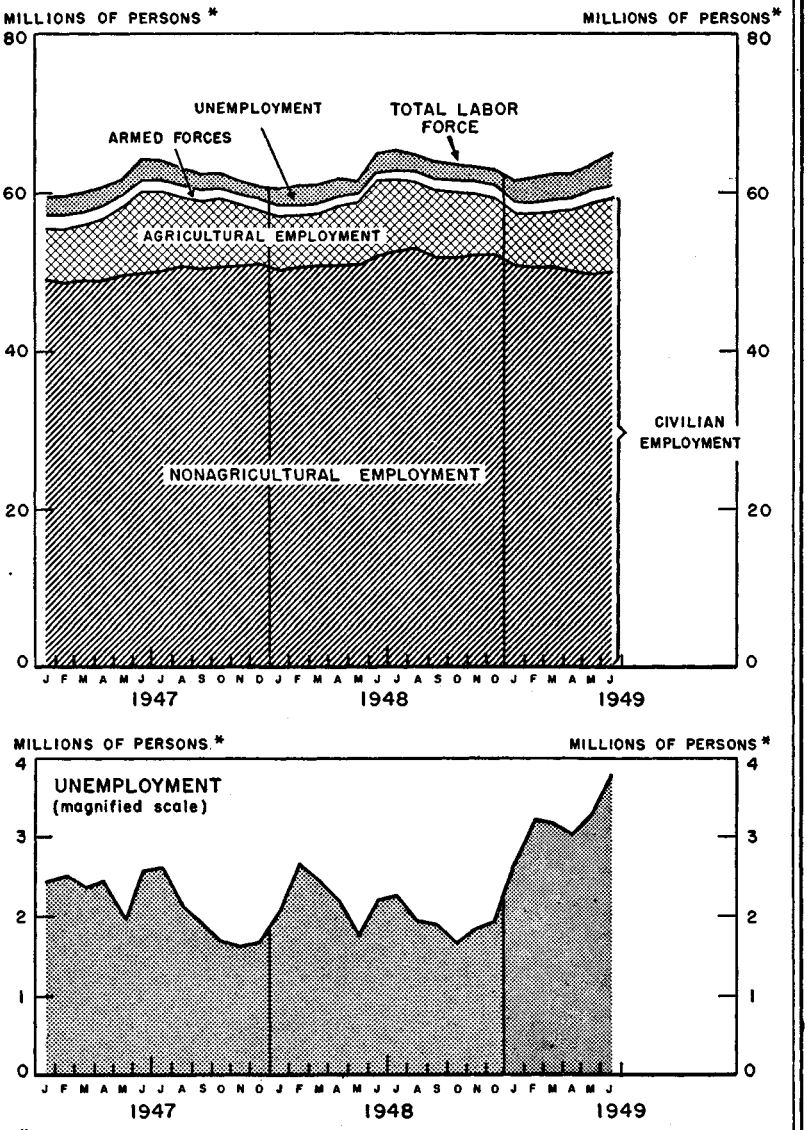
In January, 1949, the objective of maximum employment for the year was set at about 1 million more jobs than in 1948. Developments during the first half of this year have fallen short of this objective, and the trend of employment has not compared favorably with the first half of 1948.

The most significant employment development of 1949 has been the substantial decline in employment opportunities in nonagricultural industries, particularly in manufacturing. Nonagricultural employment has averaged about 600,000 less during the first half of this year than during the first half of last year and it is currently nearly 2 million below the level of 12 months ago. Aside from government employment, none of the major industry divisions during the first half of 1949 registered significant increases in employment over the first half of 1948. Transportation and service industries have shown some employment losses, but most significant for the state of the economy has been the substantial decline in manufacturing employment which had, by May, fallen by nearly 10 percent from the peak

CHART 2

# LABOR FORCE

**Increased unemployment and decreased nonagricultural employment (mainly in manufacturing industries) highlighted labor force developments in the first half of 1949.**




*14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF COMMERCE.

level of last September. The decline in manufacturing was about equally divided between durable and nondurable goods industries. (See appendix table D–8.)

This downward trend in nonagricultural employment has been somewhat obscured by increases in the number of persons engaged in agriculture, which have resulted in the average total volume of civilian employment for the first half of 1949 being only slightly less than the average for the first half of 1948. But it must be remembered that agricultural employment is subject to wide fluctuations because of weather conditions and that in periods of declining markets some industrial workers who would otherwise be unemployed support themselves by farm work. Both these factors appear to have played some part in increasing the level of farm employment from an average of 7.6 million in the first 6 months of 1948 to an average of 7.9 million in the first half of 1949. (See chart 2.)

The true employment picture is disclosed not only by the numbers employed but also by the hours worked. These have declined significantly in some industries. In manufacturing as a whole, the average of weekly hours has declined by more than 1 hour between the first half of 1948 and the first half of 1949. This has resulted both from the elimination of much of the overtime that was still present a year ago and from the institution of shortened workweeks in industries where output has been reduced. Bureau of the Census data show that in May of this year about 1.5 million persons were working a shortened workweek by reason of slack work, material shortages, job turn-over, and similar economic factors, compared with 800,000 last September. In addition, about 900,000 persons with regular part-time jobs in May wanted and would have accepted full-time work, compared with about 550,000 last September.

Against the declines in employment and hours in manufacturing, there has been some increase in Government and agriculture. Partly because of the long hours worked in agriculture, the total man-hours worked in the whole economy in the first half of 1949 were practically unchanged from those of the first half of last year. On a seasonally adjusted basis, they were perhaps 1 to 2 percent below those of the last half of 1948.

The difference between unemployment this year and last year cannot be shown solely by the employment figures, because there has been a growth in the labor force which would require more employment this year than last year to sustain maximum employment and hold unemployment to minimum practical levels. The average total labor force during the first half of this year was about 1 million higher than that for the first half of 1948. Unemployment during the first 6 months of 1949 averaged almost 3.2 million, compared with 2.2 million during the first 6 months of 1948, a difference of about 1 million which means that there has been practically no absorption of this labor force increase into employment. Actually, average civilian employment decreased by about 250,000, balancing an equivalent increase

in the armed forces. While unemployment in 1948 decreased from 2.4 million in March to 1.8 million in May and stood at 2.2 million in June, in 1949 it increased from 3.2 million in March to 3.3 million in May and stood at 3.8 million in June.

Adult male workers have been at least as severely hit by declines in employment opportunities as have women and boys. This has been particularly noticeable since last autumn as employment declines have been registered in the heavy manufacturing industries.

The duration of unemployment is a significant indicator of the extent to which unemployment is primarily frictional or something more basic. By June the number of persons unemployed 7 weeks or longer had risen to 1,549,000 compared with 693,000 in June 1948 and 581,000 last October. Furthermore, 262,000 had been out of work for half a year or longer, about double the number at the same time last year.

The number of persons unemployed more than a week and claiming unemployment compensation under State programs throughout the Nation early in June was 6.2 percent of the total covered, compared with 2.4 percent last October. In most of New England the number amounted to more than 10 percent in June 1949. Other States where unemployment is relatively heavy are California, New Jersey, New York, South Carolina, and Tennessee. The number of areas in which labor supply remains tight has diminished rapidly. Out of nearly 100 major labor market areas, 33 were in tight supply last fall but by midwinter the number had fallen to 8 and by early summer to 2.

The employment developments of the first 6 months of this year may be summarized by saying that the weakening in the first quarter was more than seasonal, and that continued declines in manufacturing in the second quarter outweighed seasonal gains in construction and other outdoor activities.

With unemployment now in excess of 3¾ million we have clearly passed the point where we can consider it primarily a "spot" or local problem. In fact, unemployment and underemployment have become widespread, both industrially and geographically, with heavy concentrations in many industrial centers.

It is estimated that during the past few months one out of four unemployed persons was not eligible for public unemployment benefits. In most cases ineligible persons were not covered by any plan or had been unemployed so long that their unemployment benefit rights had been exhausted.

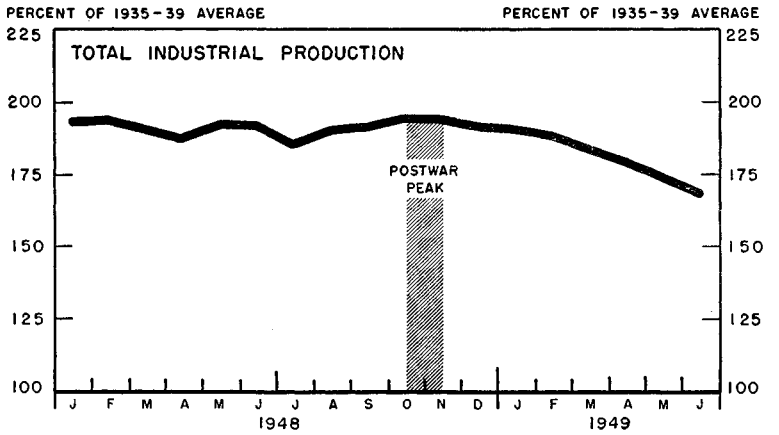
*Production*

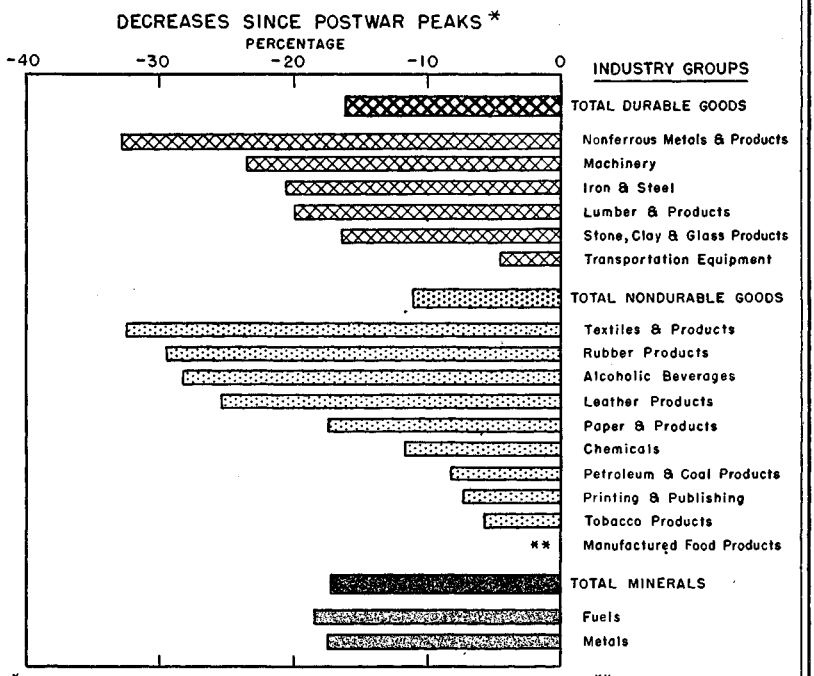
The dollar value of all goods and services produced (the gross national product) during the first half of 1949 was about 3½ percent below the level of the second half of 1948. (See appendix table D–1.) Part of this drop was due to a decline in prices. Rough adjustments for price changes suggest that the actual output of all goods and services together dropped

CHART 3

# INDUSTRIAL PRODUCTION

Total industrial production has declined about 13 percent since reaching a postwar peak last fall. Declines have occurred in almost all major industrial groups.




* DECREASES BASED ON PRELIMINARY JUNE FIGURES. DATES OF POSTWAR PEAKS VARY. ** NO CHANGE.
SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

by something like 1½ percent. This contrasts with the goal of maximum production of goods and services which we estimated in January 1949 at from 3 to 4 percent above the output of 1948.

The most persistent and substantial declines have been in industrial production (manufacturing and mining), which on a seasonally adjusted basis declined continually after last November and by June was about 13 percent below the high level attained last fall. This rapid fall in industrial output, in contrast with the relative stability of the nonindustrial segment of the economy, has been typical of past recessionary movements. For manufactures, the seasonally adjusted index, which in June 1948 was 198 percent of the 1935–39 average and reached a peak of 202 in October, declined to 193 by March 1949 and to 174 by June. During the early part of this period of decline, reductions were greater in the production of nondurable goods than in the production of durable goods. In May and June, however, output of nondurable goods has shown little further decline while output of durables has fallen off considerably. For the minerals the seasonally adjusted index, which stood at 161 in November 1948, fell to 146 in May of this year and, with coal output curtailed, declined further to 134 in June. (See chart 3 and appendix table D–13.)

Situations in the major industry groups have varied. Some of the largest declines (20 percent or more) from postwar peaks are found in nonferrous metals and products, textiles and textile products, rubber products, alcoholic beverages, leather products, machinery, and lumber and products, each of which has been declining for more than a year. Iron and steel production is currently also about 20 percent below its first quarter 1949 peak, with pronounced drops during recent weeks.

On the other hand, automobile production has increased and activity in the tobacco products, printing and publishing, and most manufactured food products industries has shown little or no decline.

The volume of private nonresidential construction put in place so far this year has declined compared with the same period in 1948, but this decline has been virtually balanced by increases in public construction. (See appendix table D–14.) New nonfarm housing units started through June are about 7 percent fewer than the number started in the same period last year, but starts in June 1949 were about the same as in June 1948. (See chart 12, p. 38.)

This year's agricultural production for human use is likely to approach that of 1948 unless weather becomes less favorable. Production of most livestock products is running slightly ahead of 1948, and an appreciable increase in hog marketings is in prospect toward the end of the year. Another large wheat crop is being harvested. Preliminary information indicates a total crop acreage about the same as last year's, and, except for continuing drought in the Northeast, weather in the major agricultural areas so far has been generally favorable for crop development.

*Prices*

Prices during the first half of 1949 declined on a broad front, thus marking the first general reversal in the upward trend of prices which followed World War II. This decline signalized the end of the inflationary process that began in 1940, was held under control from 1942 to the middle of 1946, and then rapidly accelerated with the lifting of government price controls. At their August 1948 peak, wholesale prices had increased about 120 percent above 1939, and about 50 percent above June 1946. Consumers' prices also reached their peak in August 1948, but with less extreme advances—about 75 percent above 1939 and about 30 percent above June 1946. (See chart 4.)

*Wholesale prices.* Compared with their previous large rise, the declines in wholesale prices during the first half of 1949 have in the main been moderate and orderly, although there have been sharp declines in individual commodities. Wholesale prices through June have declined about 9 percent from their postwar peak and about 5 percent from December 1948. They have now returned to the levels prevailing in August 1947, or about 100 percent above the 1939 level and about 36 percent above the June 1946 level. As the following table shows, the price declines from the peaks have been unevenly distributed, with the largest declines in farm products and foods, chemicals, and hides and leathers. (See table 1 and chart 5.)

TABLE 1.—*Changes in wholesale prices*

| Commodity group | Date of postwar peak | Percentage change to postwar peak from— | | Percentage change to June 1949 [1] from— | |
|---|---|---|---|---|---|
| | | 1939 | June 1946 | Postwar peak | December 1948 |
| All commodities | August 1948 | +120.2 | +50.4 | −9.3 | −5.2 |
| Farm products | January 1948 | +205.1 | +42.4 | −15.4 | −5.0 |
| Foods | August 1948 | +169.6 | +68.1 | −14.1 | −4.2 |
| Other than farm products and foods | September 1948 / November 1948 | +88.9 | +45.5 | −5.6 | −5.3 |
| Hides and leather products | December 1947 | +112.8 | +66.2 | −12.2 | −3.7 |
| Textile products | May 1948 | +118.2 | +39.3 | −8.9 | −5.6 |
| Fuel and lighting materials | November 1948 | +88.2 | +56.7 | −5.2 | −4.9 |
| Metals and metal products | January 1949 | +86.0 | +56.5 | −5.2 | −4.2 |
| Building materials | September 1948 | +125.5 | +57.1 | −6.2 | −5.3 |
| Chemicals and allied products | January 1948 | +84.1 | +45.1 | −16.0 | −10.4 |
| Housefurnishing goods | December 1948 | +72.0 | +34.4 | −2.3 | −2.3 |
| Miscellaneous | January 1948 | +65.2 | +25.5 | −11.0 | −7.2 |
| Special groups: | | | | | |
| Raw materials | July 1948 | +162.5 | +45.9 | [2] −9.9 | [2] −3.6 |
| Semimanufactures | August 1948 | +109.4 | +52.5 | [2] −7.3 | [2] −7.0 |
| Manufactured articles | August 1948 | +104.7 | +53.4 | [2] −8.0 | [2] −3.9 |

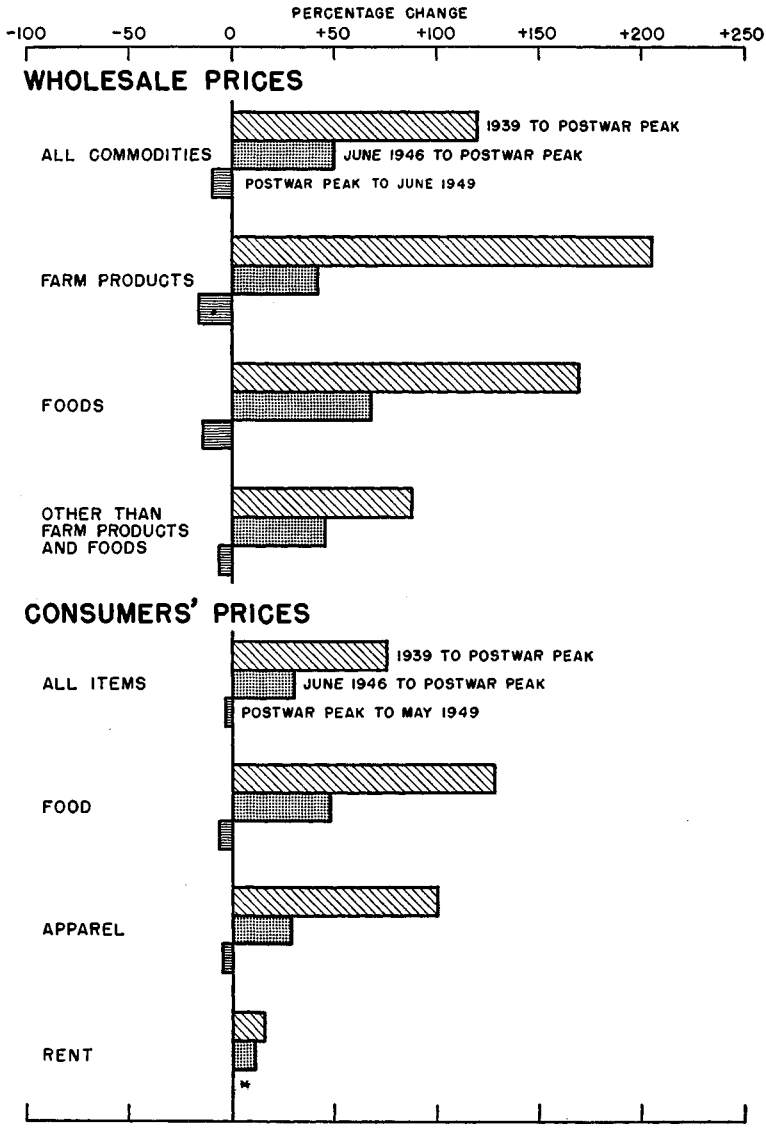
[1] Preliminary estimates based on weekly indexes for June.
[2] Based on index for May; June not available.

Source: Department of Labor. (See appendix table D-20.)

CHART 4

# PRICE CHANGES

The fall in prices from the postwar peaks has been much greater for wholesale prices than for consumers' prices. Compared with the previous large increases from 1939 and from June 1946, the declines have been very moderate. Rents continued to advance.

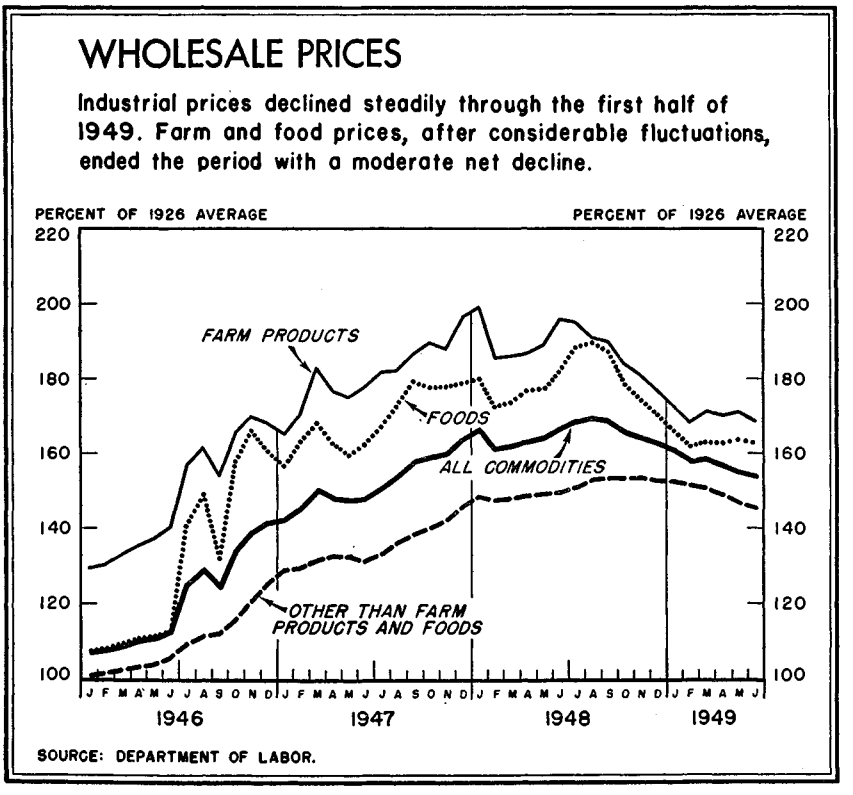



SOURCE: DEPARTMENT OF LABOR. *POSTWAR PEAK IS MAY 1949.

During the first quarter of 1949, the outstanding development was a sharp drop in farm and wholesale food prices in late January and early February, reminiscent of the drop during the same period a year earlier. Some farm commodities, notably corn, fell substantially below their support prices, but from mid-February forward there occurred a sizeable recovery in the levels of farm and food prices. Prices of fuel oils continued weak, and weakness developed in scrap metals and in lead and zinc. By the middle of the quarter, the general level of industrial prices had begun a downward drift as the prices of metals and metal products, building materials, and fuel and lighting materials turned down. The prices of textiles and other industrial groups continued the decline which had begun in 1948.

In the second quarter, while farm and food prices fluctuated, most groups of industrial prices declined fairly continuously. Particularly striking were the series of declines in lead, zinc, and copper as well as in scrap metals. Lead and zinc, which had advanced more than 40 percent and 60 percent, respectively, during 1948, dropped 44 percent and 47 percent between March and June of 1949. Copper, which had advanced less than 10 percent during 1948, declined 32 percent from April to June 1949. The declines in scrap-metal prices, which began before the break in the primary

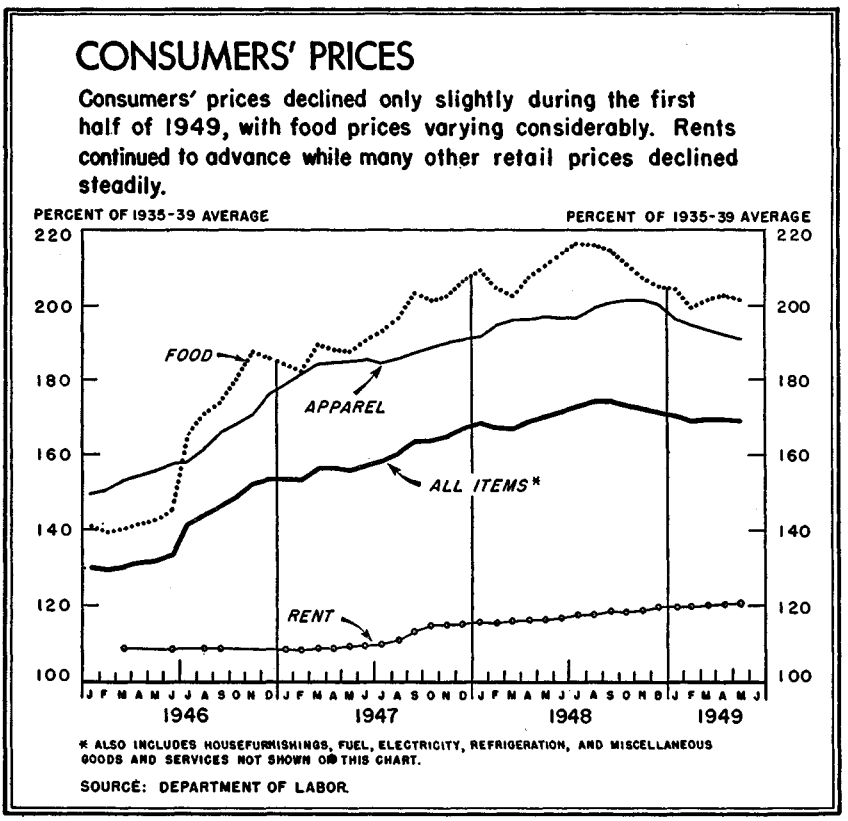
CHART 5



metals, were somewhat greater, scrap lead, zinc, copper, and steel declining on the average about 50 percent. By midyear, some firming in the markets for lead and copper was noticeable. The base prices of steel remained steady, but some steel producers lowered prices on individual products where their prices were out of line with the general level. The cost of steel to consumers declined through the disappearance of gray-market premiums, some revisions of extras, and the end of high-cost conversion deals.

*Consumers' prices.* The general course of consumers' prices during the first half of 1949 differed considerably from that of wholesale prices, declining only slightly from the levels at the end of 1948 and only moderately from the August 1948 peak. Consumers' prices declined during the first two months of 1949, continuing the fall that began in October 1948, then recovered slightly, and finally dropped again in May. By May 1949, consumers' prices were 1.3 percent below the December level and 3.0 percent below the August 1948 peak. This still left them about 70 percent above the 1939 level and about 25 percent above the June 1946 level. (See table 2 and chart 6.)

CHART 6



There was no uniform pattern in the price changes of the major groups of consumer items during the first half of 1949. Retail food prices, which are a dominant factor, first declined, then recovered part of the decline, then weakened again, following the course of wholesale food prices. Meat prices in particular were strong in the second quarter. Apparel and housefurnishings dropped steadily during the first half of 1949, continuing the downturn that began in late 1948; fuel, electricity, and refrigeration advanced slightly during the first quarter to a new postwar peak and then began to decline. The miscellaneous category rose during most of the period, reflecting the increase in the cost of transportation, the rise in gasoline prices, and the continuing upward movement in such items as medical care and other services. Rents, which had previously increased much less than other prices, advanced steadily through the period.

The changes in consumers' prices during the first half of 1949 and from their postwar peaks are shown in the following table:

TABLE 2.—*Changes in consumers' prices*

| Group | Date of postwar peak | Percentage change to postwar peak from | | Percentage change to May 1949 from | |
|---|---|---|---|---|---|
| | | 1939 | June 1946 | Postwar peak | December 1948 |
| All items | August 1948 / September 1948 | +75.6 | +30.9 | −3.0 | −1.3 |
| Food | July 1948 | +127.7 | +48.9 | −6.6 | −1.3 |
| Apparel | October 1948 | +100.5 | +28.2 | −5.1 | −4.5 |
| Rent | May 1949 | +15.4 | +11.0 | ---------- | + .8 |
| Fuel, electricity, and refrigeration | March 1949 | +40.3 | +25.7 | −2.5 | −1.7 |
| Housefurnishings | October 1948 | +96.2 | +27.4 | −4.7 | −4.6 |
| Miscellaneous | April 1949 | +53.5 | +20.9 | − .1 | + .3 |

Source: Department of Labor. (See appendix table D-19.)

*Wages and labor relations*

As 1949 opened, the average real earnings of wage earners were slightly higher than a year earlier. This improvement had occurred, however, only in the closing months of 1948, when the modest decline in the cost of living served to increase slightly the real value of workers' money wages.

Such wage increases as occurred during the first half of 1949 had only limited effect on the average of wages earned, and were, at least in manufacturing, more than offset by declines in the average length of the workweek. Consequently, average weekly money earnings fell in all manufacturing after reaching a postwar peak of $55.01 in December 1948, and by May 1949 had declined to $53.08. In some manufacturing and other industries, the first half of the year registered declines in average hourly earnings as overtime work and other premium payments were reduced or eliminated and as some wage rates were reduced. (See appendix tables D–9, D–10, and D–11.)

The slight declines in the earnings of wage workers were approximately balanced during the half year by further slight declines in the cost of living,

leaving average real weekly earnings of all wage earners practically unchanged.

The first half of 1949 was marked by delays in settlement of labor contracts in some of the major industries; by a number of important instances, such as in the textile and apparel industries, where wage increases were either denied or not sought; by some scattered wage reductions; and by the settlement of many contracts, particularly in local industries such as local public utilities, construction, and printing, which provided for wage increases and frequently additional benefits in the form of health or welfare plans, retirement programs, or additional paid holidays. Such increases in wage rates as occurred in manufacturing industries were typically between 5 and 10 cents an hour. The most important agreement of the year to date was that between the railroads and the 16 nonoperating unions which provided a retroactive 7-cent-an-hour wage increase and a reduction to start in September in the workweek from 48 to 40 hours without a reduction in pay for approximately 1,000,000 employees.

With major negotiations still unsettled in coal, rubber, and steel, as well as in automobile, electrical machinery, and most other metal-working industries, the wage developments of the second half of the year will overshadow those of the first half. In fact, the development of a trend in wage settlements which might have widespread effects necessarily awaits the settlements in the dominant mass-production industries, which are still engaged in negotiation.

Labor relations during the first half year were relatively undisturbed by major work stoppages. Coal miners were out on two occasions—the "memorial" stoppage in March and the "stabilizing inactivity" stoppage in June—and the Ford company was struck for 3 weeks in May. Aside from these disruptions, most work stoppages during the 6 months were essentially local in nature and generally of limited duration.

For the first 6 months of the year, the number of work stoppages was about 10 percent greater than in the corresponding period of 1948; idleness resulting from this year's stoppages, however, is estimated to be approximately one-third less than the January to June period of 1948. This development is at least in part a reflection of the postponement of negotiations in the major mass-production industries to midyear, with the result that the second half of the year may witness a more crucial testing of labor relations than the first.

*Profits*

After attaining record levels in 1948, profits declined during the first half of 1949, reflecting the reductions in prices and production. Corporate profits, before taxes (not adjusted for inventory valuation), which were estimated at 32.8 billion dollars in 1948 and at a peak annual rate of 34.7 billion dollars in the fourth quarter of 1948, declined to an estimated annual rate of 27.2 billion dollars during the first half of 1949, a fall of 17

percent from the level of 1948, and of 22 percent from the peak rate of the fourth quarter of 1948. Corporate profits after taxes were at an annual rate of 16.2 billion dollars in the first half of 1949 compared with 20.1 billion dollars in 1948 and an annual rate of 21.2 billion dollars in the fourth quarter of that year. (See appendix tables D–27 through D–31 for statistics on corporate profits.)

Corporate profits after taxes in the first quarter of 1949 represented about 4.8 percent on sales and about 8.5 percent on net worth, compared with about 5.3 percent on sales and about 10.0 percent on net worth in 1948.

A much more moderate decline was registered for unincorporated business and the professions, net income before taxes (not adjusted for inventory valuation) declining from an estimated 25.8 billion dollars in 1948 to an annual rate of 23.9 billion dollars in the first half of 1949, a decline of somewhat more than 7 percent. Net farm income before taxes declined from 18.2 billion dollars in 1948 to an annual rate of 16.8 billion dollars, or about 8 percent. (See appendix table D–2.)

The decline in profits from the fourth quarter levels to the first quarter of 1949 affected most manufacturing groups. The largest declines were recorded for most nondurables and for such durable groups as electrical machinery, fabricated metal products, and motor vehicles. Chemicals, on the other hand, showed only a slight decline, and apparel and printing showed increases. Compared with a year ago, the following durable groups showed increases: nonferrous metals, iron and steel, and motor vehicles. These differences in profit experiences reflected, of course, the uneven changes in rates of activity, prices, and costs among various industries.

The estimated annual rate of corporate profits before taxes of 27.2 billion dollars in the first half of 1949 represents a decline of about 5.6 billion dollars from the 1948 levels. This difference is about equal to the change in the replacements costs of inventories between the two periods, with the prices of goods in inventories rising in 1948 and falling in 1949. (This is discussed in more detail in appendix A–3, Business Account.) Although the two profit rates after the inventory valuation adjustment are virtually identical for the two periods, there was, however, an important difference in trend, corporate profits rising quarter by quarter in 1948, but falling quarter by quarter in the first half of 1949.

Although total profits for the first half of 1949 are considerably below the levels attained in 1948, this does not preclude the maintenance of healthy levels of return under conditions of high employment. In the present period of price-income adjustment the adverse effects of inventories acquired at high prices and of operating costs not yet fully pruned or shaken down color the picture unduly. Likewise we are now feeling the effects of reduced operating rates in many companies or industries due to current factors of uncertainty. As these are removed, we shall have a better opportunity to ascertain what reductions in unit costs can be achieved

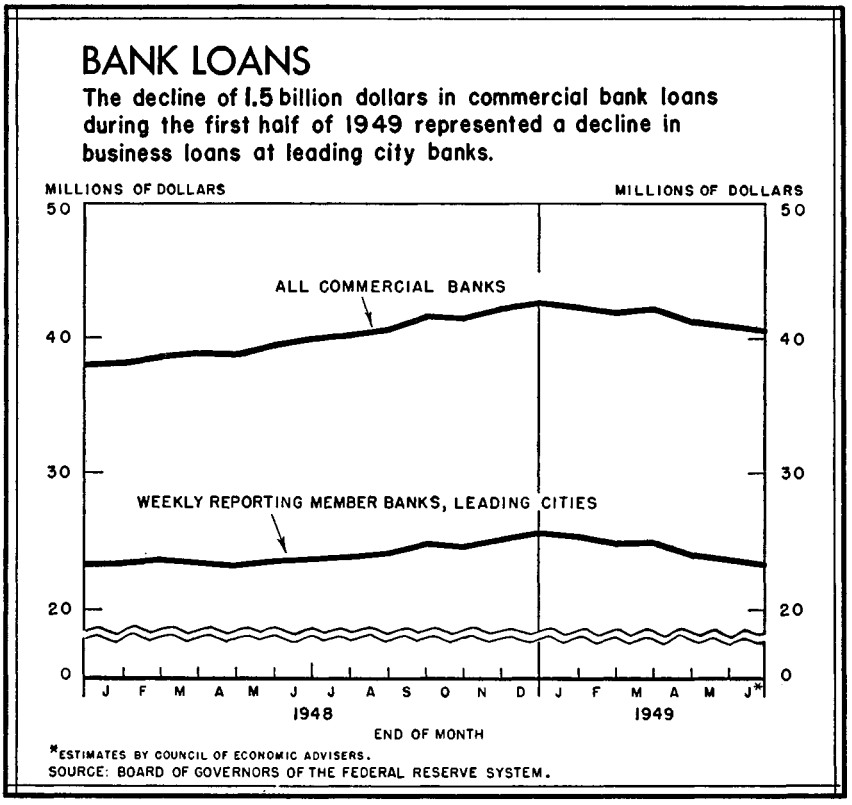
by efficient management at high operating rates and what profit margins are needed to assure proper maintenance and expansion.

## Money and Credit

The easy credit conditions which have prevailed since the war and which contributed to inflationary pressure have continued and are now an important element of strength when the process of readjustment entails difficulties in other aspects of the economy. Interest rates on business loans made by banks have risen slightly since the latter part of 1948, but the interest yield on corporate bonds and on Government securities has fallen. Pursuant to the policy of the Government to prevent excessive fluctuations in bond prices, the Federal Reserve banks have sold substantial amounts of Government bonds in order to moderate the rise in market price. Further easing of credit conditions has been brought about by a reduction in reserve requirements, and the Board of Governors has recently announced its policy to permit a decline in interest rates.

The requirements of business firms for working capital, especially to carry increasing inventories and customer receivables, lessened when ac-

CHART 7



cumulation of inventories was arrested. After the close of the Christmas shopping season it was possible for business concerns to pay off bank loans, and this process continued throughout the first half of this year. It affected the portfolios of the banks in the larger cities, whose commercial loans declined about 2.4 billion dollars, or 15 percent. (See chart 7 and appendix table D–23.) Other types of loans by banks and total loans and investments by other financial institutions have been relatively stable.

Instalment buying adds to market demand during an inflationary movement but creates a condition which may aggravate a spiralling deflation. Consumers who suffer a decline in income must reduce their current buying in order to meet their outstanding obligations on instalment contracts. Instalment credit increased steadily after the war as durable goods, especially automobiles, became available, but the total amount at the end of 1948 was not so high, in proportion to consumer income, as in 1940. (See appendix table D–22.) During the first half of 1949, instalment credit increased only half as rapidly as in the corresponding period of 1948. In view of the growing weakness in many consumer durable goods markets, the regulations covering instalment credit were relaxed early in March and again in April.

The supply of money—bank deposits and currency in the hands of the public—declined by 3.2 billion dollars in the first half of 1949 as a result of the reduction in business loans, the lowering of prices, and the seasonal accumulation of a Treasury cash surplus. Adjusted bank deposits were 140.8 billion dollars on June 30, 1949, and 140.1 billion dollars a year earlier, and currency outside banks declined from 25.6 billion dollars to 25.1 billion dollars. (See appendix table D–24.) The amount of bank deposits, adjusted, on December 31, 1948, was 143.0 billion dollars, and currency outside banks was 26.1 billion dollars.

## The Flow of Goods and Purchasing Power

### *Consumer income, spending, and saving*

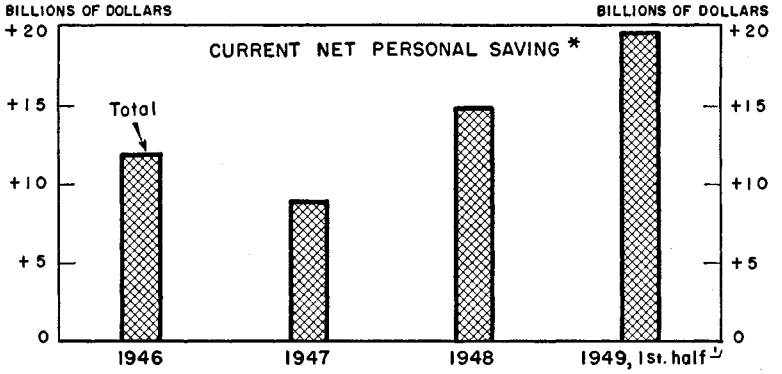
Consumer disposable income was smaller in the first half of 1949 than in the last half of 1948, but the decline was less than that of the national income. Increased unemployment compensation payments offset in part the decline in wages and salaries, and corporate income absorbed a considerable part of the impact of declining prices and sales. Personal taxes also declined. Consumption expenditures fell off more than disposable income, so that personal saving was above the level of the first half of 1948 both absolutely and in relation to income. However, there was a substantial drop in saving from the first to the second quarter.

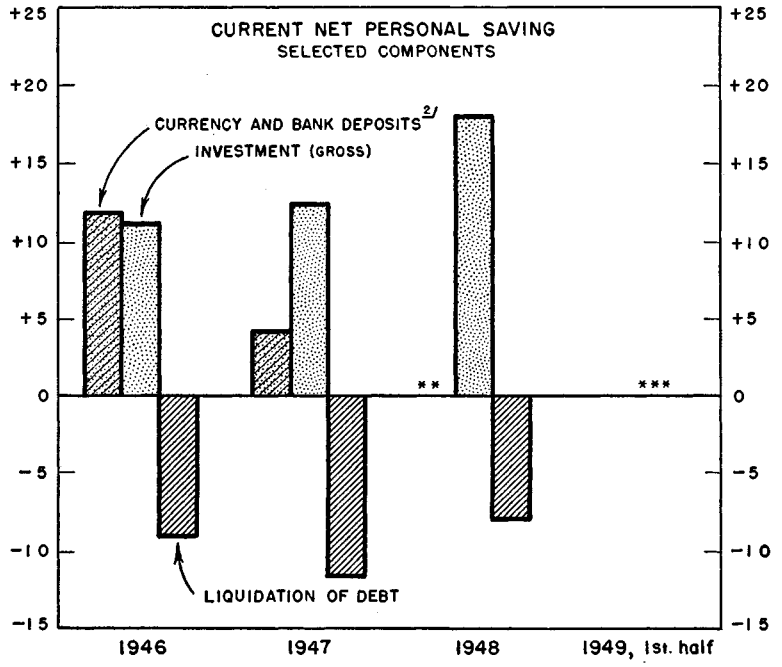
*Personal income.* Personal income ran at the annual rate of about 214 billion dollars during the half year, a drop of about 2 percent from the second half of 1948. In the second quarter of 1949 it was 4 percent below

CHART 8

# CURRENT NET PERSONAL SAVING

**Current net personal saving has increased substantially since 1947. Personal investment has absorbed a larger share of the saving increase and currency and bank deposits a smaller share.**




1/ SEASONALLY ADJUSTED, ANNUAL RATE.

2/ INCLUDES SHARES IN SAVINGS AND LOAN ASSOCIATIONS.

* SAME AS CONSUMER SAVING IN THE NATION'S ECONOMIC BUDGET. ** NO CHANGE. *** NOT AVAILABLE.

SOURCE: DEPARTMENT OF COMMERCE AND SECURITIES AND EXCHANGE COMMISSION.

the fourth quarter of 1948. The sharpest relative cut-back was in proprietors' income—farms and other unincorporated businesses and professions. In absolute amount, the largest decrease was in wages and salaries, which account for nearly two-thirds of total personal income. Other income shares (dividends, rents, and interest) continued to increase although dividends turned down in the second quarter. An increase in government transfer payments to individuals—mainly unemployment compensation benefits and payments to veterans for educational purposes—partly offset the decreases in income from other sources. (See appendix table D–3.)

The decrease in personal income in the first half of this year was partly compensated for by the rather sharp drop in income tax payments, so that disposable personal income fell not much more than one percent from the level of the last half of 1948. Consumers' prices meanwhile went down 2 percent over the same period, and, with a slight increase in population, real disposable income per capita remained about constant. (See appendix tables D–4 and D–5.)

*Personal consumption expenditures.* Throughout 1948, rising personal income went increasingly into saving (including personal investment), with relatively small increases in personal consumption expenditures. (See appendix tables D–4 and D–6.) When income began to fall off in the first half of 1949, consumption expenditure in dollar terms dropped somewhat more than income. After the moderate price declines in the first half of 1949, the level of consumption was not changed significantly.

Important changes have been taking place in the structure of consumer demand during the postwar years. The proportion of disposable income spent for nondurable goods has been steadily declining since early 1947. Until 1949, this accounted for most of the increase in consumer saving, since expenditures for durable goods and services rose nearly in proportion to income. In the first half of this year, however, expenditures for durable goods fell off significantly in relation to income. Meanwhile, expenditures for services continued to go up, and absorbed an increasing proportion of the declining personal income. This reflected in part continuing increases in rents and in prices of other services.

The fall in market demand for durable goods in the first half of this year was an important development in consumer purchasing. For major durables, except some makes of automobiles, market demand at current prices no longer exceeds supply.

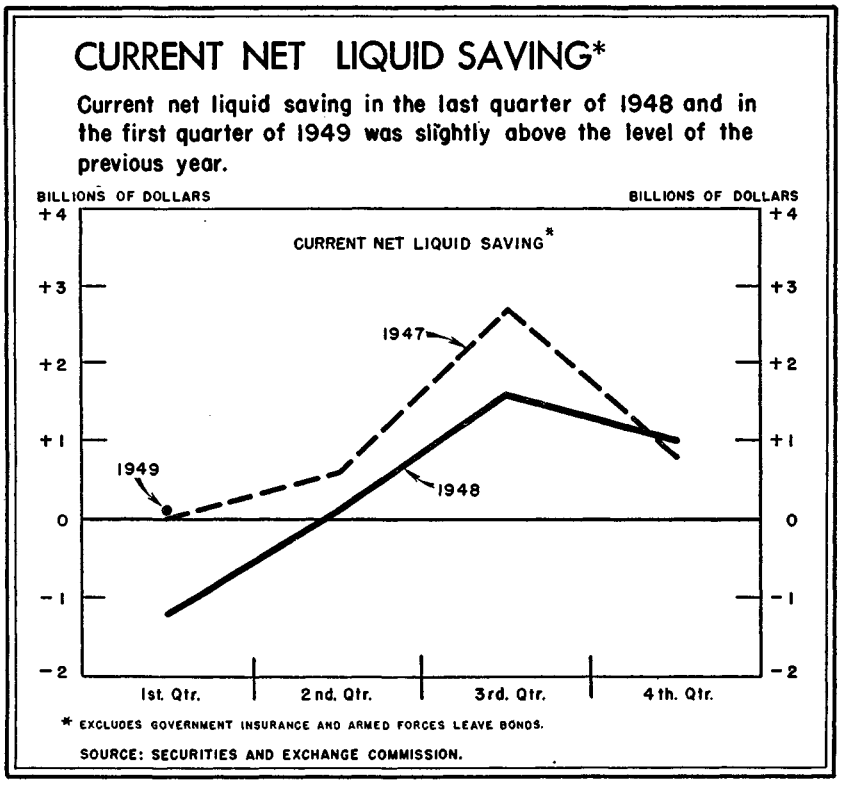
*Personal saving.* Net personal saving increased both in absolute terms and as a ratio to disposable income from mid-1947 through the first quarter of 1949, but declined substantially in the second quarter. This saving has taken the form both of direct investment in homes, farms, and businesses, and also of accumulation of liquid assets such as securities and bank deposits and the building up of insurance reserves. Increase in personal debt is offset against the increase in investments and liquid assets in order to arrive

at net personal saving. This offsetting item increased greatly until the first quarter of 1949.

Although net personal saving was increasing, net liquid saving (additions to currency and bank deposits, securities and insurance reserves, less the increase in consumer and mortgage debt) declined from 1946 to 1947, and from 1947 to 1948. Saving was going increasingly into direct personal investment in homes and in farm and business inventories and plant and equipment. A considerable part of the increase in personal investment between 1947 and 1948, it is true, was due to an increase in farm inventories, which is largely involuntary. (See appendix table B–4.) Nevertheless, the growth in investment, as shown in chart 8, is quite striking. Since it constitutes a direct demand for goods and services, it has been an important factor in sustaining the economy.

The trend of liquid saving, on the other hand, has until recently been downward. Liquid saving shows marked quarterly fluctuations, as is shown in chart 9. In the first quarter it is low because funds are withdrawn to pay taxes. In the first quarter of this year it amounted to about 100 million dollars, or less than half a billion at an annual rate. It contrasts sharply, however, with the 1.2 billion-dollar reduction in liquid assets in

CHART 9



the same quarter of 1948. The largest difference was in consumer debt, where repayments exceeded new loans so that, for the first time since the war, there was a net contraction of consumer credit for the quarter as a whole. (See appendix table B–5.) Withdrawals of currency and bank deposits also were less than in the first quarter of last year.

Unlike direct personal investment, liquid saving does not constitute a direct demand for goods and services. To maintain total demand, the liquid savings put aside by some groups must be matched by borrowings on the part of other groups. A rising rate of saving in liquid form would reinforce the importance, pointed to elsewhere in this report, of maintaining a high level of business investment.

While as yet we have little evidence whether income has become more or less concentrated in the last year or 18 months, we do know that holdings of liquid assets are less evenly distributed throughout the population than they have been at any time since the end of the war. In early 1947, 24 percent of families had no liquid assets, and the percentage had increased to 29 by early 1949. The number of families owning United States savings bonds has been declining ever since the war, and it dropped substantially in 1947 and in 1948. The volume of deposits in the smaller bank accounts has likewise gone down over the past year, and has gone down relatively more than have deposits as a whole.

*Business investment and finance*

Total business investment in new construction, equipment and inventory accumulation, at a seasonally adjusted annual rate, reached an all-time peak of 43.6 billion dollars in the final quarter of 1948. This represented 16.4 percent of the total national product of goods and services. In the first quarter of 1949, this private investment, again adjusted for seasonal variation, fell to 38.9 billion dollars or 15.1 percent of the gross national product, and in the second quarter to 32.4 billion dollars or 12.9 percent. Comparing the adjusted annual rates in the fourth quarter of last year and the second quarter of this year, total private investment declined by 26 percent while the gross national product declined by only 6 percent. Most of the decline in investment was due to a shift from net accumulation to net liquidation of inventories. (For further details, see appendix table C–1.)

This illustrates the greater relative fluctuation in investment outlays as compared with other expenditures, a characteristic of previous swings in the business cycle. As earlier reports have stressed, the unusually high ratio of business investment to consumption in the postwar period is significant because it raises the question whether it can be permanently maintained. As regards investment in expansion of inventories, it is quite clear that the pace set in the first three postwar years was abnormally fast.

It is desirable to seek a more stable ratio of business investment to consumption. A downward swing in total investment may generate large-scale

unemployment and business uncertainty if it is too abrupt and goes too far. Too often in the past, declines in investment have aggravated a depression trend as the reduction of employment and income in producers' goods and construction industries weakened the consumer markets on which profitable further investment in facilities depended. The present problem is thus to see that business investment does not fall to levels below those needed for the maintenance of technological progress, but provides for a healthy rate of growth. In this sector of the economy, as elsewhere, it is necessary to prevent some of the excesses of the boom from leading to excesses in the opposite direction.

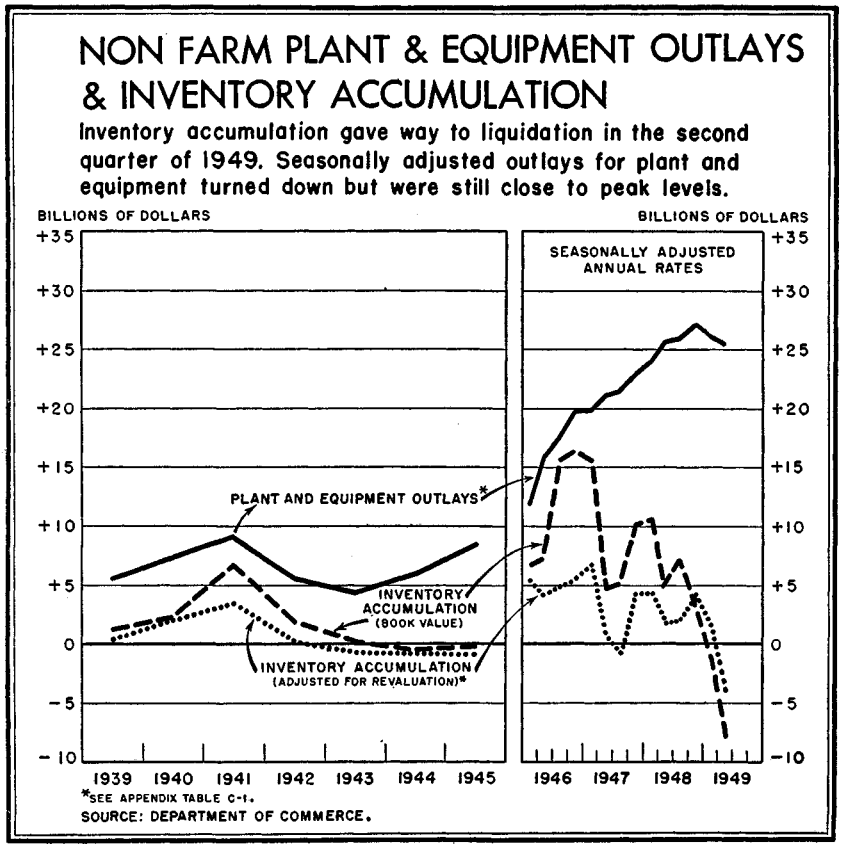
*Plant and equipment.* The high levels of plant and equipment investment in recent years have been a response to high postwar levels of demand, straining the capacity of facilities which in all but a few industries at the end of the war were still geared to prewar markets and production techniques. (See chart 10.) A nongovernmental survey made late in 1948 indicated that the larger manufacturing concerns expanded capacity during the 3 years 1946–48 at an average rate of about 6 percent a year, which is much faster than the long-run growth trend of industrial output in the past.

In the second quarter of 1949 the dollar rate of nonfarm plant and equipment outlays was apparently, for the first time in the postwar period, no higher than that of a year earlier, although still at a very high level. The quarterly SEC-Commerce sample survey of investment anticipations made in May showed that businessmen expected to spend 4 percent less on plant and equipment in the third quarter of 1949 than in the second quarter of 1949 or the third quarter of 1948. Taking into account the decline in costs of construction and equipment, this probably represents little change in volume. Though the plant and equipment investment outlays of gas and electric utilities are still running well above levels of a year ago, those of most main fields of nonfarm business are expected to fall below those levels in the third quarter, according to this survey. (See appendix table D–15.) Construction contracts and equipment orders indicate that plant and equipment outlays in the fourth quarter of this year will be below those of the fourth quarter of 1948.

Projects already scheduled are generally being followed through, but there appears to be hesitation in scheduling new major investment commitments in view of uncertainties as to markets, prices, and costs. Investment plans will, of course, be influenced by the trend of changing economic conditions.

If expenditures for plant and equipment should decline below current levels, the decline would not reflect a general excess of productive facilities in relation to the needs of a maximum employment and production economy. For such an economy, present capacity in general is now no more than adequate and in some industries is distinctly inadequate. Continued long-run economic growth will call for further expansion of productive capacity, though quite possibly not at as rapid a pace as in the first postwar years.

CHART 10




Moreover, there is no definite ceiling on the amount that might be spent continuously, under favorable conditions, for modernization of facilities. It appears, in fact, that in some important classes of capital goods, including motor vehicles, tractors, locomotives, railroad cars, and oil refining equipment, there is now a special backlog of deferred replacement needs arising from the unusually high proportion of over-age units in service.

*Nonfarm business inventories.* By the spring of 1949, postwar replenishment of stocks was completed in virtually all lines, and the weakening sales and prices led businessmen in general to buy a little less than they expected to sell. Even though inventory accumulation had been generally moderate throughout 1948 and inventories were not out of line with current sales, book values of inventories were sufficiently high to arouse caution when the outlook weakened. Business was sensitive to the effect of possible price declines on the value of such inventories, based as they were on high postwar levels of prices.

The total book value of inventories in manufacturing and trade declined by 2.1 billion dollars during the half year, from 54.0 billion at the end of

1948 to 51.9 billion at the end of June 1949. Changes in book values reflected in part the price decline and the normal seasonal tendency for stocks to rise in the first quarter and to decline in the second. The most significant development was the shift from accumulation of nonfarm inventories at an annual rate of 1.4 billion dollars during the first quarter, after adjustment for revaluation and seasonal variation, to liquidation at a similarly adjusted annual rate of 4.0 billion dollars in the second quarter.

TABLE 3.—*Changes in manufacturing and trade inventories and index of new orders, 1948–49*

[Not adjusted for seasonal variation]

| Item | 1948 | | | | 1949 | | |
|---|---|---|---|---|---|---|---|
| | First quarter | Second quarter | Third quarter | Fourth quarter | First quarter | April | May [1] |
| | Change in book value, millions of dollars | | | | | | |
| Inventories: | | | | | | | |
| Manufacturing and trade | +3,222 | +104 | +2,331 | +318 | +806 | −1,010 | −1,224 |
| Manufacturing | +1,044 | +663 | +983 | +1,003 | +80 | −527 | −443 |
| Materials and goods in process | −32 | +176 | +683 | +194 | −537 | −590 | −485 |
| Finished goods | +1,076 | +487 | +300 | +809 | +617 | +63 | +43 |
| Wholesale trade | +324 | +84 | +290 | +72 | +130 | −293 | −268 |
| Retail trade | +1,854 | −643 | +1,058 | −757 | +596 | −190 | −513 |
| | Average quarter or month of 1939=100 | | | | | | |
| New orders received by manufacturers: | | | | | | | |
| All manufacturing | 253 | 254 | 254 | 246 | 222 | 195 | 202 |
| Durable goods | 297 | 289 | 294 | 277 | 257 | 206 | 206 |
| Nondurable goods | 227 | 233 | 230 | 227 | 201 | 188 | 200 |

[1] Preliminary estimates.

NOTE.—Detail will not necessarily add to total because of rounding.

Source: Department of Commerce.

The shift of inventory position, shown in chart 10, has had an important impact on producers' order books and on the financial requirements of business in general, as discussed elsewhere in this review. During at least the first 4 or 5 months of the year, manufacturers' stocks of finished goods awaiting sale rose while their stocks of materials and goods in process (related to actual and prospective production) were falling off. This held good in both durable and nondurable lines, with the accumulation of finished stocks predominant in durables and the reduction of materials and process stocks predominant in nondurables. Attempts to cut inventories of materials were offset by an unwanted piling-up of unsold goods.

The relatively cautious and well-informed inventory policies of business in general in the postwar period, as compared to previous periods of prosperity, had moderated the potential inflationary effects of inventory buying and left the ratio of inventories to sales still low, by prewar standards, after 3 years of postwar restocking. Adjustments in individual business, and the broader adjustment to general business slackening in the first half of 1949, were therefore accomplished more quickly and with less

effect upon production rates than had been the case in most comparable earlier periods. During the second quarter, the stocks of retailers, wholesalers, and manufacturers all declined in both value and physical volume, reflecting general expectations of falling sales and prices. At the middle of the year, stocks were still a little below prewar ratios to sales, and even the proportion of manufacturers' stocks of finished goods to their total stocks was likewise still conservative by prewar standards. (For further details see appendix tables D–16, D–17, and D–18.) In a number of specific lines of business, the liquidation of inventories had proceeded so far by the middle of 1949 that some recovery of business purchasing and even a moderate resumption of inventory accumulation in these lines could be expected later in the year. In other lines, the outlook is for further liquidation.

*Corporate finance.* During the first half of 1949 the postwar corporate financing picture underwent a drastic change. In 1947 and 1948 corporations had used an average of 10.5 billion dollars a year to finance inventory accumulation and expansion of customer financing, but during the first six months of this year they needed no new capital for these purposes. On the contrary, there was a net liquidation of these accounts to the extent of 4.8 billion dollars. Funds obtained from this liquidation, plus a continued high level of profits, enabled corporations to reduce their existing indebtedness substantially, principally in the form of bank loans and accounts payable, and at the same time to finance a continued high level of plant and equipment expenditures. (See appendix table D–32.)

Though the decline in financial requirements for increase of working capital was abrupt, it represented a natural adjustment following a postwar period of restocking, and rapidly rising prices, in which the value of both inventories and credit to customers increased much more than would be required for long-run normal business growth. Even in 1948, as chart 11 indicates, there was a marked trend toward smaller new working capital requirements.

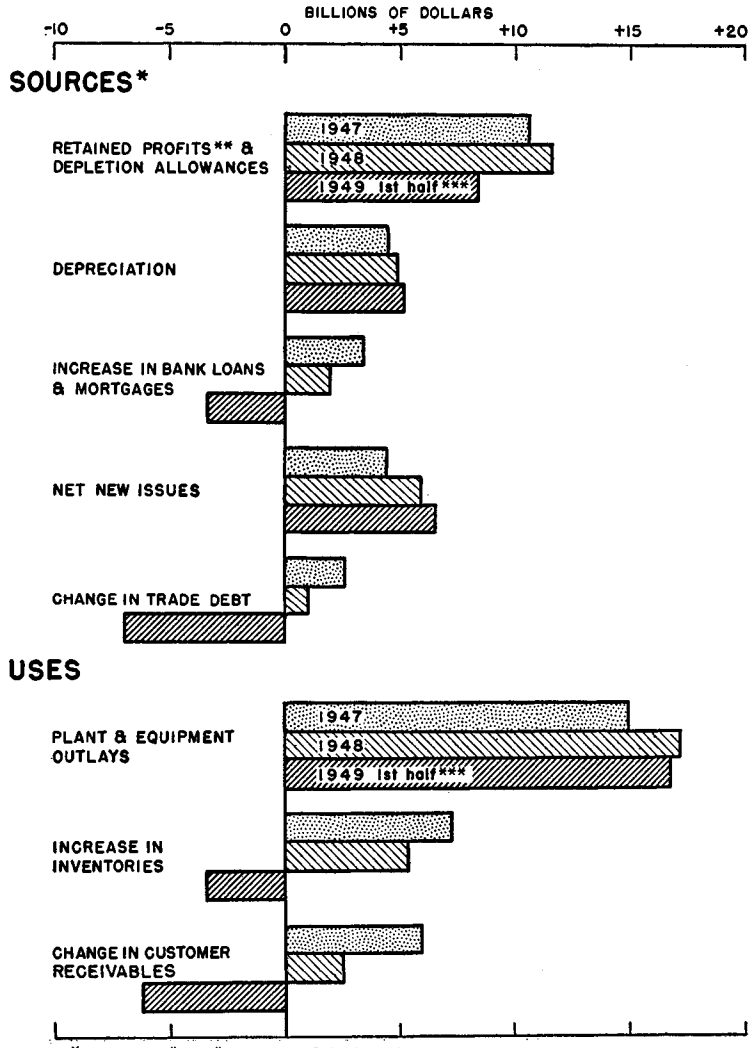
During the first 6 months of 1949, internal sources of funds for new investment fell about 18 percent below last year's level. Because of general maintenance of dividend payments, retained earnings fell by a greater proportion than total profits during this period. Depreciation reserves continued to rise moderately; and in general corporations did not reduce their liquid assets significantly, either to finance expansion or to reduce indebtedness.

Since this decline in internal funds was much less than the decline in total financial requirements, corporations were able to reduce their total liabilities by more than 3.5 billion dollars in the first half of 1949. This is in sharp contrast with the experience of the last several years. Corporations acquired debt capital to the extent of about 12 billion dollars in 1947 and about 9 billion dollars in 1948. The net reduction in total corporate liabilities was due to a very sharp decline in short-term debt, partially

CHART 11

# CORPORATE FUNDS SOURCES AND USES

**The major changes in the corporate financial picture during the first half of 1949 were a liquidation of nearly 5 billion dollars in inventories and customer receivables, and a large repayment of bank and trade debt.**




* FUNDS FOR "OTHER" SOURCES NOT SHOWN HERE.
** PROFIT ESTIMATES FOR 1st HALF 1949 BY COUNCIL OF ECONOMIC ADVISERS.
*** ANNUAL RATES, NOT ADJUSTED FOR SEASONAL VARIATION.

SOURCES: DEPARTMENT OF COMMERCE ESTIMATES BASED ON SECURITIES AND EXCHANGE COMMISSION AND OTHER FINANCIAL DATA.

offset by an increase in long-term debt. During the first half of the year, bank loans fell by about 2 billion dollars, and debts to other firms by 3.5 billion dollars. On the other hand, new bond issues and mortgage loans together exceeded the 1948 rate during this period. This is in part a reflection of the continued large demand for investment funds in the public utility field. Also, corporations have used proceeds from long-term loans and bond issues to retire existing short-term indebtedness. Stock issues continued to be small in comparison with bond issues though there has been some rise in common stock financing.

The burden of corporate debt, as measured by its relation to income, is very much smaller at the present time than in either the 1920's or the 1930's. Moreover, interest rates are significantly lower, particularly in comparison with the 1920's.

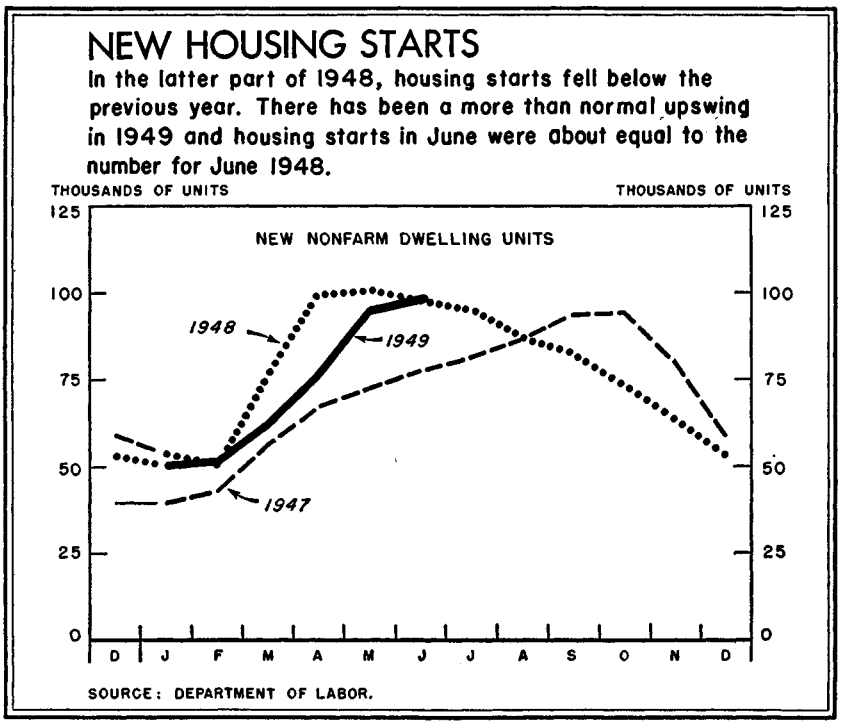
In evaluating the present financial position of business firms, it should be emphasized that there are wide differences in the financial positions of individual concerns, and there is some evidence that in the present weakening of business conditions these differences have increased. Smaller corporations have experienced a relatively sharper decline in profits, and their position with respect to liquid assets is not as favorable as that of the larger corporations.

*Housing.* Last year 931,000 new dwelling units for nonfarm families were started, according to estimates of the Department of Labor. (See chart 12.) The total number of units added from all sources, including conversions, remodeling, and shift from farm to nonfarm categories, was considerably greater. This was a high figure, but certainly inadequate to meet the needs of a growing population and improved standards of housing. For example, about the same number of dwelling units were started in 1925, with a much smaller population and a much smaller accumulated housing shortage. More important, the distribution of this housing among various price ranges has been inadequately adjusted to the income structure. This creates the problem of avoiding a decline in housing construction when the relatively thin demand for high-priced housing is saturated.

In the first part of 1949 housing starts were less than a year earlier. There has been a sharp upturn since March, but even if a favorable trend continues it is certain that the output for 1949 as a whole will be far below the estimated need of well above 1 million units a year, exclusive of farm housing. From the viewpoint of investment and employment opportunities, an expanding housing program would be an important stabilizing factor in an expanding economy. The problem is primarily one of housing costs in relation to the income structure.

There is evidence that economies are now being made through declines in cost of materials and narrowing of margins of contractors and subcontractors, and that the efficiency of the new labor force trained since the war has increased. Partly in consequence of this, the houses started this

CHART 12




summer should sell for considerably less than the houses started last summer. Price adjustments this year fall far short of an adequate alignment of housing costs to housing needs and to the incomes of purchasers. The housing problem is still outstanding, and its solution will require redoubled efforts.

*International transactions*

In the final quarter of 1948, the surplus of exports over imports of goods and services had increased for the first time since the inception of the European Recovery Program, reversing more than a year of continuous decline. In the first half of 1949, the total export surplus continued to increase, as is shown in chart 13 and in table 4. From an annual rate of 6.1 billion dollars in the last quarter of 1948, it rose to an estimated annual rate of 7.3 billion dollars in the second quarter of 1949, providing a moderate offset to the domestic forces making for sagging production and employment. (The relation of the export surplus to the net foreign investment component of the Nation's Economic Budget is explained in appendix A.)

TABLE 4.—*United States exports and imports of goods and services*

[Billions of dollars]

| Period | Exports of goods and services [1] | Imports of goods and services [1] | Surplus of exports of goods and services [1] |
|---|---|---|---|
| 1936–38 average | 4.1 | 3.6 | .5 |
| 1946 | 15.0 | 7.2 | 7.8 |
| 1947 | 19.8 | 8.5 | 11.3 |
| 1948 | 16.8 | 10.5 | 6.3 |
| Annual rates: | | | |
| 1948: | | | |
| First quarter | 17.7 | 10.1 | 7.6 |
| Second quarter | 16.9 | 10.1 | 6.8 |
| Third quarter | 15.8 | 11.0 | 4.8 |
| Fourth quarter | 16.8 | 10.7 | 6.1 |
| 1949: | | | |
| First quarter | 16.5 | 10.2 | 6.3 |
| Second quarter [2] | 17.1 | 9.8 | 7.3 |

[1] Includes income on investments.
[2] Estimates based on incomplete data.

Source: Department of Commerce.

The increase in the first part of this year took the form of an expansion in the surplus of exports of goods rather than of services, resulting both from increased exports and reduced imports. The increase of merchandise exports resulted almost entirely from increased shipments to Asia, chiefly to Japan, and to western Europe, the areas receiving increased government aid. In 1948 the European Recovery Program had tended to support rather than increase our shipments to the participating countries. In the first quarter of 1949, exports to participating countries for the first time approached the level that had existed prior to the establishment of the program. Total exports of goods in the first 4 months were almost as high as in the corresponding period of 1948, with agricultural exports 17 percent higher in value and nonagricultural exports about 7 percent lower. (Additional information concerning merchandise exports is provided in appendix tables D–35, D–36, and D–37.)

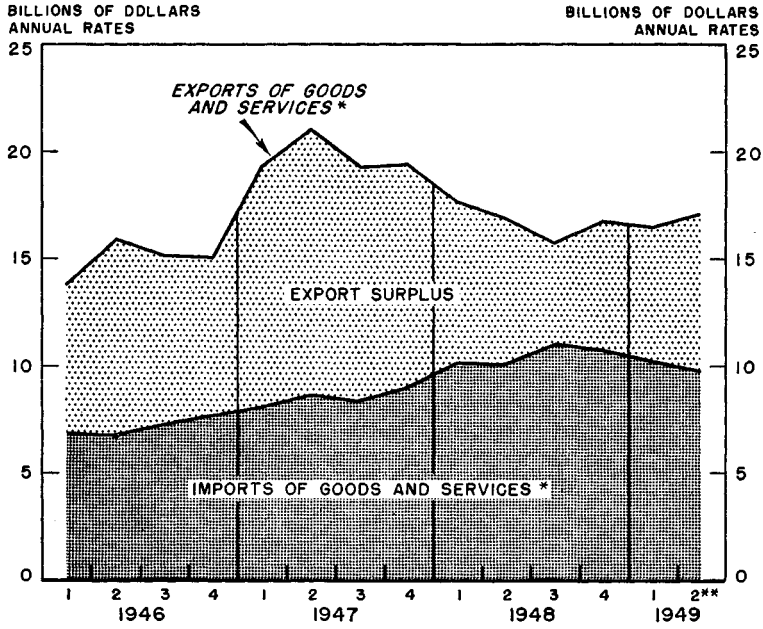
As inflationary pressures have eased, government export controls have been adapted to the changing situation. Until the latter part of 1948, the major emphasis in the administration of export controls was the protection of the supply needs of the domestic economy. At the beginning of 1949 there were still 422 commodities on the list of items under export quotas. Easing of the supply situation has made possible the removal of license control on exports of many goods and also the removal and liberalization of quotas on exports of many others that remained under license. Despite the imposition of license control on some additional items for security reasons, the total number of commodities under license was reduced to 326 by the end of June.

The dollar value of merchandise imports in the first half of the year fell almost 10 percent below that of the rate prevailing in the last quarter of 1948, apparently reflecting mainly the movement of domestic business ac-

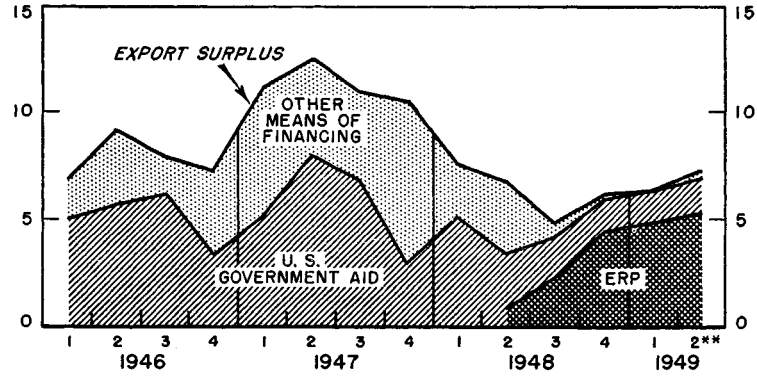
CHART 13

# EXPORTS AND IMPORTS
## OF GOODS AND SERVICES

**The export surplus continued to rise in the first half of 1949, primarily because of declining imports.**




**Practically all of the export surplus was financed by ERP or other Government aid.**




* INCLUDES INCOME ON INVESTMENTS.
** ESTIMATE BASED ON INCOMPLETE DATA.
SOURCE: DEPARTMENT OF COMMERCE.

tivity. The physical quantity of imports, after having moved upward irregularly but definitely for more than a year, declined, although foreign ability to supply exports continued to increase. In physical terms, the level of imports in the first 4 months of 1949 was only 20 percent above prewar levels, although the increase in domestic production and purchasing power above prewar was vastly greater and United States tariffs were lower. This level of imports is considerably lower than interwar relations between imports and domestic production would lead one to expect, the difference being concentrated in Europe and Asia. (Additional information relating to merchandise imports is shown in appendix tables D–38, D–39, and D–40.)

Until recently it was possible to regard the relatively low quantity of imports as a temporary result of the war-caused reduction in foreign capacity to export, which left the United States demand for foreign goods unsatisfied. If this were still the cause, a fall in domestic business activity might not reduce imports correspondingly. The decline of imports in the first half of this year, however, indicates that the United States market demand for foreign goods was being substantially met at the going prices and exchange rates. This situation suggests that a continuation of recent declines in domestic demand and production would, with present relations between foreign and American prices and present exchange rates, result quite promptly in a further decline in the dollar value of our imports.

Under prevailing conditions of depleted dollar reserves there is a close relation between our foreign purchases and sales. A reduction in the dollars available to foreign countries, therefore, would tend to reduce domestic economic activity unless it were offset by changes in the amount of our foreign aid.

Foreign aid is not as great as it had been during the spring of 1947, when it reached a rate of 8 billion dollars a year and accounted for nearly two-thirds of the total export surplus of goods and services. But, as table 5 shows, payments made under it are now almost equal to the total export surplus. (More detailed information relating to the balance of international payments and foreign aid is shown in appendix tables D–33 and D–34.)

Payments under the European Recovery Program are probably about at their peak. The effects of the program upon the domestic economy are felt before payments are made, however. Taking into account the probable course of procurement to be authorized under the European Recovery Program, it appears likely that the most intense effect of existing foreign aid programs upon the domestic economy has already been felt. Proposed military aid under the North Atlantic Pact is not expected to have any significant economic impact during 1949.

Government aid and United States imports of goods and services have recently been virtually the entire source of dollars that foreign countries have employed currently for purchasing American goods and services. With foreign aid about at its peak and with imports showing a tendency to slacken,

no further impetus to domestic employment, production, and purchasing power appears likely to come from exports during the rest of this year.

TABLE 5.—*Financing the surplus of goods and services supplied to foreign countries*

[Billions of dollars]

| Period | Surplus of exports of goods and services [1] | Means of financing | | |
|---|---|---|---|---|
| | | Government aid (net) [2] | Liquidation of foreign gold and dollar assets (net) [3] | Other means of financing (net) [4] |
| 1936–38 average | .5 | ---------- | .8 | −.3 |
| 1946 | 7.8 | 5.1 | 2.0 | .7 |
| 1947 | 11.3 | 5.7 | 4.5 | 1.1 |
| 1948 | 6.3 | 4.7 | .9 | .8 |
| Annual rates: | | | | |
| 1948: | | | | |
| First quarter | 7.6 | 5.1 | 1.4 | 1.1 |
| Second quarter | 6.8 | 3.4 | 2.2 | 1.2 |
| Third quarter | 4.8 | 4.1 | .6 | .1 |
| Fourth quarter | 6.1 | 6.0 | −.8 | .9 |
| 1949: | | | | |
| First quarter | 6.3 | 6.3 | −.1 | .1 |
| Second quarter [5] | 7.3 | 7.0 | .4 | −.1 |

[1] Includes income on investments.
[2] Includes grants and loans, but excludes subscriptions to the International Bank and the International Monetary Fund. For detail, see appendix table D–34.
[3] Includes net sales of gold to the United States and net liquidation of foreign dollar assets, including long-term investments. Excludes liquidation of assets held by the International Bank and the International Monetary Fund.
[4] Includes movement of United States private capital, gifts, net dollar disbursements by the International Bank and the International Monetary Fund, and allowance for errors and omissions.
[5] Estimates based on incomplete data.

Source: Department of Commerce.

*Government transactions*

In the main, trends in the receipts and expenditure programs of the Federal, State, and local governments during the first 6 months of this year have conformed to the picture set forth in the Council's review in January 1949. In some cases, however, these trends have been sharper than anticipated.

As has been customary in previous reports, all figures in this section are on the so-called consolidated cash basis, rather than on the conventional budget basis. They reflect the volume of current cash transactions between government and the public, and hence are useful in judging the immediate economic impacts of government programs. (A detailed description of the concepts used is given in "The Budget of the United States, 1950," p. 1375.)

*Cash payments by the Federal Government.* Table 6 shows the volume of Federal cash payments to the public, classified according to function, for 1948 and the first half of 1949. In terms of seasonally adjusted annual rates, the total volume of payments increased by 5.6 billion dollars, or 15 percent, over 1948 during the first 6 months of this year.

TABLE 6.—*Federal cash payments to the public, by function*

[Billions of dollars, annual rates, seasonally adjusted]

| Function | 1948 | | 1949, January June [1] |
|---|---|---|---|
| | January-June | July-December | |
| National defense | 11.1 | 11.2 | 12.7 |
| International affairs and finance | 5.2 | 6.1 | 7.3 |
| Veterans' services and benefits | 7.0 | 6.9 | 7.4 |
| Social welfare, health, and security | 2.2 | 2.5 | 2.6 |
| Agriculture and agricultural resources | .4 | 2.3 | 2.9 |
| Interest on the public debt | 3.9 | 3.8 | 4.0 |
| Other | 5.3 | 6.6 | 6.1 |
| Deduction from Federal employees salaries for retirement | −.2 | −.3 | −.3 |
| Clearing account for outstanding checks and telegraphic reports | +.2 | −.5 | −.2 |
| Total payments to the public | 35.1 | 38.7 | 42.5 |

[1] Estimates based on incomplete data.

NOTE.—Detail will not necessarily add to totals because of rounding.

Sources: See appendix A.

Three major areas of increase were already clear by the second half of 1948, namely, purchases for defense, international affairs and finance, and Federal construction programs for resource conservation and development, highways, and other purposes. In addition, the continuing decline in farm prices had led to an increase in net outlays for price support operations; and there had been a significant increase in payments from unemployment insurance trust funds and in veterans' benefit payments. Payment of National Service Life Insurance dividends is likely to start around the beginning of next year.

It was feared at the start of the year that certain of these expanding programs, especially in the defense and construction fields, might aggravate supply shortages and upward price trends which were then evident. These difficulties have not developed, and it is clear that Federal programs have provided substantial support to an otherwise weakening market situation. The increases in net outlays for farm price supports, and in unemployment compensation payments were, of course, an automatic response to farm price declines and rising unemployment. They have partially offset the loss in farm and consumer incomes that would otherwise have taken place.

*Cash payments by State and local governments.* As nearly as can be determined from incomplete information, payments by State and local governments still are following the upward trend which was described in the Council's review in January 1949. Total payments for the first 6 months of this year are estimated to have run at an annual rate of about 16.5 billion dollars or about 10 percent above the total for the year 1948, and about 6 percent above the second half of 1948.

As has been true since the end of the war, public construction continues to be the most sharply rising component in the activities of State and local

governments. State-local construction in 1948 was 46 percent above the 1947 level, and for the first half of this year it was 42 percent above the same period of 1948. (See appendix table D–14.) While some progress is thus being made in providing for schools, hospitals, streets and highways and other community facilities, the requirements yet to be met are still very large. In terms of physical volume, construction activity of State and local governments is still well below its 1930 level. The disappearance of inflationary pressures has been accompanied by an appreciable drop in construction costs. State and local governments should make sure that their planning is sufficiently advanced to allow them to take full advantage of this situation.

Staffs are still being expanded and salaries increased in line with postwar developments. The total number of employees of State and local governments was 3,994,000 in January 1949, as compared with 3,859,000 a year before—an increase of 3½ percent. An additional but temporary influence which has reenforced the upward trend of government cash payments has been the granting of veterans' bonuses by a number of States.

*Federal cash receipts from the public: the cash deficit.* Federal cash receipts from the public for the first half of 1949, on a seasonally adjusted annual rate basis, were about 41.6 billion dollars, only slightly below the level of the last 6 months of 1948, although about 5.8 billion dollars below the first part of 1948 and 3.4 billion below the total for 1948 as a whole. This reflects not only the fact that the drop in business activity during the first 6 months of this year was moderate, but also the fact that receipts from a number of taxes during these 6 months reflected the activity levels of the preceding year. Recent declines in corporate profits, for example, will not be fully reflected in Federal cash receipts until the first half of 1950.

The increase in expenditures and decline in receipts resulted in a cash deficit of about 1 billion dollars (annual rate, seasonally adjusted basis) for the first half of this year as compared with a cash surplus of about 3.9 billion for the last half of 1948, and of 8.1 billion for 1948 as a whole. Under existing legislation, the continued upward trend in payments will result in a larger deficit for the year 1949, even with the maintenance of fairly high levels of business activity.

*State and local cash receipts.* On the basis of incomplete information, it is estimated that the cash receipts of State and local governments during the first half of 1949 were equivalent to an annual rate of about 15.1 billion dollars, or about 4 percent above the receipts of 14.5 billion for the year 1948. If business activity remains fairly high, the new taxes and increased rates which have been enacted since the war—including a number of new municipal nonproperty taxes recently permitted by State enabling legislation—may be expected to produce a continued upward trend in receipts. The increasing reliance of State and local governments on sales and income

taxes, as compared with the relatively inflexible property tax, however, will tend to mean a greater responsiveness in State and local tax revenues to changes in general business conditions.

The estimates of the annual rates of cash payments and receipts for the first half of 1949 indicate a cash deficit of about 1.4 billion dollars, as compared with the figure of nearly 600 million for the year 1948. The considerable increase in borrowing which has been required to meet large capital outlays and veterans' bonuses has brought the gross debt of State and local governments close to its all-time peak in 1940. Despite this increase in debt, however, their fiscal position is considerably stronger than in the prewar period or in 1929. The total of State and local gross debt in 1948 was about 1.4 times tax collections (excluding unemployment compensation taxes), whereas the ratio for both 1939 and 1929 was about 2.6. State and local governments are therefore in a better position to borrow in order to maintain needed programs.

Table 7 summarizes the aggregate cash transactions of all levels of government—Federal, State, and local combined. Aggregate cash payments during the first half of 1949 are estimated to have been equivalent to a seasonally adjusted annual rate of about 59.0 billion dollars, or more than 13 percent above the 1948 level of 52.0 billion. The annual rate of cash receipts by all levels of government during this period is estimated at 56.7 billion dollars, or about 5 percent below the 1948 level. On the basis of seasonally adjusted annual rates, this is equivalent to a deficit in aggregate government transactions of about 2.4 billion dollars, as compared with a surplus of about 7.5 billion dollars for 1948 as a whole, and of about 3.0

TABLE 7.—*Government cash receipts from and payments to the public*

[Billions of dollars, annual rates, seasonally adjusted]

| Receipt or payment | 1948 | | 1949, January–June [1] |
|---|---|---|---|
| | January–June | July–December | |
| Cash receipts: | | | |
| Federal | 47.4 | 42.6 | 41.6 |
| State and local | 14.3 | 14.7 | 15.1 |
| Total cash receipts | 61.7 | 57.3 | 56.7 |
| Cash payments: | | | |
| Federal | 35.1 | 38.7 | 42.5 |
| State and local | 14.5 | 15.6 | 16.5 |
| Total cash payments | 49.6 | 54.3 | 59.0 |
| Surplus (+) or deficit (−): | | | |
| Federal | +12.3 | +3.9 | −1.0 |
| State and local | −.2 | −.9 | −1.4 |
| Total surplus (+) or deficit (−) | +12.1 | +3.0 | −2.4 |

[1] Estimates based on incomplete data.

NOTE.—Detail will not necessarily add to totals because of rounding.

Source: See appendix A.

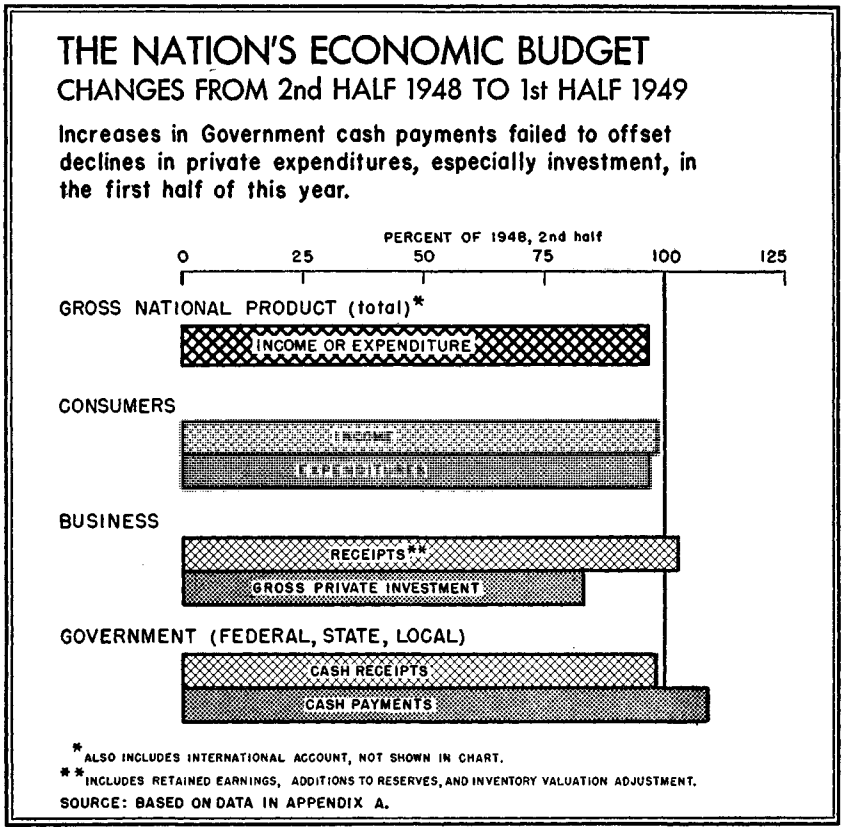
billion for the second half of 1948. The prospect is that this deficit will increase substantially in the second half of this year, even if business activity continues at high levels.

*Summary: The Nation's Economic Budget*

For the first time since the immediate postwar readjustment period, the Nation's Economic Budget reflects a decline in business activity extending over 6 months or more. As shown in the accompanying table, the Budget total, or gross national product, declined about 9 billion dollars (seasonally adjusted annual rate) from the second half of 1948 to the first half of 1949. This is a decline of about 3½ percent in current dollars, or about 1½ percent after allowing for declining prices. (See chart 14.) The percentage drop from the fourth quarter of last year to the second quarter of this year was about 6 percent in terms of current prices.

The most conspicuous facts reflected in the Nation's Economic Budget are that business investment shows a sharp reduction from the second half of 1948 to the first half of 1949 while consumer income and expenditures dropped only moderately. The decline in business investment represents

**CHART 14**



largely a reversal in the trend of inventory accumulation, which in turn largely accounts for the present decline in economic activity. This inventory adjustment has resulted from a basic discrepancy between the trend of increasing production and relatively stable consumer demand over the last few years. With the progressive fulfillment of extraordinary backlog demands over the past 6 to 12 months a slack developed first in the demand at prevailing prices for certain luxury items and subsequently for one category after another of consumers' and producers' goods. With production increasing more than consumption, inventories were built up steadily. As consumers failed to absorb promptly the growing flow of goods,

TABLE 8.—*The Nation's economic budget*

[Billions of dollars, annual rates, seasonally adjusted]

| Economic group | 1948, second half | | | 1949, first half [1] | | |
|---|---|---|---|---|---|---|
| | Receipts | Expenditures | Excess or deficit | Receipts | Expenditures | Excess or deficit |
| CONSUMERS | | | | | | |
| Disposable income relating to current production | 183.1 | | | 179.6 | | |
| *Transfers and interest* | *14.7* | | | *15.8* | | |
| *Disposable personal income* | *197.8* | | | *195.4* | | |
| Expenditures for goods and services | | 180.6 | | | 175.8 | |
| *Personal saving (+)* | | | *+17.2* | | | *+19.6* |
| BUSINESS | | | | | | |
| Retained business receipts [2] | 25.5 | | | 26.2 | | |
| Gross private domestic investment | | 42.8 | | | 35.7 | |
| *Excess of investment (−)* | | | *−17.3* | | | *−9.5* |
| INTERNATIONAL | | | | | | |
| *Net cash Government loan transfers abroad* | *.9* | | | *1.1* | | |
| Net foreign investment | | .5 | | | .6 | |
| *Excess of receipts (+) or investment (−)* | | | *+.4* | | | *+.5* |
| GOVERNMENT (FEDERAL, STATE, AND LOCAL) | | | | | | |
| Tax payments or liabilities | 58.9 | | | 54.5 | | |
| *Adjustment to cash basis* | *−1.6* | | | *2.2* | | |
| *Cash receipts from the public* | *57.3* | | | *56.7* | | |
| Purchases of goods and services | | 38.8 | | | 41.8 | |
| *Government transfers* | | *15.5* | | | *17.2* | |
| *Cash payments to the public* | | *54.3* | | | *59.0* | |
| *Excess of receipts (+) or payments (−)* | | | *+3.0* | | | *−2.4* |
| ADJUSTMENTS | | | | | | |
| For receipts relating to gross national product | −4.6 | | −4.6 | −6.5 | | −6.5 |
| *Other adjustments* | *+1.3* | | *+1.3* | *−1.7* | | *−1.7* |
| Total: Gross national product | 262.7 | 262.7 | 0 | 253.9 | 253.9 | 0 |

[1] Estimates based on incomplete data.
[2] Includes adjustment for inventory valuation. See appendix table A–3.

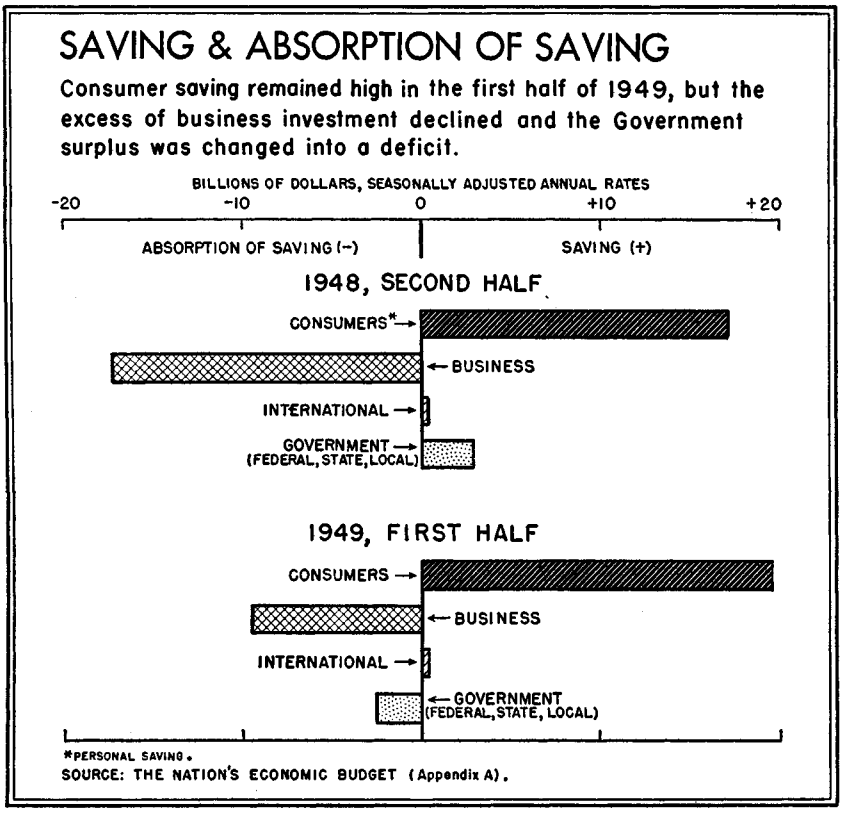
NOTE.—Items relating to current production of goods and services are shown in roman type. Transfer payments and receipts and subtotals including them are in italics; these items are not included in the gross national product.
Details will not necessarily add to totals because of rounding.

Source: See appendix A.

swelling inventories induced business to cut down its orders and to stop and recently to reverse inventory accumulation.

The sharp cut in industrial production and the inventory decline had only a moderate effect on consumer income and expenditures for the first half of 1949 as a whole. A noticeable decline started, however, in the second quarter. The relatively high level of the first half of the year has been due to the fact that, while employment in manufacturing and mining industries was curtailed, employment in most other activities was maintained or increased (after allowance for seasonal variation). Thus productive activity, employment, and personal incomes derived from productive employment decreased much less in the aggregate than in manufacturing industries alone. As a strengthening factor, there was a rise in expenditures by Federal, State, and local governments, as indicated in the Nation's Economic Budget table. Some of these additional government expenditures are reflected directly in an increase in transfer incomes derived from rising unemployment compensation and veterans' allowances, in part offsetting the decline in incomes derived from current production. For the first half

CHART 15



of the year, government ran a deficit, as compared with a surplus in the preceding period. (See chart 15.)

Some conditions are now favorable for a reversal of the downward trend in industrial production and employment. Inventories in several lines of business already have been brought into a better relationship with sales, there are indications that prices are being brought into a better relationship with disposable incomes, and it is probable that orders have in many cases been cut below the level justified by current markets. The expected further rise in government expenditures will continue to give support to demand.

There are other factors, however, which could produce a further weakening. For example, present surveys indicate that business expenditures and investments in plant and equipment in the third and fourth quarter of 1949 may run increasingly below the levels attained in 1948. Thus, if counteracting forces are not marshalled, it is at least possible that the inventory and price adjustment may develop into an investment recession later this year or next year.

Despite the significance of investment, it should be stressed that the downturn commenced with a failure of consumer markets to expand in line with total output. The maintenance and stimulation of consumer expenditures are essential both for maintaining total expenditure commensurate with our increasing productive capacity under maximum employment, and for providing a substantial basis for a sustainable high level of investment itself.