The Annual Economic Review

January 1950

A Report to the President

By the

COUNCIL OF ECONOMIC ADVISERS

LETTER OF TRANSMITTAL

Council of Economic Advisers,
Washington, D. C., January 3, 1950.

The President:

Sir: The Council of Economic Advisers herewith submits a report, the Annual Economic Review: January 1950, in accordance with section 4 (c) (2) of the Employment Act of 1946.

Respectfully,

Leon H Keyserling

Acting Chairman.

John D. Clark

Contents

I. Economic Developments in 1949

The Course of Employment and Production

Employment

EMPLOYMENT levels for 1949 as a whole did not meet the maximum employment goal set forth at the beginning of the year, which called for an average employment about 1 million above that in 1948 to absorb a growing labor force. Average civilian employment in 1948 was 59.4 million, and in 1949 it was 58.7 million, a drop of 700 thousand, instead of the needed increase of 1 million. However, the fairly steady drop in total civilian employment which began late in 1948 and continued through February 1949 was checked in March, due primarily to a seasonal increase in agriculture. The low point in nonagricultural employment was reached in May. Since then the trend in nonagricultural employment has been upward, except for the period affected by the steel and coal stoppages. By the end of the year, total civilian employment stood at 58.6 million, or about 850 thousand below December 1948. (See chart 2.)

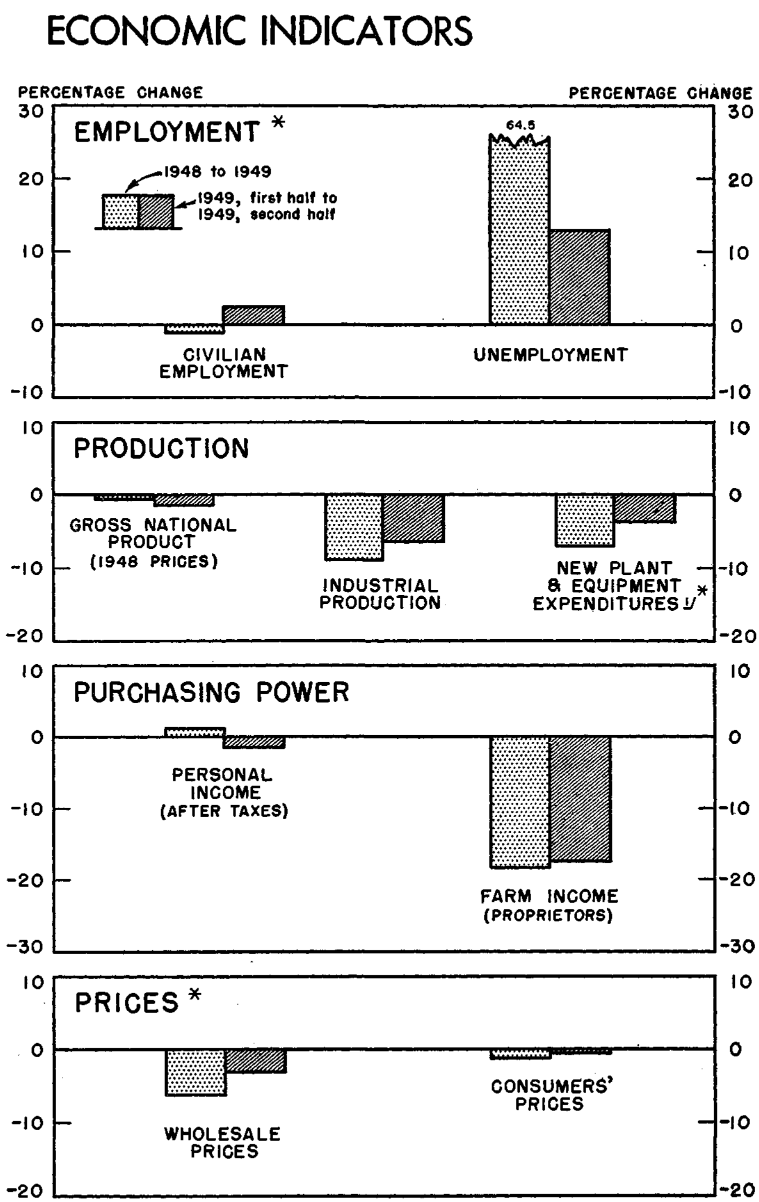
Manufacturing employment fell from an average of 15.3 million in 1948 to an average of 14.2 million in 1949. The decline from the September 1948 peak was steady until midsummer, when it was halted and reversed. The drop during the first half of the year was most notable in durable lines, although textiles also dropped significantly. Certain manufacturing segments, such as automobiles, aircraft, printing, and apparel, remained at high employment levels throughout 1949. Employment also continued at high levels in construction, trade, finance, and services. Government employment increased, largely in State and local government. There were significant decreases in mining and railroad transportation.

Particularly noteworthy during the latter half of 1949 was the improving employment situation in industries manufacturing nondurable goods. By the year's end, total nonagricultural employment was 2.1 million higher than in May.

Employment in agriculture averaged slightly higher in 1949 than in 1948, but in December 1949 the number of farm workers was about 600 thousand less than in December 1948.

The number of employed persons tells only part of the employment story, since the number of hours worked is also important. For all employed nonagricultural workers, the hours worked averaged about half an hour a

CHART 1



1/ NONAGRICULTURAL BUSINESSES.
* DATA FOR FIRST AND SECOND HALF 1949 NOT ADJUSTED FOR SEASONAL VARIATION.
SOURCE: APPENDIX C

week less in 1949 than in 1948. Relating the total number of persons employed to the average weekly hours of work indicates that total man-hours on the job in 1949 were some 2 percent lower than in 1948.

Part of this decline in working time was a result of the sizable increase in involuntary part-time work caused by the decline in production. In September 1948, less than 1.4 million workers were working part time because of work slack, inability to obtain full-time work, and job turn-over. The number had risen to nearly 2.5 million by May 1949, increased slightly during the summer, but probably declined somewhat in the fall and early winter.

As manufacturing activity declined, the number of jobless rose from a low of 1.6 million in October 1948 to 4.1 million at the high in July 1949. There was an average of 3.5 million persons unemployed during the fourth quarter of 1949, compared with 1.8 million during the last quarter of 1948. Virtually every important manufacturing area in the country experienced some increased unemployment in 1949; New England, with its heavy concentration of textile, leather, and machinery factories, was the most severely affected. In Rhode Island, as many as 20 percent of the workers covered by the State unemployment insurance laws were drawing benefits at midyear. In other States in this region, the ratio of insured unemployment at its peak ranged between 10 and 12 percent. Other States which had a relatively high incidence of unemployment were New York, New Jersey, Maryland, the Carolinas, Kentucky, Tennessee, Alabama, Illinois, and California.

Unemployment represented 12 percent or more of the labor force in 12 major labor market areas out of the 100 reporting in December 1949. In addition, there were numerous smaller areas where unemployment was relatively as serious. These areas included textile and leather centers in New England, coal and copper mining areas in Pennsylvania, Illinois, Indiana, Michigan, and Alabama, and metal-working centers in New England and Michigan. Because of the nature of the industries affected, unemployment rose somewhat more sharply among men than among women. In the fall of 1948, 27 out of every thousand men in the labor force were unemployed, contrasted with 33 out of every thousand women. In the fall of 1949, the ratios were 54 per thousand men and 58 per thousand women.

For the whole of 1949 there was an average of 3.4 million persons unemployed or over 5 percent of the labor force, compared with an average in 1948 of 2.1 million or over 3 percent of the labor force. Since July, after allowing for the adverse effects of the strikes, there has been a more-than-seasonal decline in unemployment. During the latter part of the year unemployment receded in virtually all major labor market areas. In December 1949 there were just under 3.5 million persons unemployed, compared with 4.1 million in July.

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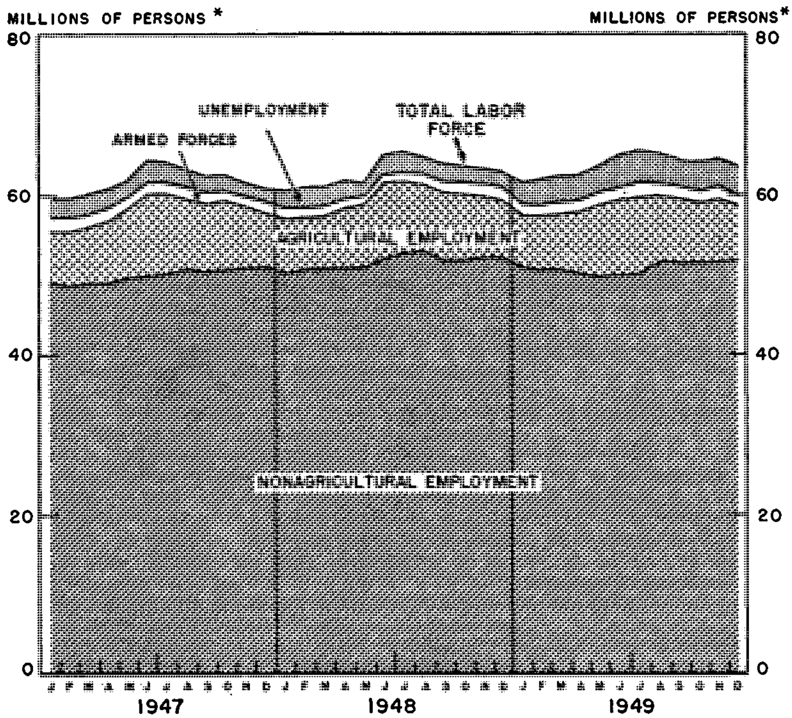
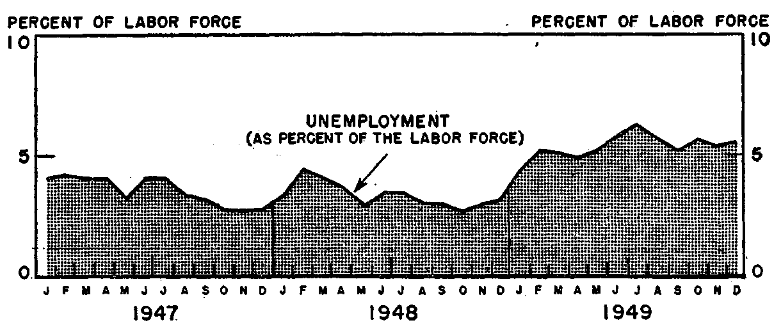
CHART 2

LABOR FORCE

The labor force increased by about 800,000 from 1948 to 1949 and civilian employment dropped about 700,000.



Unemployment throughout 1949 was much higher than in 1948.



*14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF COMMERCE.

There has been a rapid rise during the year in the number of unemployed workers exhausting their rights to unemployment benefits. During the third quarter of 1949 more than 500 thousand persons exhausted their rights to further benefits before finding employment, while in the comparable quarter of 1948 this was true of only about 225 thousand persons. In a considerable number of the major labor market areas as many as 60 to 70 percent of the unemployed are not now eligible for unemployment compensation, compared with about 35 percent nationally. (Statistics on employment are shown in appendix tables C–9 and C–10.)

Production

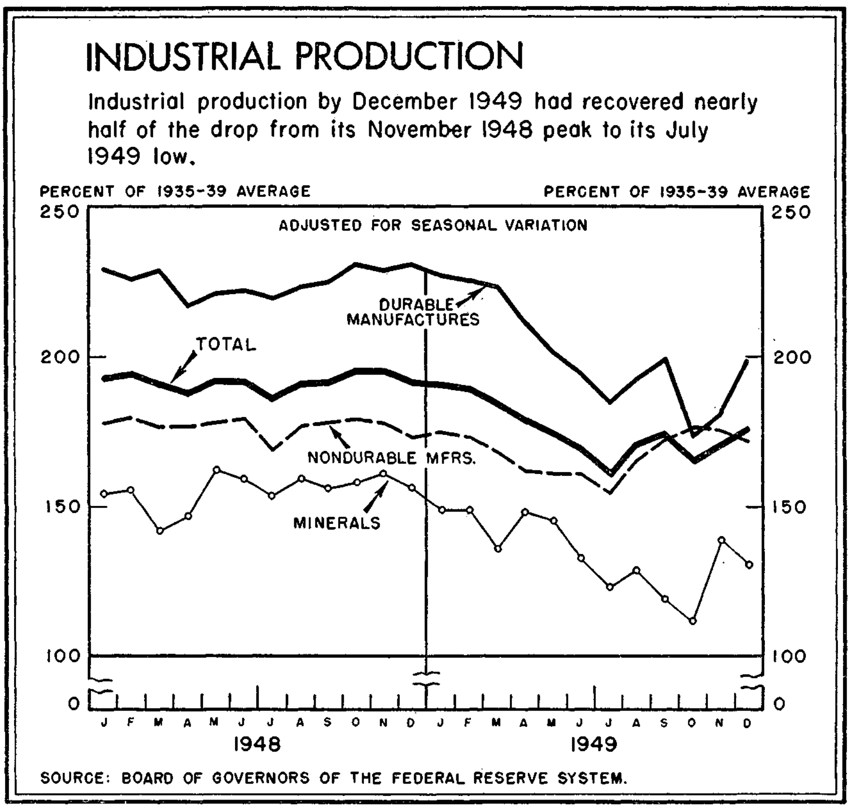
In January 1949, an increase in the total production of goods and services of 3 to 4 percent, or 8 to 10 billion dollars measured in 1948 prices, was set as a reasonable objective for the year. This production goal was not accomplished. The dollar value of all goods and services produced (the gross national product) was estimated at 262.4 billion dollars in 1948 and at 258.7 billion in 1949, a drop of about 1.5 percent. This drop in dollar value was due in part to lower prices and in part to a drop in real output. The gross national product estimates, together with statistics on the physical output of goods, indicate that the total production of goods and services dropped about 1 percent from 1948 to 1949. Thus we fell 4 to 5 percent below the goal set at the beginning of the year, a deficiency of 10 to 13 billion dollars. Moreover, since output in the second half of 1949 was less than in the first half, the deficiency widened during the year. (See appendix table C–1.)

The physical goods component of total output in 1949 was about 5 percent below the level of 1948. (See appendix table C–14.) Industrial production dropped 8.8 percent, and agricultural output fell 1.4 percent. Construction increased 4.6 percent and the output of electricity and gas rose 1.6 percent. The Department of Commerce estimates of changes in personal consumption expenditures from 1948 to 1949 suggest that there was some increase in the output of service industries. Evidently the drop in output of goods in 1949 was almost offset by an increase in services.

The 1.4 percent drop in agricultural output represented a decline of about 4 percent in the production of crops and an increase of about 5 percent in the output of meat and animal products. The production of wheat and of feed grains continued at very high levels, although falling a little below 1948. Larger plantings caused cotton production to increase in spite of a drop in yield per acre. Food supplies available to the American public continue ample compared with those of most previous years.

The index of industrial production reached a peak of 195 percent of the 1935–39 average in October and November 1948, and then fell rather steadily until it reached a low of 161 in July 1949. This represented a drop of 17 percent from the peak. The greatest rate of decline was in durable goods and minerals, production of which fell 20 percent and 24

CHART 3



percent, respectively, while the output of nondurables fell only 14 percent. (See appendix table C–15.)

Since July the trend of industrial production has been reversed and a considerable recovery has occurred. After the low of 161 in July, the index of industrial production recovered substantially in August and September, dropped temporarily in October because of the coal and steel stoppages, and recovered further in the last two months of the year, reaching 176 in December. The December figure was 9 percent above the midsummer low, but still 10 percent below the peak of October and November 1948. The recovery in industrial production has been greater in the nondurable goods industries, the output of which rose 12 percent, than in the output of durable goods industries, the output of which increased only 8 percent. (See chart 3.)

Thus, in the closing months of 1949, industrial output was rising, although it was still considerably below the peak level attained in 1948. Construction and the output of gas and electricity were above 1948 levels, and agricultural output was only slightly below the 1948 record.

Prices

Price movements during 1949 paralleled the course of total economic activity. A general but moderate decline in prices during the first half of the year was followed by relative stability in the second half. The abatement of the postwar inflationary boom did not bring with it an accelerating decline in prices.

Wholesale prices. Wholesale prices by the end of 1949 had declined 6.9 percent from their level of a year earlier and were 11.0 percent below their August 1948 postwar peak. The largest drops were in wholesale farm and food prices, while industrial prices fell least. (See chart 4 and table 1.) The bulk of the drop was during the first half of the year. During the second half, the slight further drop was accounted for mainly by wholesale farm and food prices while industrial prices levelled off.

Wholesale prices of farm products and prices received by farmers both fell about 12 percent during 1949, and ended the year more than 20 percent below their peak of January 1948. Prices paid by farmers decreased only about 3 percent during the year, and the ratio of prices received to prices paid fell to 98 percent of parity in December, compared with 108 a year before. This was the first time since 1941 that the parity ratio had stood below 100. (See appendix table C–23.)

Downward pressure on farm prices was exerted by the continuing high level of crop production, which brought some surpluses. The decline continued in the second half of the year, when marketings of hogs and of eggs and poultry increased markedly. The demand for the better grades of beef cattle continued strong, and while the drop in hog prices was sharp, marketing was orderly and support was not required. Grain prices were quite firm at the end of the year.

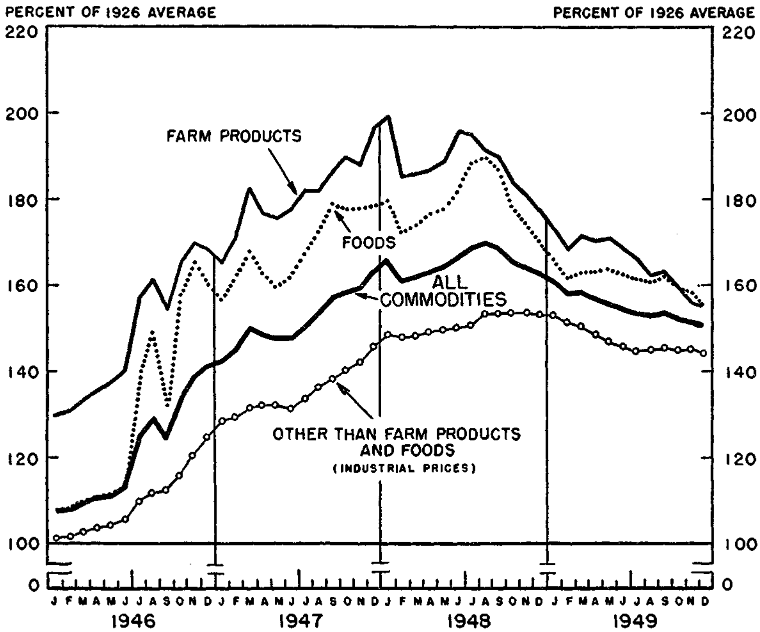
Wholesale food prices during the year declined 8.5 percent and at the end of the year were 18.0 percent below their 1948 peak level. Following a considerable decline early in the year, wholesale food prices were quite stable through the third quarter. Subsequently, under the pressure of seasonal increases in supply, food prices began to decline again. Noteworthy, however, was the strength of certain imported commodities, with coffee, cocoa, and pepper reflecting in part speculative expectations about the future size of the crops.

Industrial prices declined during the first half of the year and then levelled off. During the year, industrial prices declined 5.0 percent and ended 5.3 percent below the 1948 peak level. The weakness in industrial prices during the first half year reflected the process of inventory liquidation which was a major economic development during that period. The greatest pressure was on the prices of industrial materials, because manufacturers' inventories of such materials were reduced first and

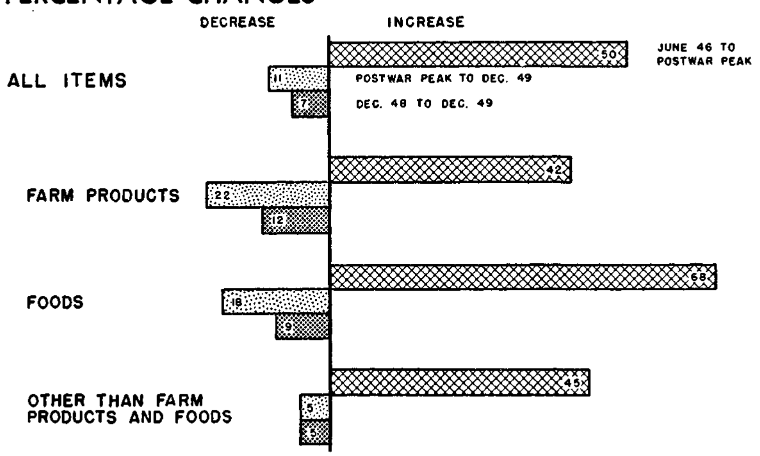
CHART 4

WHOLESALE PRICES

Industrial prices, after a moderate decline in the first 6 months, stabilized in the second half of the year. The trend of farm prices was downward. Wholesale food prices after little change for most of the period dropped in the last quarter.



PERCENTAGE CHANGES



SOURCE: DEPARTMENT OF LABOR

most sharply. (See appendix table C–19.) The downward movement embraced most categories, with notable exceptions, including the steel and automobile groups.

TABLE 1.—*Changes in wholesale prices*

Commodity group	Percentage change		
	December 1948 to June 1949	June 1949 to December 1949 [1]	December 1948 to December 1949 [1]
All commodities	−4.9	−2.1	−6.9
Farm products	−4.8	−8.1	−12.5
Foods	−4.6	−4.1	−8.5
Other than farm products and foods	−4.9	−.1	−5.0
Hides and leather products	−3.5	+.8	−2.8
Textile products	−5.1	−.6	−5.7
Fuel and lighting materials	−5.3	+.1	−5.2
Metals and metal products	−3.6	−.1	−3.7
Building materials	−5.3	−.7	−6.0
Chemicals and allied products	−10.9	−1.0	−11.8
Housefurnishing goods	−2.2	−.3	−2.5
Miscellaneous	−6.3	+.4	−6.0
Special groups:			
Raw materials	−4.5	[2]−2.5	[2]−6.9
Semimanufactured articles	−8.9	[2]−1.0	[2]−9.8
Manufactured products	−4.4	[2]−1.7	[2]−6.0

[1] Percentage changes based on preliminary estimates for December 1949, except as noted.
[2] Change from December 1948 to November 1949.

Source: Department of Labor (see appendix table C–22.)

By July the major wave of industrial price cuts was over. During the third quarter, there was a considerable firming up in the prices of many industrial materials, particularly those which had suffered the greatest decline during the first half of the year. Thus, there were increases in the prices of cotton and rayon textiles, steel scrap, the nonferrous metals, lumber, and other commodities.

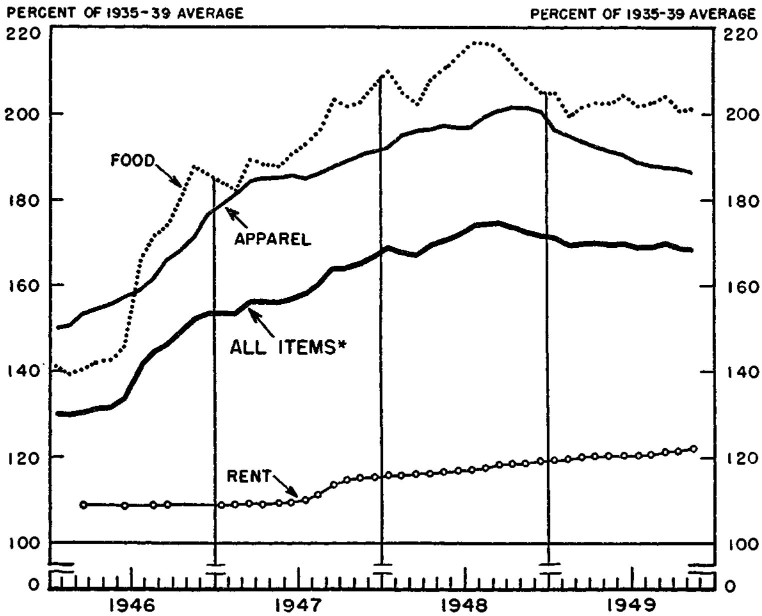
While the firmness of the industrial price level continued into the fourth quarter, there were a number of divergent trends. Copper and zinc continued strong while lead weakened again. Lead prices were under the pressure of foreign competition. Tin prices were dropping as they were freed to find their level in the open market and supplies were increasing. Lumber prices continued to reflect the high level of construction. Late in 1949 steel prices were advanced. Most finished goods prices continued stable but increases were recorded for tires and tubes, carpets, sheets, and some others. (Data on wholesale prices may be found in appendix table C–22.)

Consumers' prices. Consumers' prices were firm during most of 1949. The decline which began in October 1948 continued steadily until February 1949. From then until November consumers' prices moved within a relatively narrow range. In November the consumers' price index was 168.6, less than 2 percent below the level of 171.4 reached in December 1948, and about 3 percent below their postwar peak of 174.5. (See chart 5 and table 2.) Preliminary indications are that consumers' prices declined in December.

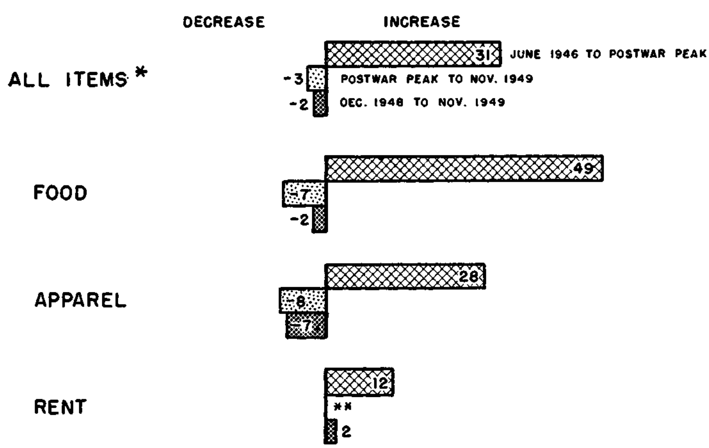
CHART 5

CONSUMERS' PRICES

For most of the year, consumers' prices fluctuated within a relatively narrow range primarily because of the movements in food prices. Apparel prices declined steadily while rents continued to rise.



PERCENTAGE CHANGES



* ALSO INCLUDES HOUSEFURNISHINGS, FUEL, ELECTRICITY, REFRIGERATION, AND MISCELLANEOUS GOODS AND SERVICES NOT SHOWN ON THIS CHART.

** NOVEMBER 1949 IS POSTWAR PEAK.

SOURCE: DEPARTMENT OF LABOR

The course of consumers' prices throughout the year was dominated by the behavior of retail food prices, which had been declining steadily since July 1948 and reached an initial low point in February 1949. From then until June, retail food prices moved up again. A minor dip occurred in July, but by September there was a return almost to the June level. In November retail food prices were 2 percent below the level of December 1948. The drop from their postwar peak was about 7 percent, less than half that in wholesale food prices.

Apparel prices declined steadily, and housefurnishings declined for most of the year. Fuel prices recovered from the midyear decline. The miscellaneous items in the consumers' price index increased during the year and rents moved continuously upward. (See appendix table C–21 for more detail on consumers' prices.)

TABLE 2.—*Changes in consumers' prices*

Commodity group	Percentage change		
	December 1948 to June 1949	June 1949 to November 1949	December 1948 to November 1949
All items	−1.1	−.6	−1.6
Food	−.3	−1.7	−2.0
Apparel	−5.0	−2.1	−7.0
Rent	+.9	+1.2	+2.1
Fuel, electricity, and refrigeration	−1.6	+2.6	+.9
Housefurnishings	−5.7	−1.0	−6.6
Miscellaneous	+.1	+.5	+.6

Source: Department of Labor (see appendix table C–21).

Wages and related matters

Wages. In the face of some decline in the cost of living and a slackening in employment, demand, and profits in many industries, the pressure for wage increases, which had been general during the first three postwar years, became less urgent and more selective in 1949. A substantial number of organized workers obtained wage increases, but the increases were far fewer and somewhat smaller in amount than in previous years. With the labor market easing off, and with the union drive for higher wage rates slackening, nonunion and clerical workers in private industry apparently also received smaller increases than in previous years.

It is estimated that general wage rate increases negotiated in 1949 affected about one-third of the 15 million organized workers, while in 1948 a large majority of them received wage increases. The number of nonunion workers receiving wage increases in 1949 is not known, but it doubtless was well below previous postwar years. There was no general wage pattern in 1949. In fact, the industries where wage increases were common in 1949 were not pattern setters, and in many instances had not been pattern followers in former years. Federal legislation raised the salaries of some 3 million United States Government workers, including those in the armed services.

For the first time in the past decade, some organized workers were called upon to accept wage cuts. In the main, however, the wage decreases for unionized workers resulted from agreements tying wage rates to small changes in the consumers' price index. There were a few instances of union locals agreeing to a general cut in wage rates. Wage cuts were apparently more frequent among nonunion establishments.

Salaries, wages, and other labor income increased from 135.1 billion dollars in 1948 to 136.8 billion in 1949. Average weekly earnings in manufacturing increased from $54.14 to $54.78. Since the consumers' price index went down 1.6 percent, the real income of employed wage and salary workers appears to have increased slightly more than is indicated by the change in money income. (See appendix tables C-11, C-12, and C-13 for detail on hours and earnings.)

Pensions, insurance, and other supplementary benefits. One of the outstanding developments in 1949 was the growth of pension and social insurance plans financed in whole or in part by employers. Although an estimate of the number of workers securing additional benefits in 1949 under established plans or acquiring coverage for the first time is not presently available, it appears likely that it will be substantially more than 1 million. In many instances the change in established plans amounted to a small concession to unions seeking greater gains, but in other instances the changes represented an important long-run charge upon industry. Most of the recently negotiated plans are tied to the social security program, so that the costs involved in the private plans will decline if benefits under the Government program are increased.

Other supplementary benefits appeared in most of the year's settlements. Only a minority failed to provide either a wage increase or some fringe benefit, sometimes of significant size.

Commitments to establish company-financed pension and insurance plans and the adoption of a higher Federal minimum wage to take effect in January 1950, have substantially increased potential expenditures for labor.

Work stoppages. The number of work stoppages was about the same as in 1948. The two most important were those in the coal and steel industries which affected about 800 thousand workers and accounted for half of the man-days lost through work stoppages. As a result, man-days of idleness were 50 percent higher than in 1948. By the year's end, the steel shut-down was over and steel output was above 93 percent of capacity. The issues involved in the coal stoppage were still largely unsettled although the miners had returned to work on a 3-day-week basis.

Profits

The moderate decline in economic activity and in prices which marked 1949 was accompanied, as was only to be expected, by a sharper drop in profits. As conventionally measured, corporate profits before and after taxes averaged more than 20 percent below their 1948 levels, while the gross national product dropped less than 2 percent and wholesale prices less than 7 percent.

Corporate profits before taxes (not adjusted for inventory valuation) for 1949 are estimated at 27.6 billion dollars, compared with the 1948 level of 34.8 billion.

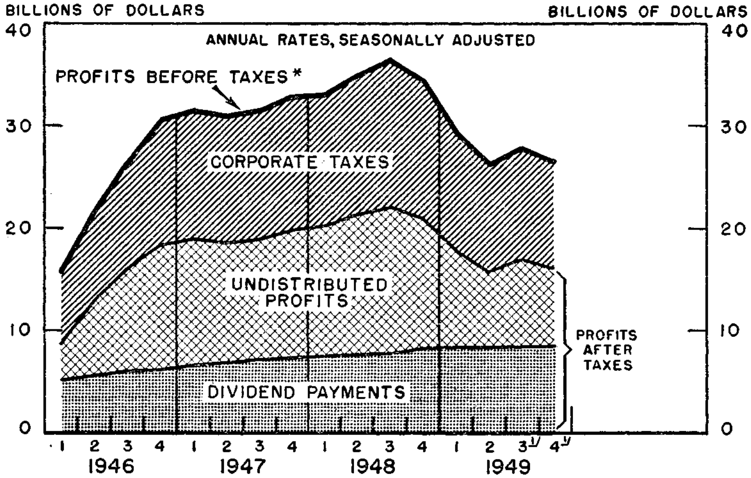
Corporate profits declined sharply during the first half of the year, and by the second quarter were at an annual rate of 26.4 billion dollars before taxes. During the third quarter, profits before taxes were at an annual rate of 28.0 billion dollars. The rebound in manufacturing activity and the peak rate of automobile output were mainly responsible for this increase. Largely because of the work stoppages, however, profits before taxes fell to an estimated annual rate of 26.5 billion in the fourth quarter. (See chart 6.)

Corporate profits after taxes in 1949 are estimated at 16.7 billion dollars, compared with 21.2 billion in 1948. The 1949 return represented over 4 percent on sales and over 8 percent on net worth, compared with about 5 percent and 11 percent, respectively, in 1948.

CHART 6

CORPORATE PROFITS

Corporate profits during the 1st half of 1949 showed a considerable decline reflecting the drop in prices and production. The trend of profits was upward in the second half of the year, interrupted by work stoppages. Dividends continued to rise.



* NO ALLOWANCE FOR INVENTORY VALUATION ADJUSTMENT.

1/ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS; BASED ON INCOMPLETE DATA.

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED)

The drop in net farm income also was substantial. Net farm income before taxes (including value of physical changes in inventories) is estimated at 15.0 billion dollars for 1949, a drop of more than 18 percent from the 1948 level of 18.4 billion. The most stable element in profits was the income of unincorporated business and the professions. For this group, net income before taxes (not adjusted for inventory valuation) is estimated at about 23.4 billion dollars, a decline of 6 percent from the 1948 level of 24.9 billion. (See appendix table C-4.)

The conventional measures of business profits during the past four years have been complicated by the changes in the price level and by the effect of these changes upon the value placed upon inventories. Prior to the last quarter of 1948 the price level was constantly rising. Since then it has been falling. When inventories are sold and replaced at higher prices, part of the profits reported by business are locked up in the higher costs of the inventory and are therefore unavailable for other purposes. In periods when inventories are replaced at lower prices, funds are released, thus increasing the availability of funds to business beyond that indicated by the current reports on profits. Thus, the conventional measure of profits leaves uncertain the availability of such profits for investment in new plant and equipment, and for the payment of dividends.

For the years 1946 to 1948, when prices were rising, the added cost of replacing inventories relative to the profits reported by corporations was as shown in table 3. During 1949, when prices fell, the costs of replacing inventories were correspondingly reduced. The reduction in cost of replacing inventories during 1949 is estimated at 2.7 billion dollars, in contrast to an increase of 2.2 billion in 1948.

TABLE 3.—*Corporate profits and costs of replacing inventories*

[Billions of dollars]

Period	Corporate profits before taxes	Corporate profits after taxes	Changes in costs of replacing inventories [1]
1946	23.6	13.9	+5.2
1947	31.6	19.1	+6.0
1948	34.8	21.2	+2.2
1949 [2]	27.6	16.7	−2.7

[1] Inventory valuation adjustment with signs reversed. See appendix table C-4.
[2] Estimates based on incomplete data; first half by Department of Commerce and second half by Council of Economic Advisers.

Sources: Department of Commerce (except as noted).

This resulted in a net shift of 4.9 billion dollars in the cost of replacing inventories, compared with 1948. Hence, although corporate profits after taxes fell 4.5 billion dollars, the funds internally available for new plant and equipment and for the payment of dividends were somewhat more in 1949 than in 1948. There was no longer need for working capital to absorb an increasing value placed on goods in inventory, a factor which had been responsible for much of the increase in bank credit required by business in earlier years. Coupled with the liquidation of inventories which marked the recession in the first half of the year, this made funds available which permitted corporate managers to reduce bank borrowings and to increase dividends, while maintaining new investment in plant and equipment at a high level. (Detailed statistics on profits may be found in appendix tables C–4, and C–29 to C–34.)

Money and Credit

The four important features in the field of money and credit in 1949 were the relaxation of credit restrictions, the usual heavy draft upon the supply of money incident to the payment of Federal taxes in the first quarter of the year, the resumption of private credit expansion during the latter part of the year, and the beginning of a period of deficit financing and public debt enlargement.

The decline in business loans during the first half of the year did not reflect any real credit tightness. Most business firms were comfortable in their financial situation. The volume of business, even while the recessionary movement was under way, was sufficiently large and profitable for business loans to be paid off when declining inventories released a part of the working capital invested therein. In the first 7 months of the year, business loans of the leading city banks declined 17 percent reaching 12.9 billion dollars at the end of July.

Before the end of the third quarter, the downward trend of business loans was reversed. Expanding business activity again created a demand for working capital, and the movement continued to the end of the year, when the business loans of leading city banks were 13.9 billion dollars, compared with 15.6 billion a year earlier. The business loans and other loans of country banks were never affected in the same degree. Total loans of all commercial banks in the United States continued at a higher level in every month in 1949 than in the corresponding month of 1948. However, the course was very different in the two years. In 1948, bank loans were rising steadily throughout the year, reaching the postwar peak in December. In 1949, there was a slight decline in bank loans until July. There then began an expansion which gained a higher level in each succeeding month.

In the first quarter of the year, automobile instalment credit increased moderately while other kinds of instalment credit declined markedly. Regulations affecting instalment credit terms were then relaxed and the volume of instalment credit resumed its advance at about the previous postwar rate. In the third quarter, with the expiration of controls, the growth of instalment credit was accelerated. By the end of the year automobile instalment credit outstanding had increased over 60 percent from the end of 1948.

The Federal Reserve System contributed to the general easing of credit terms during the year by a number of actions including several reductions in reserve requirements. Although business loans continued to diminish as business requirements contracted, Federal Reserve action helped to avoid any general pressure for credit liquidation and improved the foundation for the expansion of business which occurred later in the year. There was also some easing in the terms and availability of credit to private borrowers and to State and local governments. Both long- and short-term interest rates declined during the year. One important observable result of the reduction of reserve requirements was an enlargement of bank holdings of Government securities, with a corresponding expansion in bank liquidity positions.

Since income tax payments are so much higher than before the war, the heavy concentration of Federal tax payments within the winter months has the effect of causing a sharp decline in bank deposits during the first quarter of each year. Although this decline is often anticipated in part by a preceding accumulation of deposits, the concentrated drain within a short period reduces buying power.

Demand bank deposits, the largest element in the money supply, declined 2.9 billion dollars from the end of December 1946 to the end of March 1947. In 1948, the decline in the first quarter was 5.6 billion dollars, and in the first quarter of 1949 it was 4.4 billion. These declines are closely related to the payment of Federal taxes within this period, when a heavily disproportionate part of the personal and corporate income taxes of each year are paid notwithstanding the shift to the withholding plan affecting most individual income taxpayers. The interruptions in the march of strong and inflationary forces in early 1947 and early 1948, and the progress of the recessionary movement in the first half of 1949, were not unrelated to this seasonal reduction in the money supply. (See chart 7.)

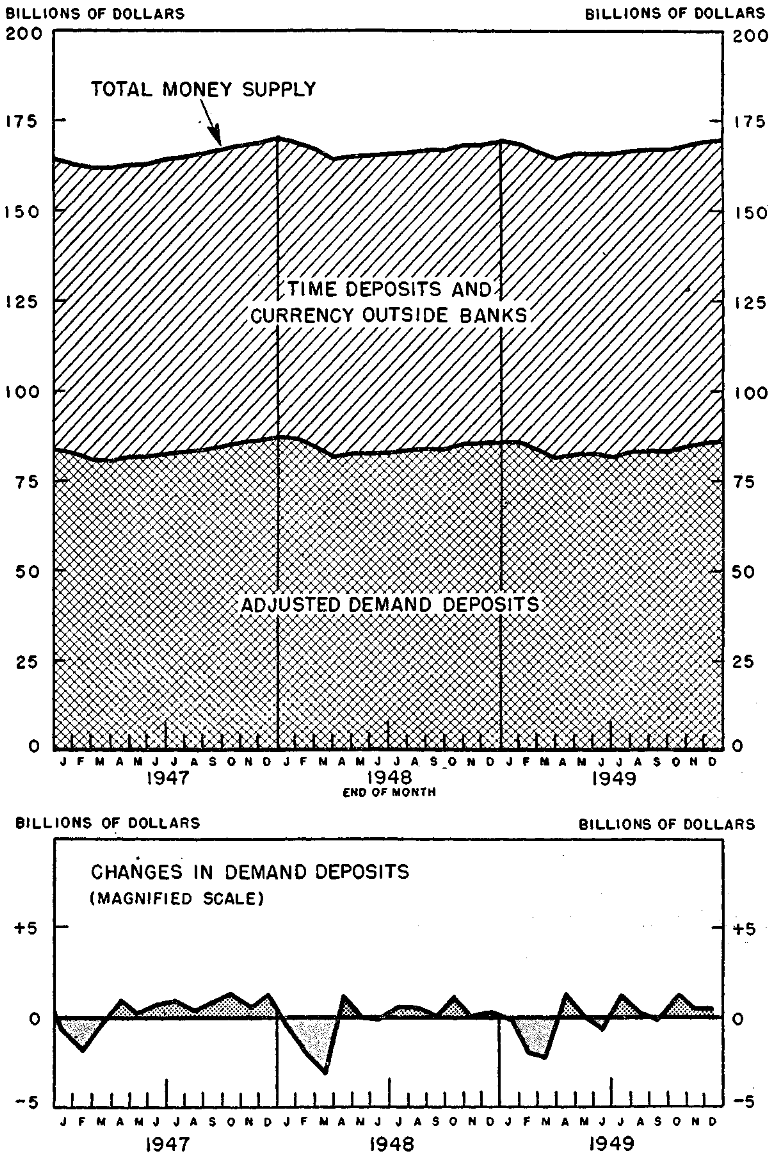
In April 1949, the gross national debt was reduced to 251.6 billion dollars by use of the Treasury surplus of the preceding 3 months. Federal expenditures exceeded receipts in every succeeding month except June, September, and December, when quarterly income tax payments created surpluses. The gross Government debt increased each month, reaching about 257 billion dollars by the end of the year.

In 1949, the monetary and fiscal policies adopted since the beginning of the war again permitted the Treasury to secure funds without causing a tightening of the money market or a restriction of credit. On the contrary, there developed a movement to lower interest rates which was exhibited in a market demand for Government securities so strong that the Open Market Committee of the Federal Reserve System felt that it should exert less pressure against a rise in the market price. Its statement on June 28, 1949, that its open market operations in buying and selling Government securities would permit greater freedom to the market was followed by a substantial rise in bond prices and by an increased

CHART 7

MONEY SUPPLY

The heavy concentration of Federal income tax collections in the 1st quarter tends to contract the money supply in that period of the year.



SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM market demand for short-term securities. Yields were driven down so low that the Committee directed sales by the Federal Reserve Banks of large amounts of short-term issues in order to provide a means for investment of some of the excess reserves and thereby avoid disorderly money-market conditions. During the second half of the year, yields on long-term bonds continued at close to the lowest levels of the postwar period, while short-term rates rose somewhat from the low level reached in July. (Statistics on money, banking, and credit are given in appendix tables C–24 to C–28).

THE FLOW OF GOODS AND PURCHASING POWER

Consumer income, spending, and saving

For 1949 as a whole, consumer income (personal income before taxes) and expenditures were about equal to the levels of 1948. Such income in each year totaled about 212 billion dollars, and expenditures were about 179 billion. Since income taxes were lower, income at the disposal of consumers increased slightly, and the rate of saving went up correspondingly.

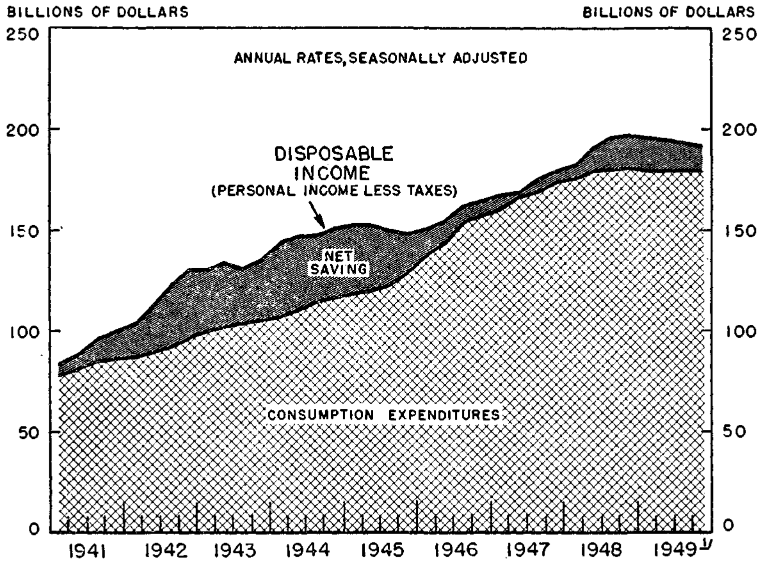
Peak rates of disposable income (income after taxes) were reached late in 1948, and personal saving reached a peak early in 1949. Disposable income in 1949 was 192.9 billion dollars, compared with 190.8 billion in 1948. But the trend of disposable income in 1949 was downward, falling in every quarter. (See chart 8.) It reached an annual rate of 191.1 billion in the fourth quarter. This was in marked contrast to the 1948 trend, when disposable income rose in each quarter. Personal saving declined from the exceptionally high rate of 16.3 billion dollars or 8.4 percent of disposable income in the first quarter of 1949 to 13.1 billion or 6.9 percent of disposable income in the fourth quarter. This decline resulted from declines in income coupled with remarkable stability in total consumption expenditures. (Appendix B and appendix tables C–2, C–5, C–6, C–7, and C–8 provide statistics on consumer income, spending, and saving.)

Major components of personal income. The major impact of the decline in business activity was registered principally in lower incomes of corporate business, rather than in personal incomes. During the first half of 1949 total compensation of employees dropped, but has since then remained firm despite work stoppages. Business and professional income was fairly constant in 1949 after a small initial drop from the fourth quarter of 1948. Farm income, on the other hand, dropped substantially throughout 1949. Cash farm incomes from marketings fell from 30.5 billion dollars in 1948 to 27.7 billion in 1949. Net farm income after expenses fell more than total income because farm expenses remained high, and inventories increased less than in 1948. The minor components of income (rents, dividends, and interest) remained nearly stable throughout last year or increased slightly.

CHART 8

CONSUMER INCOME, SPENDING, AND SAVING

Although postwar peaks of disposable income and expenditures were reached late in 1948, the crest in personal saving was not attained until the first part of 1949. Income and saving dropped during 1949, while expenditures remained almost stable.



[1] FOURTH QUARTER ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS; BASED ON INCOMPLETE DATA.

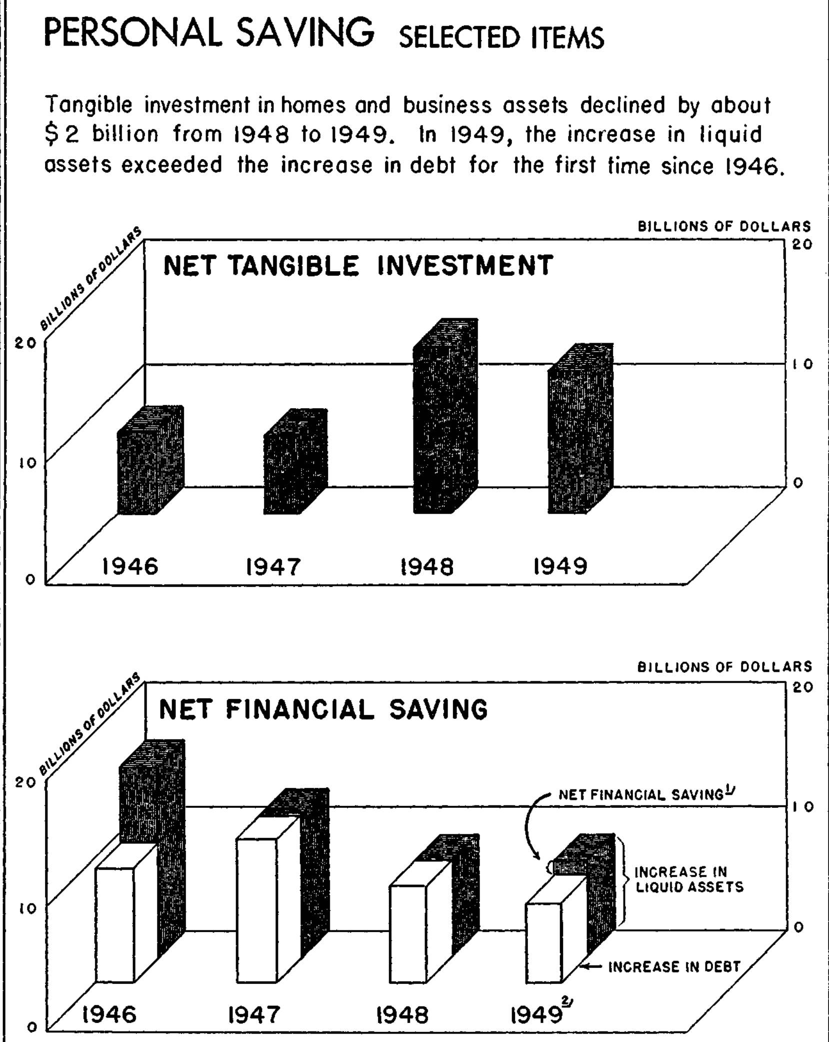
SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED)

Consumer expenditures. Consumer expenditures were fairly stable throughout 1949 at an annual rate between 178 and 179 billion dollars. This level was equal to that for 1948 as a whole, but about 2 billion dollars below that of the second half of that year. Throughout 1949 there was a noticeable change in the composition of expenditures, with an increased proportion going to services and durable goods.

Heavy purchase of durable goods in 1949 was due largely to the greater availability of automobiles, for which there was a substantial excess demand at the beginning of the year. Automobile instalment credit outstanding expanded rapidly starting in March, and other instalment credit also increased. Moderate drops in the prices of foods and apparel helped to sustain volume in nondurable lines. While department store sales were about 5 percent below the dollar volume of 1948, unit volume was probably maintained through price reductions, promotions, and sales of lower-priced merchandise. (See appendix table C–20.)

Service expenditures continued to increase in 1949. Housing services increased as a result of higher actual and imputed rental values, and an increased total supply of residential units. Rents and utility costs were both significantly above 1948, offsetting to a considerable extent declines in other consumer prices. A variety of miscellaneous service charges, such as interest on consumer debt, also rose, pushing total expenditure for services up significantly.

CHART 9



1/ NET FINANCIAL SAVING EQUALS THE INCREASE IN LIQUID ASSETS MINUS THE INCREASE IN DEBT.
2/ ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS; BASED ON INCOMPLETE DATA.
SOURCES: DEPARTMENT OF COMMERCE AND SECURITIES AND EXCHANGE COMMISSION (EXCEPT AS NOTED)

Net personal saving. Net personal saving (gross saving less increases in consumer credit and other forms of dissaving) in 1949 as a whole was 14.4 billion dollars, compared with 12.0 billion in 1948. However, it decreased throughout the year. The first quarter saving was at an annual rate of 16.3 billion dollars. By the fourth quarter it had fallen to 13.1 billion.

This net saving represented a much larger positive saving on the part of many families, offset in part by very substantial dissaving by other families. The main forms of dissaving are drawing down liquid assets and going into debt for durable consumer goods or family expenses. Personal saving includes both investment in tangible assets—such as homes, business and farm equipment—and liquid (or financial) saving. It does not include purchases of durable consumer goods, even though the purchasers of such goods may regard them as long-term capital assets. Personal saving includes not only what we ordinarily think of as consumer saving, but also the saving done by unincorporated businesses, farms, and nonprofit organizations.

In chart 9, showing all forms of personal saving, the tangible forms are shown in the top segment, and in the lower segment is shown the financial saving, which includes increases in liquid assets (such as currency and deposits in banks, bonds, and stocks) less net increases in debt.

TABLE 4.—*Components of personal saving* [1]

[Billions of dollars]

Item	1946	1947	1948
Increases in liquid assets	15.3	11.5	7.8
Currency, deposits, U. S. Government bonds, and saving and loan shares	11.6	6.5	1.4
Insurance reserves	3.4	3.7	3.5
Corporate and State and municipal securities	.3	1.4	2.9
Less: Increase in debt	9.2	11.6	7.9
Mortgage debt (residential)	3.2	4.1	4.1
Consumer debt	3.3	3.3	2.5
Business debt	2.6	4.2	1.4
Equals: Net financial saving	6.1	−.1	−.1
Plus: Net tangible investment	6.8	6.4	13.6
Personal business investment	4.3	1.8	7.0
Purchases of new homes	2.5	4.6	6.6
Less: Statistical discrepancy	2.6	1.2	1.6
Equals: Net personal saving	10.3	5.1	12.0

[1] See appendix table B-2—for sources and uses of personal funds.

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

Sources: Department of Commerce and Securities and Exchange Commission.

Since the war a large part of personal saving has consisted of investment in tangible assets. This accounted for the increase in saving between 1947 and 1948. As shown in table 4, investment in assets of unincorporated businesses and farms rose from 1.8 billion dollars in 1947 to 7.0 billion in 1948, while home purchases increased from 4.6 billion to 6.6 billion. These tangible types of saving were in fact so large in 1947 and 1948 that a substantial amount of business and mortgage debt was incurred in financing them. This increase in debt offset the rise in holdings of liquid assets, so that financial saving fell from 6.1 billion dollars in 1946 to negligible amounts in 1947 and 1948. (See chart 9.) Thus on balance personal saving in 1947 and 1948 was of a type which added directly to demand and inflationary pressures but supplied no funds to the rest of the economy.

TABLE 5.—*Tangible and financial saving,*[1] *1948–49*

[Billions of dollars, unadjusted for seasonal variation]

Period	Tangible saving	Net financial saving
1948—year	13.6	−0.1
First half	6.0	−1.2
Second half	7.8	1.0
1949—year	11.6	1.4
First half	5.1	1.7
Second half	6.5	−.3

[1] The total of estimated financial and tangible saving differs from net personal saving by the statistical discrepancy of $1.6 billion in 1948 and —$1.4 billion in 1949. See Table 4 above.

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

Sources: Department of Commerce and Securities and Exchange Commission.

In 1949, as shown in table 5, according to estimates based on rather incomplete data, tangible investment declined, while for the first time since 1946 there was a significant volume of net financial saving. Liquid assets continued to accumulate at about the 1948 rate, but the rise in debt was less rapid, particularly in the first part of the year.

Saving by income groups. While personal saving in 1949 was high by any previous peacetime standards, it is estimated that about one-third of all American families did not add to their savings, but instead spent more than their current incomes, either by drawing down their assets or by going into debt. Data for 1948 (the most recent available) show that the lowest two-fifths of the population, classified in terms of current income, as a whole spent more than their incomes. There was a substantial amount of dissaving by many families in all income brackets (as shown in appendix table B–5); however, in the lower two-fifths of the population amounts dissaved greatly exceeded positive saving. Moreover, there was a sharp upward trend in the amount of dissaving by the lower-income groups from 1945 through 1948.

A great part of dissaving in the past 3 years in both lower- and middle-income groups has been in the form of consumer credit obtained to purchase automobiles and other consumer durables. About 59 percent of the dissaving families reported purchases of durable goods in 1948, despite the fact that the families in the lowest-fifth income group as a whole spent 20 percent more than their income for nondurable goods and services. (See appendix table B–8.)

In the lower- and middle-income groups a large volume of saving is now contractual, in the form of mortgage-amortization payments, life-insurance premiums, and payments into retirement funds. Private insurance equities, which are the type of asset most commonly owned by all income groups, have increased by about 3.5 billion dollars each year for the last several years. Home improvements as well as home purchases were also important in 1947 and 1948.

TABLE 6.—*Net personal saving and net income of each fifth of the Nation's spending units* [1]

Spending units ranked by size of income	Percentage of net saving [1]					Percentage of net income, 1948
	1941	1945	1946	1947	1948	
Lowest fifth	−7	0	−8	−13	−24	4
Second fifth	0	6	3	1	−3	11
Third fifth	8	9	5	7	7	16
Fourth fifth	11	21	21	12	21	22
Highest fifth	88	64	79	93	99	47
All spending units	100	100	100	100	100	100

[1] For a definition of the spending unit and a distribution of positive and negative saving, see appendix B.

Sources: Department of Labor (1941) and Board of Governors of the Federal Reserve System (1945–48).

Table 6 shows that saving has been highly concentrated among the groups with the largest incomes. Much of the saving was in the form of increased holdings of corporate securities and tax-exempt State and municipal issues. Personal holdings of these assets, which are held almost exclusively by upper-income recipients and trusts, increased 2.9 billion dollars in 1948, as shown in table 4.

The ability of families in all income ranges to spend in excess of current income has been greatly increased by the liquidation of personal debts and mortgages and the acquisition of liquid assets, mainly bank deposits and Government bonds, that occurred during the war. The increase in the amount of negative saving, especially among lower-income groups, indicates that since the war large groups of the population have incurred substantial debt obligations and made inroads into liquid reserves. Total holdings of liquid assets by all individuals have continued to increase, although at a diminishing rate.

Business investment and finance

The decline in the gross national product which marked 1949 reflected primarily a decline in the level of gross private domestic investment. In 1949 gross private domestic investment amounted to an estimated 36.8 billion dollars, compared with an estimated 45.0 billion in 1948, a drop of 8.2 billion, or about 18 percent. The drop in the gross national product was only 3.7 billion dollars. Gross private investment last year was 14.2 percent of the gross national product, compared with 17.1 percent in 1948. (See appendix table C–1.)

Investment fell steadily in the first two quarters of the year, and after that showed little change. It is estimated that the rate in the final quarter represented about 13.7 percent of the gross national product, compared with 17.8 percent in the peak fourth quarter of 1948. The current ratio is somewhat below that characteristic of previous peacetime high levels of activity.

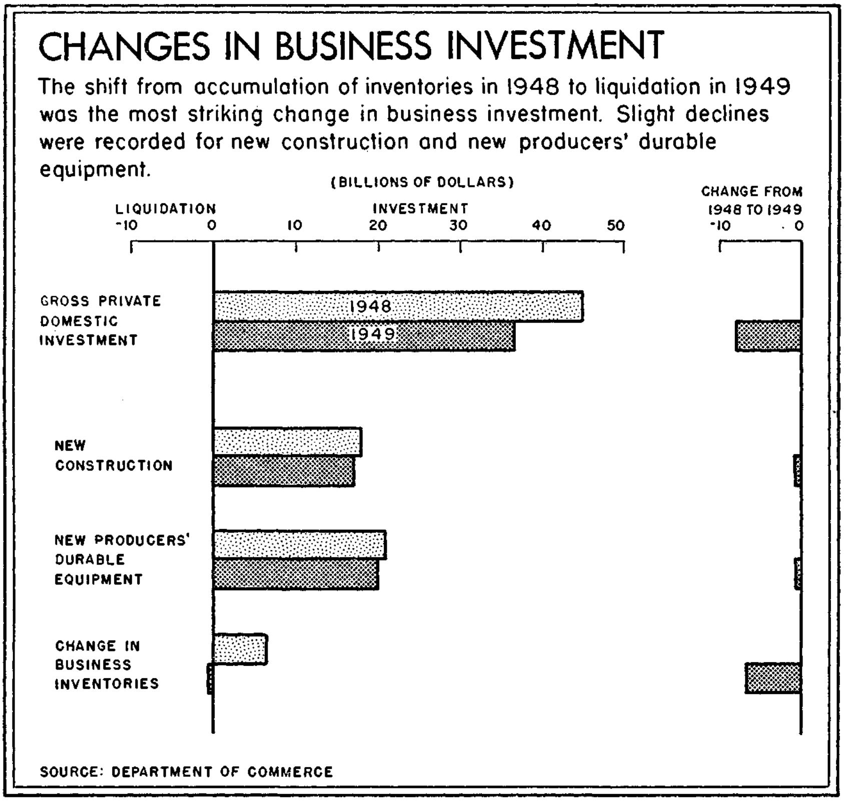
Of the three components of gross private domestic investment—construction, equipment, and inventory accumulation—it was mainly the shift from inventory accumulation to inventory liquidation which accounted for the fall in the total. Thus, on a seasonally adjusted basis the gross national product fell from its peak annual rate of about 270 billion dollars in the fourth quarter of 1948 to about 255 billion in the fourth quarter of 1949, a decline of 15 billion. During the same period, gross private domestic investment fell 13 billion dollars, or from an annual rate of 48 billion in the last quarter of 1948 to an annual rate of 35 billion dollars in the fourth quarter of 1949. The annual rate of inventory accumulation declined 10.5 billion dollars, from a rate of 9 billion dollars in the fourth quarter of 1948 to a liquidation of 1.5 billion dollars in the fourth quarter of 1949. The balance of the drop in gross private investment occurred in producers' durable equipment, which during the same period fell 3 billion dollars. Most of the drop in this component took place in the fourth quarter. Private new construction, which rose during the second half of the year, was running at a somewhat higher rate in the fourth quarter than a year earlier. (See chart 10.)

Plant and equipment. Total plant and equipment outlays declined 1.4 billion dollars, or almost 5 percent, in 1949 compared with 1948. The drop occurred in nonfarm outlays as farm expenditures for these items remained about the same. (See chart 10 and also appendix table C–3.)

Nonfarm plant and equipment outlays for 1949 are estimated at about 6 percent below the very high 1948 rate. After allowing for price changes, the decline in real volume was about two-thirds of the drop in money outlays. The trend of such expenditures has been downward from the peak in the last half of 1948, and by the fourth quarter of 1949 was almost 16 percent below the level a year earlier.

Manufacturing outlays for plant and equipment (see appendix table C–17) declined almost 15 percent between 1948 and 1949. Manufacturing (which represented 40 percent of the nonfarm plant and equipment outlays in 1949) accounted for over 90 percent of the decline in the total dollar volume of outlays for new plant and equipment. Transportation other than railroads showed a decline of over 27 percent. Outlays of mining, and commercial and miscellaneous industries declined about 9 percent and 6 percent, respectively. On the other hand, railroads and electric and gas utilities increased their investment outlays in 1949. The increase in railroad investment was only slight. Their plant and equipment outlays, which in 1949 had been ahead of 1948 in both of the first two quarters, were in the final quarter of 1949 sharply below the correspond-

CHART 10



ing quarter of 1948. Outlays by utilities increased 18 percent, gaining quarter by quarter over 1948, but the gains were narrowing.

The decline in nonfarm investment in plant and equipment during 1949 does not appear to have been accelerated by the downturn in the first half of 1949, but represents an orderly tapering off of programs along lines that had been planned by the end of 1948.

Nonfarm business inventories. The process of inventory liquidation, which was a major factor in the decline in business activity during 1949, was slackening by the latter part of the year and in many areas was being reversed. Since the level of consumption remained high, many producers discovered that inventories were being reduced more than was consistent with maintaining production equal to consumption. Business buying was resumed on a more normal basis and more in line with the rate of sales. A strong contributory factor was the firming up of the price structure. The process of rebuilding inventories in the main proceeded cautiously. There were few signs of any speculative developments.

The book value of inventories in manufacturing and trade reached a peak of 58.6 billion dollars on a seasonally adjusted basis at the end of

November 1948. By the end of October 1949, the book value had declined to 54.5 billion dollars, a drop of about 7 percent. The largest drop was in manufacturing, where book values dropped about 9 percent compared with about 5 percent in wholesaling and 4 percent in retailing. (See appendix tables C–18 to C–20.)

The drop in the book value of inventories reflected in part the drop in prices and in part actual physical liquidation. By the third quarter of 1949, the liquidation of nonfarm inventories was at a seasonally adjusted annual rate of 2.6 billion dollars, a shift of almost 10 billion dollars from an inventory accumulation at an annual rate of 7.1 billion dollars in the fourth quarter of 1948. The rate of liquidation of inventories in the third quarter of 1949 was higher than in the second quarter. However, in the last quarter of the year there was a drop to an annual rate of 1.5 billion dollars. Trade inventories, seasonally adjusted, in October were appreciably above their summer lows.

While the liquidation was continuing in manufacturing, its character was changing. Initially liquidation began in purchased materials, thus reflecting the fear of price declines. By the end of the third quarter, liquidation had substantially slackened for purchased materials but was continuing for finished durable goods. There was some evidence in the third quarter that inventories of steel were being built up in anticipation of the work stoppage. During the fourth quarter, work stoppages in the steel and the coal industries depleted the inventories of these commodities. The settlement of the work stoppage in the steel industry led to strong pressure to rebuild the stocks of this vital commodity.

The ratio of manufacturers' inventories to sales in November 1949 was lower than at the end of 1948. For wholesalers the October ratio was somewhat higher, for retailers slightly lower, than a year earlier. Manufacturers' and retailers' inventory-sales ratios were still considerably below prewar levels.

Corporate finance. The change from increasing inventory costs and increasing customer credit in 1948 to the situation of inventory reduction and small increase in customer credit in 1949 permitted corporate business to improve its liquidity position, while continuing large outlays for new plant and equipment. There were many corporations which experienced financial difficulty in 1949, but for the group as a whole there was a growth in financial strength and a large number of business firms increased their dividends.

Financing the growing volume and costs of inventories and the enlargement of customer credit in 1948 absorbed 8.6 billion dollars of corporate funds. In 1949, on the contrary, there was only a small increase in customer credit, and the liquidation of 3.7 billion dollars in inventory accounts added this sum to the funds resulting from the profits of current business operations. The internal funds available for new investment included also those from depreciation charges which rose by 13 percent, compared with 1948. (See appendix table C–34.)

On account of the improved financial position of corporations, funds from internal sources were more than equal to the requirements for capital investment in 1949, while in 1948, when there were large increases in inventories and customer credit as well as larger outlays for plant and equipment, they were only about 70 percent of such requirements. There was little change in the amount of corporate debt, a decline of 4.2 billion dollars in short-term debt being offset by an increase in bonded and other long-term debt. The net increase of 3.7 billion dollars in bond issues was substantially less than in 1948 while stock issues of 1.4 billion provided slightly more new equity capital than in the preceding year. An increase of 2.5 billion dollars in liquid assets marked the improved liquidity of corporate treasuries.

Construction. In spite of a slow start, the volume of construction in 1949 exceeded the high level attained in 1948. The strength in construction acted to minimize the general decline in the first half of 1949 and was one of the main forces of revival evident in the second half. The total volume of construction, public and private, amounted in 1949 to 19.3 billion dollars compared with 18.8 billion in 1948, a rise of 3 percent. Public construction, which accounted for 27 percent of total construction in 1949, increased by 25 percent. Private construction showed a slight drop of 4 percent in dollar terms, but residential construction was particularly strong in the second half of the year, rising on a seasonally adjusted basis to a new postwar peak in the fourth quarter. The total rate of activity at the year's end was about 11.4 percent above that for December 1948. In addition the backlog of contracts let is now considerably higher than a year ago, so that 1950 will begin at higher levels than 1949. (See appendix table C–16.)

The construction of factories and commercial facilities declined somewhat during the year. Since activity in these areas began promptly after the end of the war and went forward more rapidly than did public construction, the subsequent declines were not unexpected.

In the field of utilities, the large increase in the number of families and in income has greatly increased the demand for communication, power, and transportation facilities. To date public utilities (including a considerable amount of Federal power development) have not yet been able to meet these needs. Utility firms in general continued their long-range programs throughout the year despite the hesitancy evidenced by them early last year. While construction of communications facilities declined, this decrease was more than offset by increases in electric power and gas industries.

The year 1949 turned out to be a record one for residential construction. The increase in private building construction during the year was confined largely to residential building, and was particularly large in the field of multi-family structures. The slow start was due in part to the adjustment the industry was making to lower prices and to building for rent rather than for sale. The average cost per dwelling unit fell approximately 10 percent from the summer of 1948 to the first part of 1949. While less than 9 percent of private residential starts in 1947, and less than 11 percent in 1948, were multi-family units, over 14 percent were multi-family units in January 1949, and for the first 8 months of the year the number of these units started was 28 percent higher than in the comparable months of 1948 and represented 16 percent of all private starts.

It took time for builders, material manufacturers, and lenders to adjust to this shift in housing markets and housing types. The shift was facilitated by the renewal of section 608 of the National Housing Act which provided for insurance of rental projects on favorable terms. By May, the industry was responding to the improved conditions. In July, the private starts were higher than the July figure for any previous year since the war. The easing of interest rates and of credit, including liberalization of laws governing RFC purchases of real estate mortgages, also were important in holding this volume high through the rest of the year. Public housing rose also, and the total volume of private and public starts continued to rise until September when it reached approximately 100,000 units. It stayed at this level in October, making an all-time record for this month, and thereafter declined less than seasonally.

Public construction showed the greatest strength. This was due largely to the fact that public construction of a nonmilitary nature had been restrained since 1940. There was great need for schools, hospitals, highways, and natural resources development, despite high costs. A larger volume of public bond issues for public construction purposes was voted in 1949 than in any previous postwar year. Public school construction was three times as great as in 1947 and one and one-half times as great as in 1948. Public hospital construction was five times as great as in 1947, and more than twice as great as in 1948. Conservation and development construction also increased, being nearly double that for 1947, and one and one-fourth times that in 1948.

International developments

The most notable international economic developments of 1949 were the critical deterioration of the United Kingdom's and the rest of the sterling area's dollar position and the subsequent devaluation of the pound sterling and other foreign currencies in terms of the dollar. Although the conditions underlying these developments are of great long-run significance for the American economy, the developments themselves did not greatly affect the economy during 1949. Nevertheless, the world political and economic situation did exercise an important influence upon economic activity during 1949, not only through the continued necessity for high national defense expenditures, but also through a renewed expansion of government expenditures to aid foreign countries.

Such aid had declined from 1947 to the middle of 1948, as some of the early postwar aid programs ended and funds provided by others were used up. When the European Recovery Program got under way in the second half of 1948, our aid began to expand again. In 1949, it reached a postwar record total of 5.9 billion dollars, slightly exceeding the previous record total reached in 1947, and exceeding the 1948 total by 1.2 billion dollars. This increase did not result in an expansion of exports because it was more than offset by the decline in other sources of dollars used by foreign countries for making purchases in the United States. The dollar value of our imports of goods and services and the net outflow of private American capital decreased while foreign countries as a whole ceased liquidating their gold and dollar assets. As a result, our total exports of goods and services actually diminished by a billion dollars from 1948 to 1949. These developments, which are shown in tables 7 and 8, indicate that the effect of increased aid was to limit the decline of exports in the face of a reduction in other ways of financing them. (See also appendix tables C–35 to C–37.)

Table 7 shows that our total receipts from exports of goods and services and investment income remained high in the first half of the year but fell sharply in the second half as foreign countries took measures to stop the second and third quarter depletion of their reserves, while our total payments for goods and services, including income on investments, fell in the first half of the year and then recovered. As a result, the total export surplus first rose and then shrank rapidly. Although for the year as a whole the surplus of 5.8 billion dollars was only about one-half billion dollars below the 1948 figure, it had fallen to an estimated rate of 3.8 billion a year by the last quarter. These developments are shown in table 7 and in chart 11.

TABLE 7.—*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	0.5
1946	15.0	7.2	7.8
1947	19.7	8.5	11.2
1948	16.8	10.5	6.3
1949 [2]	15.8	10.0	5.8
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	17.0	10.4	6.6
Second quarter	17.7	9.7	8.0
Third quarter	14.5	9.9	4.6
Fourth quarter [2]	14.1	10.3	3.8

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

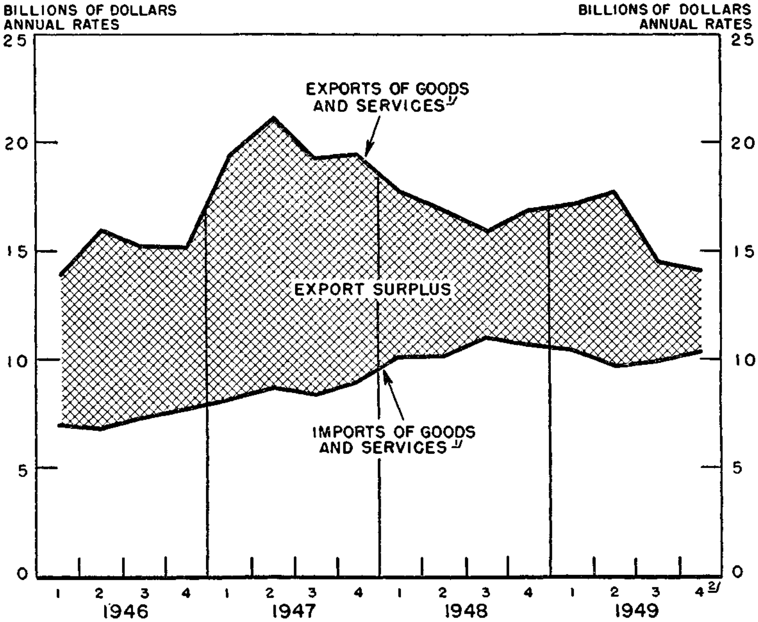
NOTE.—For greater detail see appendix tables C–35 and C–36.

Source: Department of Commerce.

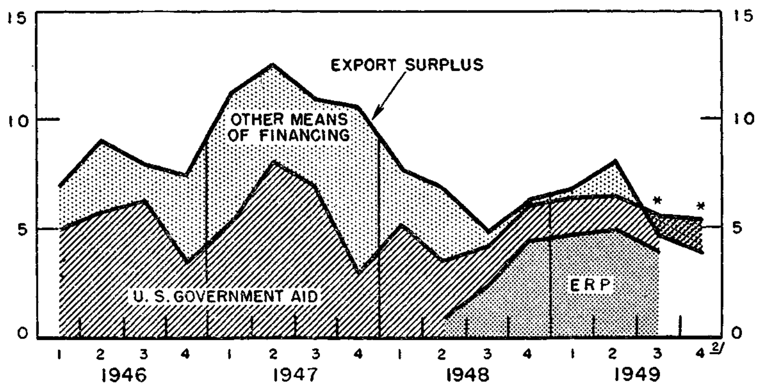
CHART 11

EXPORTS AND IMPORTS OF GOODS AND SERVICES

Exports and the export surplus fell sharply in the second half of 1949.



All of the export surplus was financed by ERP or other Government aid.



1/ INCLUDES INCOME ON INVESTMENTS.
2/ ESTIMATE BASED ON INCOMPLETE DATA.
* OTHER MEANS OF FINANCING WAS NEGATIVE IN THIS QUARTER.

SOURCE: U. S. DEPARTMENT OF COMMERCE

Imports of goods declined sharply during the first three quarters of 1949, and, despite a marked recovery beginning in the summer, were slightly lower than in 1948. Average prices of imported raw materials and foods had begun to decline in the second half of 1948. In the first half of 1949, price declines became more general among imported products, and the total quantity of goods imported also began to fall. The net result was that by the third quarter of 1949 the dollar value of our merchandise imports had fallen 20 percent below the level for the fourth quarter of 1948. All economic classes of imports fell in value during this period except manufactured foodstuffs, the average price of which rose more than enough to offset the decline in the quantity purchased. These price and quantity changes were largely a reflection of the improvement in world production of the products we import and the decline in our own demand for imports.

TABLE 8.—*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 [3] (net)	Outflow of United States private capital [4] (net)	Other means of financing [5] (net)
1936–38 average	0.5		0.8		
1946	7.8	5.1	2.0	0.3	0.4
1947	11.2	5.7	4.5	.7	.3
1948	6.3	4.7	.9	1.0	–.3
1949 [6]	5.8	5.9	–.1	.4	–.4
Annual rates:					
1948—First quarter	7.6	5.1	1.4	1.0	.1
Second quarter	6.8	3.4	2.2	1.4	–.2
Third quarter	4.8	4.1	.6	1.1	–1.0
Fourth quarter	6.1	6.0	–.8	.6	.3
1949—First quarter	6.6	6.3	–.1	.5	–.1
Second quarter	8.0	6.4	1.3	.2	.1
Third quarter	4.6	5.5	.4	.4	–1.7
Fourth quarter [6]	3.8	5.3	–1.8	.5	–.2

[1] Includes income on investments.
[2] Includes grants and loans, but excludes subscription to the capital of the International Bank for Reconstruction and Development and the International Monetary Fund. For detail, see appendix table C–37.
[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 both long-term and short-term capital but excludes purchase of obligations of the International Bank.
[5] Includes private gifts, net dollar disbursements by the International Bank and the International Monetary Fund, and allowance for errors and omissions.
[6] Estimates based on incomplete data.

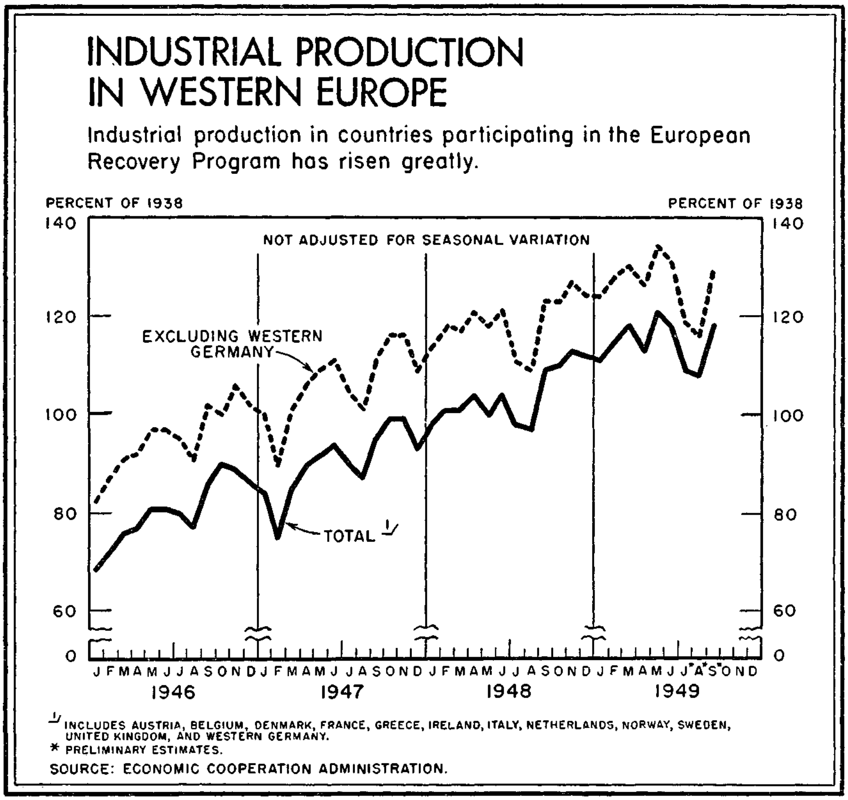
NOTE.—For greater detail see appendix table C–35.

Source: Department of Commerce.

The drop in our demand for foreign goods was chiefly the result of the decline of domestic industrial activity, especially business buying, which is the immediate determinant of imports. Following the reversal of the business trend the value of imports rose substantially. Most of the recovery was in the quantity of goods brought in. (For further statistics relating to imports of merchandise see appendix tables C–42, C–43, and C–44.)

The fall in imports of goods during the first half of 1949 was followed by sharp cuts in merchandise exports after June. In the third quarter of 1949, exports fell in value 14 percent below the last quarter of 1948, partly because of reductions in prices throughout the year, and partly because of a very drastic cut in the quantities shipped, primarily to Western Europe

CHART 12



INDUSTRIAL PRODUCTION IN WESTERN EUROPE

Industrial production in countries participating in the European Recovery Program has risen greatly.

1/ INCLUDES AUSTRIA, BELGIUM, DENMARK, FRANCE, GREECE, IRELAND, ITALY, NETHERLANDS, NORWAY, SWEDEN, UNITED KINGDOM, AND WESTERN GERMANY.
* PRELIMINARY ESTIMATES.
SOURCE: ECONOMIC COOPERATION ADMINISTRATION.

and the sterling area. Through November there was no indication of any recovery in exports. (See appendix tables C–39, C–40, and C–41 for further statistics relating to exports of merchandise.)

Events leading to devaluation. Since the Congress considered and authorized the European Recovery Program, great progress has been made by the Western European countries. In the 12 months ending in September 1949, industrial production in these countries rose 29 percent above the level of two years earlier, reaching a figure 14 percent above 1938, and, when Western Germany is excluded, it rose 21 percent in the same two-year period to a level 26 percent above 1938. (See chart 12.) The quantity of Western European exports to the rest of the world rose even more sharply, going from 20 percent below the prewar figure in the first quarter of 1948 to 11 percent above it in the first quarter of 1949, an expansion of 39 percent in one year. A net shipping deficit of 400 million dollars in 1947 was converted into a net surplus of 300 million in 1948. At the same time substantial, though unequal, progress was made by the Western European countries in controlling inflationary pressures. As a result of these steps—combined, it is true, with intensified import restrictions—these countries were able to reduce substantially their current deficit with the United States and also with other areas between 1947 and early 1949.

Despite this very great progress, the sterling area's dollar deficit began to increase rapidly in 1949, causing an acute drain on the gold and dollar reserves of the United Kingdom and culminating in the devaluation of the pound sterling and other important currencies.

Reversal of the previous expansion of United States imports from Europe and the rest of the world was only one of several factors in this development. From the first to the second quarters of the year, the sterling area's gold and dollar deficit, which is affected by payments on capital as well as current account, increased by an amount equivalent to 1.2 billion dollars a year. Of this amount, the increase in its total import surplus with the United States was at an annual rate of a little more than 700 million dollars. Nearly half of this represented an increase in sterling area purchases from the United States and about half was accounted for by a decline in the sterling area's sale of goods and services to the United States. This decline was attributable largely to our domestic business decline, though also partly to a withholding of orders for goods as the maintenance of the pound at $4.03 came into question. The price decline in the United States also had the effect of widening the disparity between domestic and foreign, especially European, export prices for manufactured goods. (See appendix table C–38.)

Among other causes were the fall in the prices of raw materials exported by the dependent overseas territories of the Western European countries and the sterling area, the deterioration in Western Europe's competitive position resulting from the relatively greater fall in the prices of manufactured products in the United States than in Europe, and the speculation concerning the value of the pound sterling to which these all gave rise. At the same time the investment of American capital abroad began to diminish as the foreign expansion programs of American companies, particularly oil companies which were responsible for 60 percent of total private American long-term investment abroad in 1948, were brought nearer completion or curtailed. Import restrictions had to be further tightened in some countries and in others earlier relaxations had to be reversed.

The pressure on the gold and dollar assets of the ERP countries, particularly on those of the United Kingdom, appears to have been mainly the result of dollar payments to other areas rather than of an increase in Western

Europe's deficit with the United States. This is shown by the changes in certain international transactions between the first and second quarters of 1949, shown in the following table in terms of annual rates:

	Changes from first to second quarters of 1949 (millions of dollars, annual rates)
Increase in liquidation of ERP countries' gold and dollar assets	1,468
Increase in ERP countries' goods and services deficit with United States	160
Decrease in ERP countries' receipts from United States gifts and investments	176
Increase in dollar payments to other areas and errors and omissions	1,132

Most of the increase in dollar payments to the rest of the world went to the dependent overseas territories of the ERP countries and to other countries in Africa, Latin America, Asia, and Oceania, areas which consist largely of the underdeveloped parts of the world. Increased deficits with the United States were the principal reason for the higher dollar requirements of these areas, except in the case of Latin America. The deficit of Latin-American countries with the United States did not increase much. As a group they increased their dollar reserves and repaid short-term debt to this country, but a large portion of this debt was incurred in financing earlier deficits.

On September 18, the pound sterling was devalued 30½ percent in terms of the dollar, and in the next 2 months many other countries, including most of those in the sterling area and Western Europe, some in South America, Finland and Canada, also reduced the dollar values of their currencies. Most of them devalued by about the same amount as the United Kingdom but some countries important to our trade devalued by less. This widespread realignment of currency values in terms of the dollar was intended primarily to correct distortions in prices, costs, production, and trade, and to make possible an improvement in the balance of payments position of the devaluing countries in relation to the United States and the rest of the dollar area.

From the point of view of the United States, devaluation of foreign currencies tends to increase the quantity of our imports. Under normal conditions, it would also tend to reduce the quantity of our total exports. These influences would normally be expected to exert a downward pressure upon prices and production in industries competitively affected by imports, and in our export industries. Under present conditions, however, our exports are limited mainly by the dollars we make available to other countries through our purchases, gifts, and foreign investment. Unless these sources of dollars increased, foreign countries that were losing reserves would have had to cut their purchases from us in one way or another. It is quite likely, therefore, that the effect of devaluation, by making our goods more expensive to the citizens of devaluing countries, will be to lessen the need of these countries for direct restrictions upon imports. If this is the case, our exports are not likely to be any lower than they would have been had devaluation not occurred.

The limited data now available in the short period since devaluation indicate few major effects in United States markets which can clearly be attributed to devaluation. It takes time to make the shifts in trade which devaluation tends to bring about.

Government transactions

NOTE: As has been customary in previous reports, government transactions are here measured on the so-called consolidated cash basis, rather than in the terms of the conventional budget. Cash payments to and receipts from the public reflect the volume of current cash transactions between government, on the one hand, and the public, including business, foreign countries, and international institutions on the other. All intragovernmental transactions are eliminated. Such data are more useful for assessing the immediate economic impacts of government programs than are the data in the conventional budget. A detailed description of the concepts used is given in the "Budget of the United States, 1950," p. 1375.

Partly under the impact of recessionary tendencies which developed during the first half of the year, and partly as a result of the international situation, the volume of cash payments in 1949 by all levels of government—Federal, State, and local—rose substantially above their 1948 levels. The 1948 tax reduction and the 1949 decline in business caused cash receipts to drop off. The result was a shift of over 10 billion dollars in the net cash position of all governments, from a surplus of over 7 billion dollars in the calendar year 1948 to a deficit of 3 billion in 1949. (See table 9 and chart 13.)

TABLE 9.—*Government cash receipts from and payments to the public*

[Billions of dollars]

Receipt or payment	Calendar year 1948	Calendar year 1949 [1]
Cash receipts:		
Federal	44.9	41.4
State and local	15.0	16.1
Total cash receipts	59.9	57.5
Cash payments:		
Federal	36.9	43.1
State and local	15.8	17.5
Total cash payments	52.7	60.6
Surplus (+) or deficit (−):		
Federal	+8.0	−1.7
State and local	−.8	−1.4
Total, surplus (+) or deficit (−)	+7.2	−3.0

[1] Estimate based on incomplete data.

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

Source: See appendix A.

With increasing government payments, and with a slight decline in the gross national product as a result of price and other changes, the ratio of government payments to total output increased from about 20 percent in 1948 to about 23½ percent in 1949.

Cash payments by the Federal Government. Table 10 shows the volume of cash payments to the public by the Federal Government during the calendar years 1948 and 1949. Aggregate payments in 1949 were 6.2 billion dollars higher than in 1948.

TABLE 10.—*Federal cash payments to the public by type of recipient and transaction*

[Billions of dollars, seasonally adjusted annual rates]

Classification of payment [1]	Calendar years	
	1948	1949 [2]
Direct payments for goods and services:		
To individuals	8.4	9.0
To business and international	8.7	10.1
Loans and transfer payments to individuals	9.8	11.1
Loans, investments, subsidies and other transfers to business and agriculture	[3] 4.6	[3] 6.5
Loans and transfer payments to foreign countries and international institutions	5.5	6.5
Clearing account and adjustment to Daily Treasury Statement	−.2	−.3
Total Federal cash payments	36.9	43.1

[1] See appendix A for explanation of revised classification used in this table.
[2] Estimates based on incomplete data.
[3] Includes about 100 million dollars in interest payments to State and local governments.

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

Source: See appendix A.

The causes of the 6-billion-dollar rise in payments between 1948 and 1949 were divided between those arising from the impact of recession, and those reflecting mainly the international situation. Recessionary forces accounted for nearly one-half of the total increase in expenditures, leading to expansion in three major fields: they meant an increase of about 1 billion dollars in unemployment compensation payments, and they meant a sharp rise in the volume of farm price support loans not redeemed by producers and taken over from private banks by the Commodity Credit Corporation, and in the volume of mortgages purchased by the Reconstruction Finance Corporation. The increase in these latter cash payments in return for loans and mortgages amounted in the aggregate to nearly 2 billion dollars.

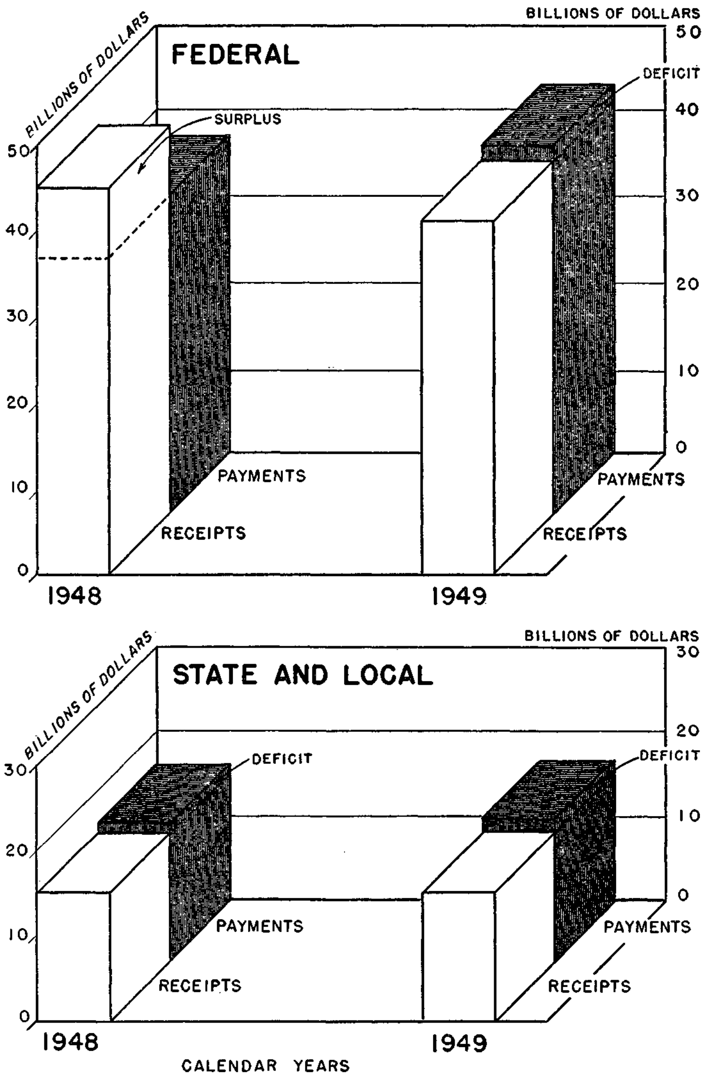
The needs of defense and foreign aid caused major program expansions, with an aggregate increase of about 2.8 billion dollars. Other important increases were in Federal public works, where construction activity in 1949 was some 20 percent higher than in 1948.

Cash payments by State and local governments. As was shown in table 9, cash payments by State and local governments increased by over 1½ billion dollars in 1949 above their 1948 level, thereby continuing the upward trend which has persisted since the war. Expenditures on schools, roads, and other public works still constitute the most rapidly

CHART 13

GOVERNMENT CASH RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

The net cash position of the Federal Government shifted from a surplus in 1948 to a deficit in 1949. State and local governments showed a cash deficit in both years.



SOURCE: SEE APPENDIX A

expanding segment of State and local activities. The increase in unemployment during 1949 led to some expansion in public assistance and other welfare expenditures, but this was partly offset by a decline in the total volume of bonus payments to veterans by State governments.

Federal cash receipts; the cash deficit. The calendar year 1949 was the first full year in which the effects of the tax reduction of the Revenue Act of 1948 were fully reflected in cash receipts. Receipts from direct taxes on individuals were over 4 billion dollars lower (at an annual rate) during the first half of calendar 1949 than during the same period of 1948, and tax refunds were over half a billion dollars higher. These were the major factors explaining the decline of 3.5 billion dollars in cash receipts of the Federal Government, from 44.9 billion dollars in 1948 to 41.4 billion last year. Corporate tax payments rose nearly 1 billion dollars, reflecting the high profits of 1948. But this was more than offset by the continued sharp down trend in receipts from surplus property and in other miscellaneous receipts. Because of the deferred payment of taxes (particularly corporate income taxes) receipts during the next 18 months will reflect in considerable degree the recession of 1949. (See table 11.)

TABLE 11.—*Federal cash receipts from the public*

[Billions of dollars, annual rates, seasonally adjusted]

Source of cash receipts	Calendar 1948	Calendar 1949		
		Total [1]	First half	Second half [1]
Direct taxes on individuals	20.9	18.4	18.7	18.2
Direct taxes on corporations	11.1	12.0	12.0	12.0
Employment taxes	2.5	2.5	2.5	2.5
Excises and customs	7.9	8.0	7.9	8.0
Surplus property receipts	1.2	.5	.7	.3
Deposits by States, unemployment insurance	1.0	1.0	.9	1.1
Veterans' life insurance premiums	.4	.4	.4	.4
Other	2.1	1.4	1.4	1.4
Less: Refunds of receipts	2.2	2.8	2.8	2.8
Total Federal cash receipts from the public	44.9	41.4	41.7	41.2

[1] Estimates based on incomplete data.

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

Source: See appendix A.

Reduced receipts and higher expenditures meant a marked shift in the net cash position of the Federal Government. While 1948 showed a cash surplus of some 8 billion dollars, the result for 1949 was a deficit of about 1.7 billion. There was an increase during 1949 of approximately the same amount in the national debt held by the public, reflecting increased sales of securities to the public.

Cash receipts of State and local governments; the cash deficit. The cash receipts of State and local governments are less flexible with respect to general business conditions than are those of the Federal Government, and State and local tax rates, in conjunction with new taxes, have shown a continuing rising tendency, in contrast to the sharp reductions contained in the Federal Revenue Act of 1948. Thus the cash receipts of State and local governments showed an increase of over 1 billion dollars in 1949 compared with 1948, despite the 1949 recession. The increase in receipts was, however, less than the increase in expenditures, and the net cash deficit of State and local governments combined increased from about 800 million dollars in 1948 to nearly 1½ billion in 1949.

Summary: The Nation's Economic Budget

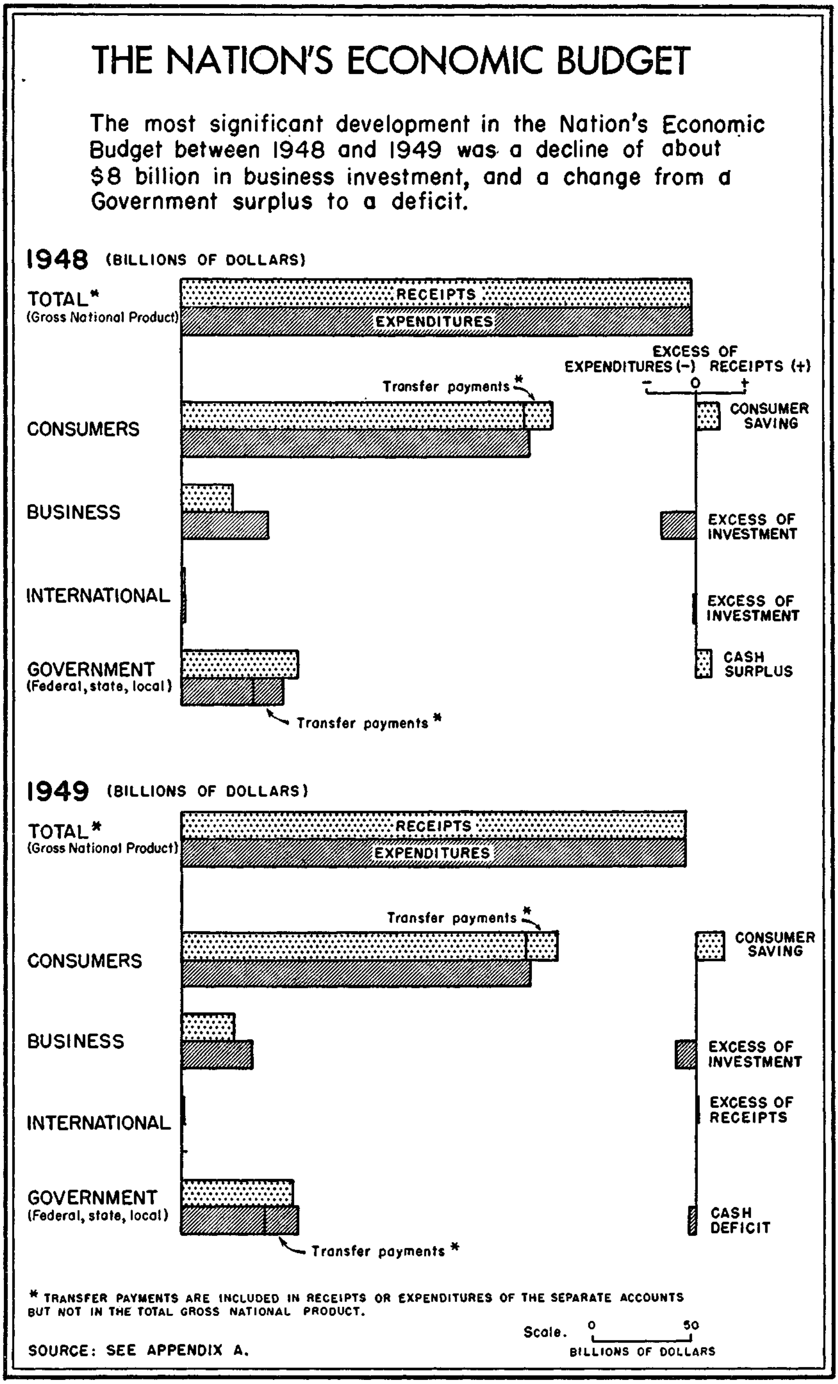
After 3 years of continuing increases, the year 1949 was the first year that showed a decline in the total output of the economy both in dollars and in real terms. This decline, however, was a very moderate one. Compared with the average of 1948, the dollar value of goods and services was less than ½ percent lower in the first half of 1949; and about 2½ percent lower in the second half. This decline continued from the first to the second half of the year and, as a matter of fact, continued from quarter to quarter, according to preliminary estimates. The regularity of the decline, however, is somewhat deceptive as an indicator of changes in effective demand for goods and services. First, some of the drop in dollar figures actually reflects a small drop in prices. Furthermore, the continued drop in the fourth quarter is explained in part by work stoppages in steel and coal.

Looking at the component parts of the Nation's Economic Budget, the most drastic cut occurred in business investment. As the details presented in appendix A show, this contraction was due mainly to the shift from inventory accumulation in 1948 to inventory liquidation in 1949. New construction and expenditures for producers' equipment remained at a high level. This was also true of business receipts, which include undistributed earnings, capital consumption allowances, and the inventory valuation adjustment. The change in inventory movement was so drastic that the net absorption of saving through domestic business investment dropped from about 18 billion dollars in 1948 to 9 billion in 1949. (See table 12 and chart 14.)

Even though the total export surplus in 1949 was nearly at 1948 levels, net foreign investment, which excludes exports financed by gifts and grants, disappeared almost entirely from the Nation's Economic Budget in 1949. In the second half of the year, both the export surplus and net foreign investment fell sharply, owing to reductions in private investment abroad, in net liquidation of foreign assets, and in other forms of foreign investment.

The significant fact is that the contraction in domestic business investment during 1949 did not initiate a downward spiral in the economy. Consumer disposable income dropped only slightly and consumer expenditures remained on an even keel. Thus consumer saving, which was very high during the first half of the year, declined somewhat during the second half. Federal, State, and local government expenditures increased nearly 8 billion dollars from 1948 to 1949. Government receipts declined,

CHART 14



THE NATION'S ECONOMIC BUDGET
The most significant development in the Nation's Economic Budget between 1948 and 1949 was a decline of about $8 billion in business investment, and a change from a Government surplus to a deficit.
1948 (BILLIONS OF DOLLARS)
TOTAL*
(Gross National Product)
RECEIPTS
EXPENDITURES
EXCESS OF
EXPENDITURES (-) RECEIPTS (+)
- 0 +
Transfer payments*
CONSUMERS
CONSUMER SAVING
BUSINESS
EXCESS OF INVESTMENT
INTERNATIONAL
EXCESS OF INVESTMENT
GOVERNMENT
(Federal, state, local)
CASH SURPLUS
Transfer payments*
1949 (BILLIONS OF DOLLARS)
TOTAL*
(Gross National Product)
RECEIPTS
EXPENDITURES
Transfer payments*
CONSUMERS
CONSUMER SAVING
BUSINESS
EXCESS OF INVESTMENT
INTERNATIONAL
EXCESS OF RECEIPTS
GOVERNMENT
(Federal, state, local)
CASH DEFICIT
Transfer payments*
* TRANSFER PAYMENTS ARE INCLUDED IN RECEIPTS OR EXPENDITURES OF THE SEPARATE ACCOUNTS BUT NOT IN THE TOTAL GROSS NATIONAL PRODUCT.
Scale. 0 50
BILLIONS OF DOLLARS
SOURCE: SEE APPENDIX A.

transforming a 7-billion-dollar cash surplus into a 3-billion-dollar cash deficit in 1949, or a net shift of 10 billion dollars. This shift in the government position coincided with a decline in the net absorption of funds for business investment of nearly the same amount. Thus the high level of private domestic investment other than inventory accumulation, the substantial increase in government expenditures, and the high level of consumer demand prevented the inventory liquidation from initiating a serious downturn in general business conditions.

TABLE 12.—*The Nation's Economic Budget*

[Billions of dollars]

Economic group	Calendar year 1948			Calendar year 1949 [1]		
	Receipts	Expenditures	Excess of receipts (+) or deficit (−)	Receipts	Expenditures	Excess of receipts (+) or deficit (−)
CONSUMERS						
Disposable income relating to current production	175.8			177.0		
Government transfers and net interest payments	*14.9*			*15.9*		
Disposable personal income	*190.8*			*192.9*		
Expenditures for goods and services		178.8			178.5	
Personal savings (+)			*+12.0*			*+14.4*
BUSINESS						
Retained business receipts from current production	26.8			27.6		
Gross private domestic investment		45.0			36.8	
Excess of receipts (+) or investment (−)			*−18.2*			*−9.2*
INTERNATIONAL						
Government loan transfers abroad	*1.3*			*.7*		
Net foreign investment		1.9			0	
Excess of receipts (+) or investment (−)			*−.6*			*+.7*
GOVERNMENT (Federal, State, and local)						
Tax payments or liabilities	60.2			56.3		
Adjustment to cash basis	*−.3*			*+1.2*		
Cash receipts from the public	*59.9*			*57.5*		
Purchases of goods and services		36.7			43.5	
Government transfers		*16.0*			*17.1*	
Cash payments to the public		*52.7*			*60.6*	
Excess of receipts (+) or payments (−)			*+7.2*			*−3.0*
ADJUSTMENTS						
For receipts relating to gross national product	−.4		−.4	−2.2		−2.2
Other adjustments	*0*		*0*	*−.8*		*−.8*
Total: Gross national product	262.4	262.4	0	258.7	258.7	0

[1] Estimates based on incomplete data. See appendix A for detail for 1949 by half years.

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; they are not included in the gross national product. Detail will not necessarily add to totals because of rounding.

Source: Based on data from the Department of Commerce and Bureau of the Budget. (See appendix A.)

II. The Significance of 1949 and the Economic Outlook

DURING the past year there has taken place an impressive demonstration of the strength and resiliency of the American economy. In the closing months of 1948, we were still confronted by inflation. We knew that it had to end and many feared that the longer the end was deferred the harder would be the fall. Our position now is more comfortable. The inevitable end of the inflationary process has come. We are now enjoying a recovery movement. The successful combination of private and public actions, which limited the recession of inflationary forces to a moderate and brief downturn in business, justifies an optimistic outlook for the coming months and confidence that we shall be able to deal with the problems of a somewhat more remote period.

Even at midyear, when the recessionary movement was reaching its most aggravated stage and a further substantial decline in industrial production in July had to be anticipated, the Council found that "many factors augur well for the successful culmination of the readjustment process in early stability followed by renewed growth." We looked forward to the "unique and fortunate experience of liquidating a major inflation without falling into a severe recession." But it was our expressed warning that the presence of some business decline should not be allowed to aggravate the pessimism which had appeared in the business world in the spring. For this would have led, as it had done in earlier periods, to a more serious deflationary movement with distributors withholding orders for new goods and manufacturers and other producers responding by reducing production and employment further.

Fortunately, business did not continue this pessimistic course. Even in July, before there had appeared many indications of improvement in scattered branches of the economy, a pronounced improvement in business sentiment developed. This made it possible for the underlying factors of economic strength, which had not yet suffered serious deterioration, to resume their upward pressure upon general business activity. By August, the signs that the recessionary movement was at or near its end were numerous, and in September the trend of revival became clear. The recovery movement was threatened by serious industrial controversies and work stoppages in the following weeks. But it proved strong enough to hold its place and to become active when production and employment in the steel industry was resumed in November and an uneasy armistice in the coal industry permitted limited production and employment.

Bases for Confidence as 1950 Opens

The past year furnished a test whether there would develop a serious deterioration in confidence which then seemed to the Council the main danger, and that main danger was surmounted. Other difficult problems still lie ahead. The recovery since last summer is still incomplete, and whether it continues and we achieve our national objective of maximum employment, production, and purchasing power in 1950 will depend upon the success of the actions of business, labor, farmers, and government in consolidating the strong forces underlying the economy.

The first basis for confidence today is that the size of the total decline in economic activity during 1949 was moderate. While drastic in some areas, it did not seriously impair our general strength. From the end of 1948 to the end of 1949, the total output of goods and services measured in dollar terms dropped about 5 percent, but when allowance is made for price changes the real decline was less than 2 percent. Total employment dropped less than 2 percent while unemployment rose from 3 percent of the labor force to over 5 percent. The decline in consumer disposable income was less than 3 percent, in industrial wholesale prices 5 percent, and in consumer prices less than 2 percent. No one should minimize the hardship and suffering inflicted upon the unemployed. But one must also give due regard to the high volume of income and employment which persisted. In these circumstances lay the force of recovery.

Although the Council was moderately optimistic at midyear 1949, few would have predicted during the decline of the first half year that the year's end would leave us in such good condition. The decline was not only moderate but also brief. By the second half, declining tendencies were supplanted by the forces of revival. Thus, there was no time for these declining tendencies to sap the confidence or reserves of business, undermine the morale or savings of the people, or impose heavy additional burdens upon government.

The simplest reason for confidence about the short-run future is the most important. It is that the economy is now moving upward, and thus is itself generating recuperative forces. At midyear, despite its basic optimism, the Council said that the most serious fact confronting us was that the decline had not yet been reversed. So long as it continued, we could not be sure that the strong factors of recovery, which we saw, would not be overcome by increasing weaknesses in other business conditions. Today the situation is reversed. Industrial production, which fell 17 percent in the 8 months from its November 1948 peak to its July 1949 low, had recovered almost half of the decline by December. A distinct upward movement has now been created, and it may be counted upon to continue unless it is interrupted by factors which we shall discuss and which must be faced. It would have to move a considerable distance in absorbing our unused resources of manpower and of plant capacity before it would encounter the danger of inflation.

Value of Affirmative Policies

The economic downturn during the first half of 1949, which began when production, employment, and personal incomes were at or near record levels, again proved that conflicting forces are always present in our complex economy, and that its basic elements of strength will at times be challenged. The course of events in the second half of the year demonstrated our improved capacity to protect the economy against depressions growing out of moderate recessions, and to fortify those forces to which a free economy must look for renewed expansion.

Evidence of this improvement was shown in the behavior of business in several ways: the avoidance of speculative excesses, the generally prudent management of inventories, the refusal to accelerate the decline by cutting wages or by resorting to large-scale lay-offs, and the general resistance to a deflationary complex. While many producers were unwilling to reduce prices, preferring to reduce output and employment, even in this respect there has been progress toward a long-range point of view. Correspondingly—and also with some exceptions—labor manifested fairness and moderation in its wage demands during the testing period and exhibited in other respects its mature concern about the condition of the whole economy and its confidence that the economic ship would safely ride through the storm.

Such economic behavior refutes those critics of our system who have argued that our difficulties and conflicts would become progressively more insoluble. The lesson of 1949 is that our free institutions, our educational processes, and the liberty of our people to make their own decisions have made us stronger than before.

The strength manifested within our business system has been matched by the contributions of government toward economic stability. The manifold improvements in our financial structure need no detailed description. Bank runs have become virtually impossible. Arrant speculation has been dampened. Credit measures have been improved. The flexible powers of the Federal Reserve System have been invoked. The management of the national debt has been prudent and reassuring to the public and has been consistent with maintaining favorable credit conditions for the benefit of business. The system of farm price supports has prevented collapse in the most volatile of all markets. Unemployment insurance has provided partial continuity of income to the main victims of declining production, and has thus served to support the demand for goods. The volume of government outlays, including those for foreign aid, while serving other important purposes, has unquestionably introduced stability into a large sector of the economy.

Clearly, in government policy no less than in private action there is need for further improvement. But the wide range of agreement about the proved utility of conscious efforts—both private and public—to protect our economy from disaster and to facilitate its intrinsic propensity for growth means that we are learning how to use our intelligence to accomplish all that our resources permit .

Short-Range Outlook

For the near future, the economic outlook is good. The revival in business activity which began in the summer of 1949 has already manifested sufficient strength to carry well into the first half of 1950. Liquidation of inventories has substantially slackened, and in many areas rebuilding is going forward. Consumer disposable income, though somewhat down from the peak level of the fourth quarter of 1948, is still above the average for that year as a whole. The demand for automobiles is still high. The large rate of construction contracts currently let promises a high level of activity for the coming months. The rate of business investment in plant and equipment, although declining, still continues relatively high. Government activity will provide strong support. It is estimated that aggregate cash payments by Federal, State, and local governments will increase by about 4 or 4½ billion dollars in calendar year 1950. The largest part of this in the form of a national insurance dividend will place about 2.6 billion dollars in the hands of veterans during the year, mostly in the first 6 months.

Although the short-range outlook is good, we are still a considerable distance from maximum employment, production, and purchasing power. The primary question in the minds of many is whether the rebound in productive activity will prove to be temporary or is the beginning of continuous growth.

The Longer-Range Outlook

There are two reasons why we cannot stop short with an analysis which presages a continued upswing of production, employment, and general business activity over the next few months. In the first place, the outlook for the next few months will be even brighter if our system of free enterprise—which includes businessmen, workers, farmers, and consumers—grows in confidence that rising prosperity is not to be short-lived and that we need not again be confronted by disruption or concern even as great as that of early 1949. And in the second place, just as improved analysis and action by business and government enabled us to get through 1949 as well as we did, similar efforts should now provide at least equivalent aid in dealing with the looming problems of the future.

The somewhat longer-range outlook may best be understood in the broad perspective of progressive adjustments since the end of the war. As earlier reports pointed out, the postwar period brought extraordinary demands for goods to carry out industrial modernization and expansion plans, to meet military and foreign requirements, to fill inventory pipe lines, and to restock the depleted store of goods in the hands of consumers. These demands, made effective by large liquid savings and access to ample credit in addition to current incomes at record levels, could not be satisfied by current levels of production. This gap between current demand and current supply generated the upward spiral of prices. The rising cost of living propelled wages upward, which further swelled the spending stream and in turn pressed costs and prices still higher. Even though the level of output was constantly reaching new peacetime peaks, it was failing to match the demand.

It was clearly foreseeable that in time the restocking boom on the part of both producers and consumers would wane, and that this demand would need to be replaced by more lasting peacetime demand in order to maintain maximum production and employment. It was also clear that this peacetime demand would have to grow even more than other types of demand declined, because the progress of technology and the growth of the labor force require a substantial increase in total national output from year to year in order to provide maximum employment. A key danger was found in the fact that the inflationary process was bringing about price-income relationships which would make the necessary adjustments difficult to achieve in an orderly fashion. If they were too long delayed, the ultimate result would be the forcing of so many adjustments into so short a period of time that an unfavorable chain reaction throughout the economy might precipitate a broad downward sweep.

Some of these adjustments took place gradually, but not sufficiently to prevent the turning point in the boom from leading into the decline of the first half of 1949. In a highly complex situation, the most crucial factor appears to have been the failure of demand to grow in proportion to the increasing potential output at maximum production and employment. There was a much greater physical availability of commodities, while rising prices had limited the growth of demand. By the latter part of 1948, consumer demand at current prices was far more selective and far less urgent than it had earlier been. There began to develop softening in some industrial prices, as the price-income structure and the current buying propensities of the public did not support a sufficient level of buying of a normal peacetime character. Thus, there was a substantial increase in the accumulation of inventories, largely of an involuntary character resulting from the failure of sales to grow at the expected rate. The sensitivity of businessmen to the possibility of further price declines, particularly in the value of inventories, led to a reduction in inventories. Orders were cut back. The weakening of price prospects created further hesitation on the part of buyers. The result was a sharp decline in industrial production and employment, and an extension of weakness to those areas, such as metals, which had been showing considerable market strength. Heavy seasonal tax payments added to the downward movement of private expenditure.

But soon after midyear, the reversal of the trend became apparent. Industrial production had been cut so sharply that it fell far below the level needed to support existing consumption, and inventories in many areas were depleted unduly. The stabilization of industrial prices by July, resulting in part from firmness in costs and in part from the sharp cut in industrial production which relieved the pressure of supply on the market, ended the expectation of further general price cuts. The sale of automobiles had continued to increase with an enlarged supply. Some readjustments in costs and prices of housing had kept production at high and increasing levels. A large upsurge in the building of rental units had followed the renewal of authority to insure projects on favorable terms. Government outlays were expanding. When renewed buying by those who had been waiting for price cuts was added to these continuing elements of high demand, the course of the economy again became definitely upward.

This review sheds light on 1950. Some changes, which can be fairly well foreseen, could halt the advance of the economy in the latter part of the year. The distribution of the insurance dividend to veterans, which will increase consumer buying power in the first six months, will have been largely completed and have a diminished effect on demand in the second half year. The diminution of the foreign aid program, together with the devalution of foreign currencies, may not be offset by an increase in foreign investment; in that case, the export surplus will be reduced. The market for automobiles at present prices has been brought fairly in line with normal demand, and continuance of production at the 1949 rate throughout the coming year may require tapping the large unfilled market among lower-income groups. Rental construction, although running strong, is primarily for those able to pay high rents, and as that limited demand is fully met, rental construction may ultimately decline unless new policies shift it into lower-cost projects. Coupling these and other possibilities with the currently declining trend of business investment, there are some who foresee a moderate business decline in the latter part of 1950. This could happen, but it is not necessary. The Council believes that affirmative action can and should be taken by business and Government to prevent it from happening.

The Council's confidence that action can be successfully undertaken to continue stability and growth throughout 1950 and beyond is based on several factors. In part it is based on the great potential demand of business and consumers, supported by ample funds and credit. The economy has demonstrated its elasticity, and we do not doubt its ability to make further adjustments. The stimulus afforded by lower prices and costs, as well as by favorable lending terms, is graphically illustrated by the sharp increase in the demand for residential construction, a segment of the economy which made a disappointing record in the second half of 1948. At the opening of the second quarter of 1949, when the general economic situation was deteriorating, housing construction began an up-trend leading to an all-time record. In the second place, our confidence is strengthened by the conviction that we have learned to take proper counter-measures when we are threatened with serious deficiencies in production, investment, or consumption. This applies to business action. It also applies to government, whose programs have been, and will continue to be, an underlying factor supporting demand.

Adjustments scaled to the longer-range outlook should begin now.

Adjustments Still To Be Made

The Council does not agree with those who suggest that business expansion may proceed so rapidly as to produce a new wave of inflation at an early date. It is true that some market shortages still exist at current levels of demand. But in general we are now operating considerably below the reasonably full utilization of our resources of plant and manpower, while technology is on the march, and further gains in population and productivity are to be expected. The ratio of demand to our producing ability would need to climb a considerable distance before we would again be confronted with the conditions which produce any generality of inflation in an economy with a basic financial structure as sound as ours and with resources for expansion so great. We may now concentrate our energies upon adjustments required for the sustained restoration of maximum levels of employment and production, confident that we can meet the dangers of inflation if and when they again confront us.

(1) The fact that we are not now threatened with general inflation does not justify price increases at any vital points in the industrial structure. Such price increases, instead of being called inflationary, should be regarded as fundamentally retarding in that they will reduce our likelihood of gaining maximum production and employment by imposing further restrictions upon a level of demand which is not yet sufficiently high. If there is any room for price change in some vital industrial areas, it is in a downward and not in an upward direction. Earnings are generally rewarding, though not so high as a year ago, and they can best be protected and advanced by those policies which will maintain and expand volume.

Steel prices are a case in point. Steel affects the whole economy, and some reduction in steel prices would favorably influence the whole economic situation. A stable and expanding economy requires a growing volume of steel output and of those other basic products which use steel. Some of these other products, whose prices are affected by steel prices, are also priced at a level where sustained and growing output seems uncertain at current prices. The statements of the steel industry accompanying the recent price increases did not in our judgment impair the shortly prior findings of the Steel Industry Board. These findings were to the effect that the price-profit-cost situation in the steel industry, allowing for pensions, did not justify price increases and in fact left room for price decreases in view of no wage-rate increases.

During the inflationary period, each price rise upon an article or service which affected the cost of production of other goods not only caused an increase in the price of the latter, but in addition such price increases were magnified through each successive step of production and distribution. Today the general situation will not always permit an increase in price to compensate for the increase in cost, and in any event it will not often be possible for the increase in price to spiral. Nonetheless, business should strive to the utmost to avoid price increases, which are unsettling even where not individually of major significance. The economy can expand more fully and confidently if prices do not rise, and the economy will be given favorable impulse by some selective downward adjustments now that the danger has been removed of a sweeping downward movement in the price structure.

(2) An outstanding problem is the maintenance of a sufficiently high level of business investment, primarily in plant and equipment. New investment for these purposes in 1949, while continuing at a level which belied the reports of business pessimism, declined by a substantial amount, and surveys of the investment plans of business firms indicate a further decline in the first quarter of 1950. Business investment should resume expansion as business recovery continues. We should also endeavor to shape our national policies to favor continued business investment at a high and growing rate. However, the real requirement for sustained business activity is the prospect of an adequate profit for a long enough time. Government policies in fields such as taxation affect the costs of enterprise, and consequently changes in such policies have some effect upon the profit expectations of the prospective investor and enterpriser. But this factor is of less significance than the current and prospective needs of consumers for goods or services to be produced. Changes in tax rates can, at most, be only small under present circumstances. The possibilities for increase in consumption are large.

(3) In a growing peacetime economy, the growth of consumption should be even more rapid than the growth in plant and equipment outlays, although both should continue to grow. We shall not be completely out of the woods after our recent difficulties until private adjustments and public policies are successful in raising the level of consumption, which is not now sufficiently high for sustained maximum production and employment or for the full prosperity of our business system.

(4) Investment and consumption cannot expand in balanced proportion unless those of influence in our business system realize fully—and many

of them now do—that domestic and world affairs do not permit even those deviations from maximum employment and production which were considered normal or tolerable in earlier times. The total real output of our economy in 1949 was between 10 and 13 billion dollars below the output that would have resulted at the maximum levels of production and employment contemplated under the Employment Act. We cannot afford for any length of time this wastage of our potential strength. The economic loss is accompanied by an aggravation of social tensions. It creates major fiscal problems as revenues decline at any given level of tax rates, thus disrupting long-range fiscal policy based on a reasonable balance between free enterprise and the inescapable obligations of responsible government. It produces international repercussions by reducing our imports, making it more difficult for other nations to solve their dollar problem, and undermining the exemplary position of our system in the eyes of the peoples of the free world.

(5) In addition to the purely domestic adjustments discussed in the present section is the problem of adjusting our policies to the prospective ending of the European Recovery Program. The international economic policies which this makes necessary are discussed in the final section of this report.

Awareness of our capacity for growth is the first step to its attainment. For our growth will be facilitated as investors, businessmen, workers, farmers, and consumers—and government—shape their judgments and actions confidently to conform to their belief in growth.

In succeeding sections of this report, we shall show to what great heights of economic strength we will be carried within a few years if we advance *steadily,* even though at a pace no more rapid than we have *averaged* in half a century of ups and downs, of booms and depressions, of war and peace. Then we shall consider the policies which may both protect the process of growth and also gain for it a greater degree of smoothness and stability.

III. Pathways to Economic Growth

In its Fourth Annual Report to the President, published last month, the Council singled out confidence in future growth as a prime conditioning factor of the American economy. In stressing the potentialities for growth, we do not propose a blueprint for the whole economy, but rather attempt to define the opportunities for future markets. This not only may serve as a guide for the course of public policy along constructive lines, but may also help to meet the needs of private business for basic bench marks for development of their programs and policies. We have stressed the fact that only through such growth could the various economic groups in this country prosper and progress together, instead of engaging in bitter and hopeless conflicts to obtain for themselves larger shares of a static national output.

Such an interpretation makes it clear that the problems of growth and stability are closely related. Affirmative efforts toward balanced growth are our main shield against serious periodic downturns. And the prevention of such downturns will remove the great obstacle to the speed and certainty of our long-range growth.

There is no *one* pathway to economic growth in a free economy, and that is why we have used the plural for the main heading of this discussion. Yet all business thinking and public decisions are based upon the realization that some roads are better than others, and that we must constantly seek to discern and follow the more promising ways in meeting the requirements under the Employment Act of 1946. The Council, under the Employment Act, must join in the search for these more promising ways.

We cannot be sure of all of our conclusions, and we would have neither the means nor the desire to enforce them upon others even if we could be sure. But in earlier reports, we set forth some tentative findings for constructive criticism. We are now prepared in the same spirit to present the results of further study and observation.

Growth Objectives for 1950–1954

There is a vital connection between the objectives which may be set for 1950 and those that we envisage over a somewhat longer span of time. It is only by looking backward over a number of years that we can truly appraise the strength and promise of the American economy. Correspond-

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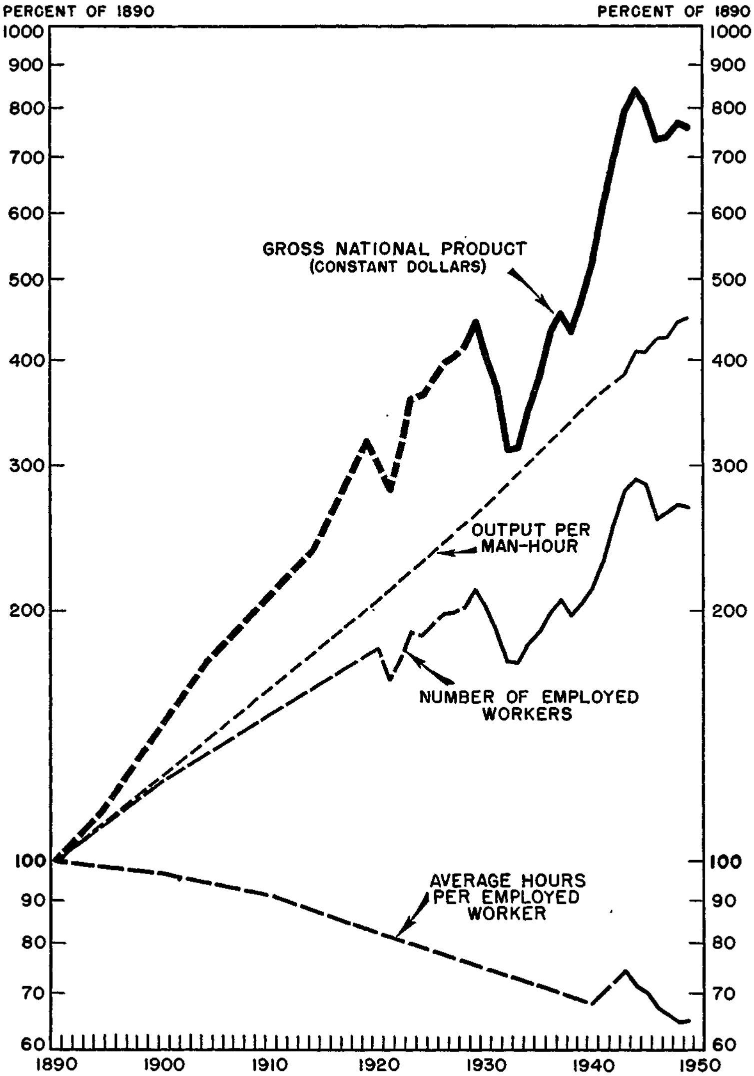
CHART 15

NATIONAL OUTPUT AND LABOR INPUT

Our long-run production achievements have been more the result of increased productivity than of increased employment. Output per man-hour has more than quadrupled in the last 60 years.



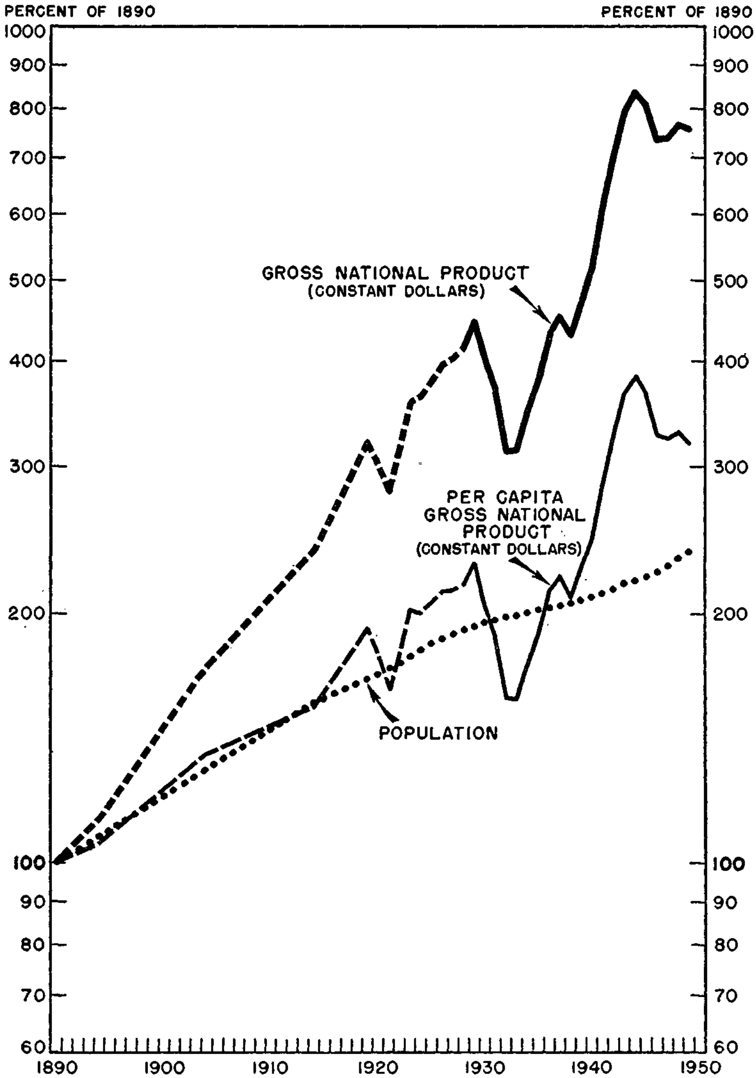
NOTE: BROKEN LINES SHOW ESTIMATES WHICH ARE BASED ON FRAGMENTARY DATA BUT WHICH INDICATE APPROXIMATE TRENDS.

SOURCES: DEPARTMENT OF COMMERCE, DEPARTMENT OF LABOR AND COUNCIL OF ECONOMIC ADVISERS.

CHART 16

NATIONAL OUTPUT AND POPULATION

Total output has increased nearly eight-fold since 1890 while the population has grown by 2½ times. As a result, production per capita has more than tripled.



NOTE: BROKEN LINES SHOW ESTIMATES WHICH ARE BASED ON FRAGMENTARY DATA BUT WHICH INDICATE APPROXIMATE TRENDS.

SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

ingly, it is only by looking forward for a few years that we can appreciate the prospects before us sufficiently to begin their achievement in 1950.

Over the past six decades, our national output of goods and services has been multiplied seven- or eight-fold, representing an average annual rate of increase of nearly 3½ percent and a virtual doubling of total output every 20 years. In 1949, this total output was about 260 billion dollars; measured in the same price terms, it was about 35 billion dollars in 1890. During the same time span, our population increased to not quite two and one-half times its 1890 size, while average working hours in industry decreased by one-third. (See charts 15 and 16.)

With a somewhat larger proportion of the population now engaged in economic pursuits, the net result has been that our total production per man-hour of work has quadrupled. This growth in productivity averaged about 2 or 2½ percent, annually compounded, and brought amazing advances in our real wealth and general standards of living. Per capita output, measured in 1948 dollars, increased from $550 in 1890 to $1,750 in 1949, or over 200 percent. The purchasing power of a typical American family now is about 130 percent greater than that of the much larger typical American family of 60 years ago.

The beginning of 1950 finds the American economy greater in its potentialities than ever before. Our managerial and working skills are greater, our farms and factories better equipped, and indications are that the pace of our technological advance will be maintained. It is a reasonable estimate that we should be able by a combination of private and public efforts to continue to increase productivity per fully employed worker by about 2 to 2½ percent annually in coming years. The total output will be affected by the net increase in the labor force which, under conditions of ample job opportunities, should a few years hence, say in 1954, bear about the same relationship to the total population as at present. Lessened participation by school-age youths and the effect of the resumption of the long-term trend toward earlier retirement may be offset by higher participation by women. Even with some further reduction in the workweek, perhaps mainly through longer and more widely enjoyed vacations, we should achieve in 1954 an expansion of about 18 percent in total output and about 12½ percent in per capita output over that of 1949. At current price levels, this would mean attainment of a gross national product in excess of 300 billion dollars. This potential increase in the annual output of the American economy would be nearly 50 billion dollars, or approximately $1,000 per family.

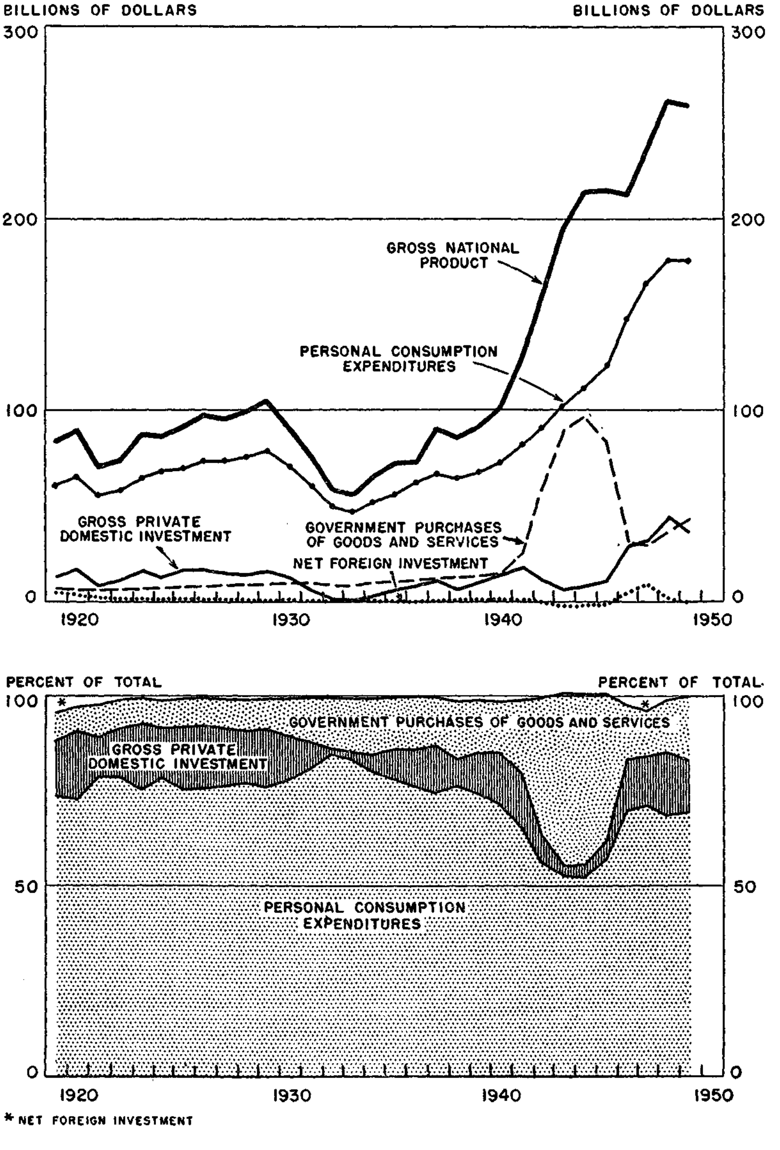
But the first step toward our goal for future years is our goal for 1950. Despite the process of recovery, we are not now measuring up even to a conservative definition of maximum employment, production, and purchasing power.

We should aim during this year to reduce unemployment from 3½ million to a figure in the neighborhood of 2, or at most 2½, million—

CHART 17

CHANGING SHARES IN NATIONAL OUTPUT

As compared with experience in the 1920's and 1930's, a relatively smaller share of national output now goes to consumers and relatively larger shares to business investment and Government.



SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS representing the "frictional" unemployment incident to the operations of a flexible economy, plus a hard core of unemployment in certain localities and occupations which can only gradually be reduced. Taking account also of the natural increase in the labor force, the goal of achieving maximum employment before the end of this year requires job opportunities for an addition of around 2 million people, bringing the total number of civilian employed to about 61 million. We must strive for fuller employment opportunities for those who are involuntarily underemployed, including people forced into low-grade employment by the absence of adequate job opportunities in their own occupations.

Maximum production for the year 1950 as a whole would require an increase of about 7 percent over last year, in order to offer the needed additional job opportunities to a growing labor force working at increasing productivity. We cannot achieve this improved level of production for the year as a whole, but it should be possible to attain maximum production on a stable basis by the end of the year.

The maximum purchasing power objective for 1950 is to promote those adjustments in the intricate network of the income and spending stream—both private and public—which will provide our economy with the requirements for both stability and growth.

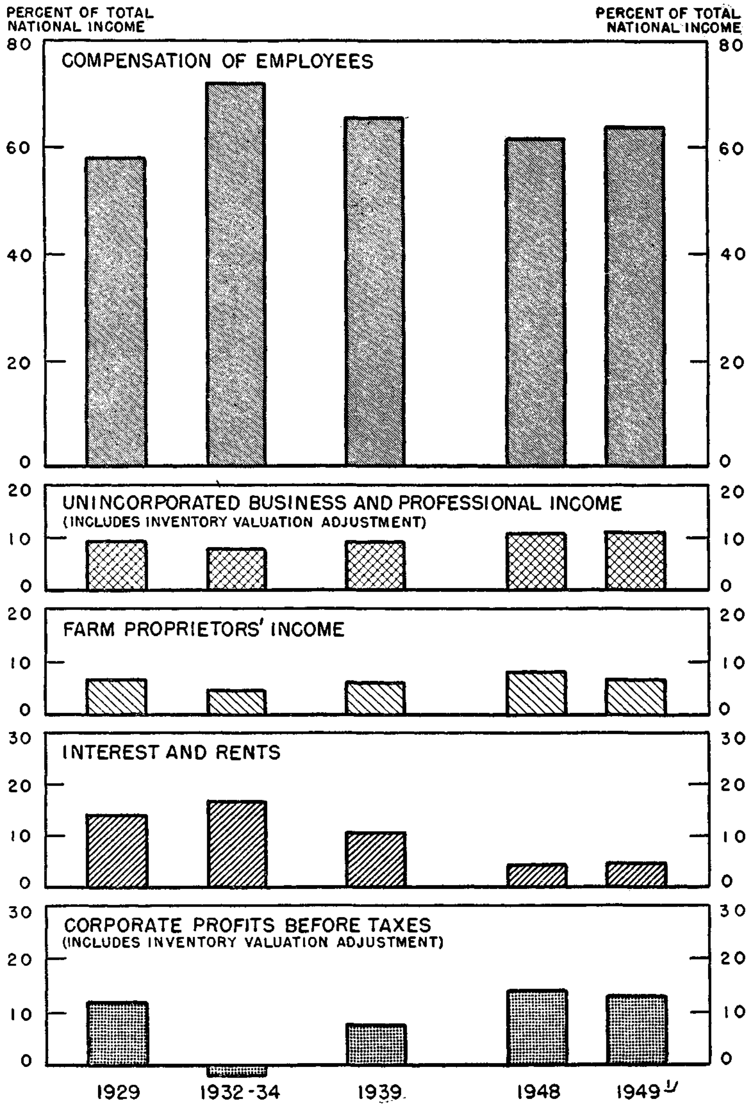
Toward a Balanced Economy

Whether or not we realize the gains within our reach depends upon achieving a sustainable balance among the various sectors of our economy. Attaining this balance requires that production and incomes shall not develop in a manner resulting in the periodic downturns we have witnessed in the past. Business income and investment should be large enough to make full use of our technology, our inventiveness, and our labor force, but not so large as to result in subsequent overproduction in relation to the absorptive capacity of markets. The income and spending of consumers should be sufficient to clear the markets of goods and to provide incentives for still more business enterprise, but not so large as to cause inflation. The expenditures of government should be large enough to provide those services which our resources permit, which our people need, and which cannot so effectively be provided in any other way, but not so large as to overstrain our resources or to dampen the incentives of free enterprise or alter the essential character of our economy. Our supply of goods to foreign countries should be sufficiently large to promote a more prosperous and more peaceful world, but not so large as to undermine our domestic strength and thus defeat the very objective which we seek. The whole task of economic policy, both private and public, is to work out these arrangements bit by bit, pragmatically as we go along, benefiting constantly by the lessons of past experience.

CHART 18

CHANGING SHARES IN NATIONAL INCOME

Wages and salaries and business earnings accounted for somewhat larger shares of national income in 1948-49 than in 1929. Interest and rents accounted for a sharply reduced share.



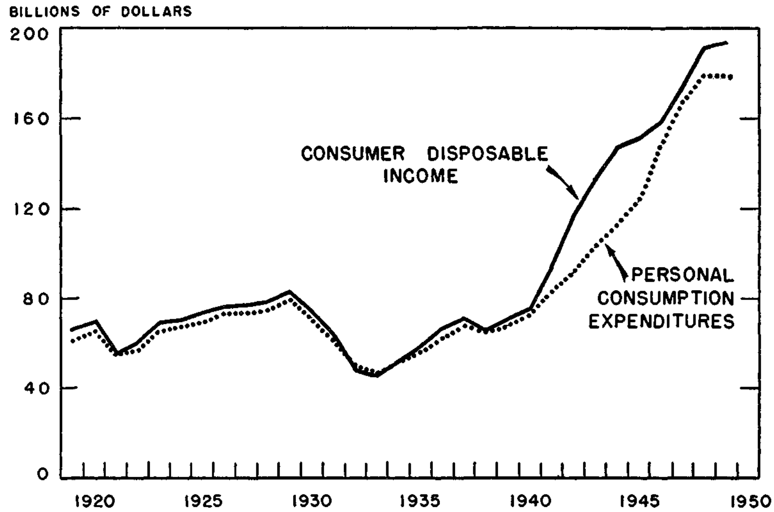
[1] ESTIMATES BASED ON INCOMPLETE DATA; INCLUDES SECOND HALF ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED)

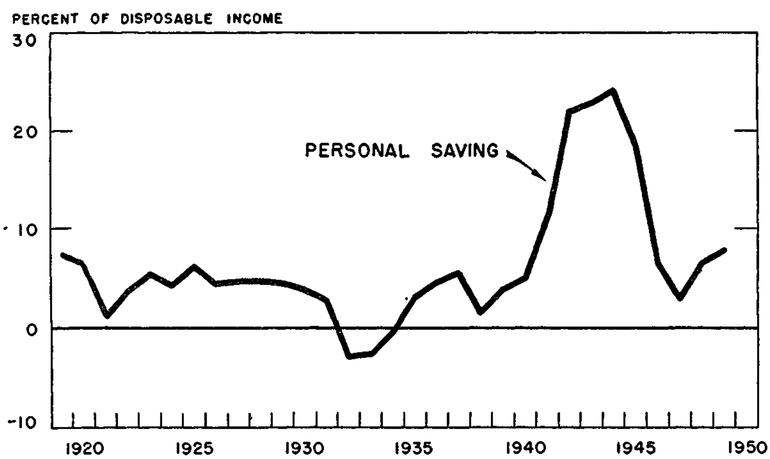
CHART 19

HOW CONSUMERS USED THEIR INCOME

Consumer income and spending have fluctuated with general economic activity, rising during prosperous years and falling during depressions.



Personal saving, which was negative in the early thirties, averaged about 5 percent of disposable income in prosperous prewar years.



SOURCES: U. S. DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS

Past experience can never give us any one exact pattern for these balanced relationships. But, when combined with quantitative analysis, it can help to point the way toward some workable relationships within a broad range. More important, past experience demonstrates fairly conclusively that enormous variations in these patterns from time to time have been a concomitant of the vast instabilities to which our economy has been unnecessarily subjected.

Whether the instabilities in these relationships are regarded as the cause or the result of the business cycle, it is clear that economic stability cannot be achieved without reduction in these excessive swings in various categories of private activities. Of course, private and public policy in a free-enterprise economy cannot completely remove fluctuations in business investment and other economic activities.

These extraordinary variations in the composition of our gross national product may be illustrated by the experience of the last three decades. (See chart 17.)

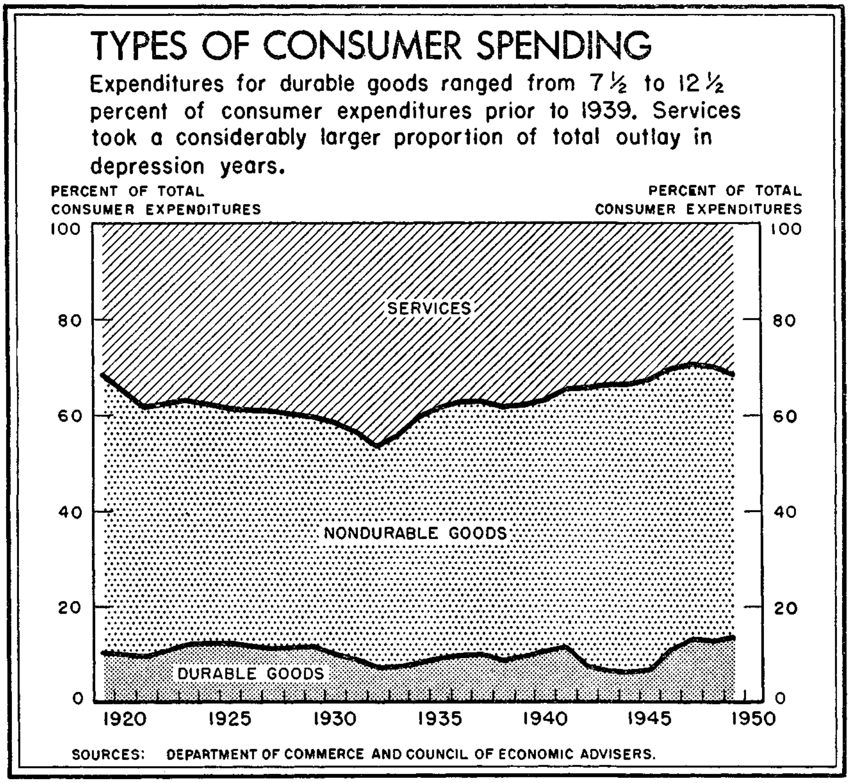
Some of these variations were caused by wars. But it will be more profitable to focus attention upon aspects of the business cycle at least partly independent of wars. Certainly we could not expect reasonably permanent stability in an economy in which gross private domestic investment swung from 15 percent of the total national product in 1919–29 to 1.5 percent in 1932. Consequently we must be deeply concerned that private domestic investment, which reached an even higher percentage in 1948 than in the boom year 1929, does not take another drastic downward swing. Certainly the cyclical shifts in the portion of gross national product represented by personal consumption expenditures from 76 percent in 1929 to 83 percent in 1933 to 68 percent in 1948 were not consistent with a reasonably stable economy.

Expenditures are mainly although not wholly determined by income, and the excessive variation in our levels of general economic activity have also been closely associated with income relationships which were not sustainable and therefore were subject to excessive periodic change. Chart 18 shows the relative changes in the main shares of national income since 1929.

Clearly, a smoothly functioning economic system was unattainable with corporate profits after taxes ranging from 9.6 percent of the national income in 1929 to minus 2.2 percent in 1932–34, or with a level of farm income dropping by more than two-thirds between 1929 and 1932. Acceptance of such wide variations as "inevitable" or "normal" in a free economy would drive business policy, labor and farm action, and Government programs along most undesirable lines.

Success in business operations requires the ability to forecast marketing conditions, which means largely forecasting the buying ability and habits of consumers. Chart 19 shows, for the period 1919–49, the excessive and unpredictable variations in consumer income, expenditure, and saving, while chart 20 indicates the impossibility of appraising even roughly the composition of consumer demand, so long as income and expenditure are subject to such wide fluctuations.

CHART 20



In an economy growing toward a gross national product of more than 300 billion dollars by 1954, the various sectors of the economy would need to function in a balanced relationship, so as to avoid the inflationary effect of demand exceeding supply or the deflationary effect of production running ahead of effective demand. If this balance can be achieved—and we believe that it can—it is possible to outline in broad terms the vast opportunities that this would offer to our business system in the form both of high investment levels and high sales of goods to ultimate consumers. The broad depiction of these opportunities is a logical extension of the idea of market analysis of business prospects, the value of which has been increasingly recognized by the business world. It is a composite estimate of what our resources can do and what our people may buy, which is correspondingly an estimate of what business may have an opportunity to sell.

The Council, since its inception and in response to its mandate, has been making exploratory studies of potentialities for economic growth. While it is relatively easy to estimate what the total output of the economy would be in a future year if resources are effectively used, it is more difficult to discern the broad relationships among the various sectors of the economy which may facilitate growth without generating the disproportions that threaten either inflations or depressions. Studies have been made specifically of expansion and modernization of productive capacity consistent with the projected rise in total output, and of the increase in consumption consistent with taking off the market the entire output of an expanding production without undue price fluctuations. In addition to domestic investment and consumption, these estimates have taken into consideration the governmental and international transactions which enter into the Nation's Economic Budget. These studies are still in the exploratory stage; The Council hopes that eventually they may develop into useful guides to voluntary adjustments and to the evolution of public policies to stabilize the economy at a high level.

Preliminary study, however, permits estimates of investment and consumption opportunities in an expanding economy within a range of variation wide enough not to seem either arbitrary or all-wise, as set forth in the following table.

TABLE 13.—*Output, consumption, and investment.*

[Billions of dollars]

Item	1948	1949	1954 [1]
Gross national product	262.4	258.7	300–310
Personal consumption expenditures	178.8	178.5	210–225
Gross private domestic investment, exclusive of inventory accumulation	38.6	37.2	38–43

[1] The 1954 estimates allow for only minor variation of prices from the present level.

Source: Department of Commerce (1948–49).

Some comments are here desirable with regard to the foregoing estimates. First, these estimates present objectives for an economy of maximum employment and production. This means that affirmative policies, both public and private, will be needed to achieve them; they are not *forecasts* of developments which will occur inevitably. Second, usefulness for the purposes intended would not be impaired if the figures were varied moderately from those shown. Third, it should be noted particularly that the figures involve a high level of private investment in equipment and construction—a level well above that contemplated for 1950 in most current forecasts. This investment trend should soon rise above the 1949 level, and within five years might even surpass the record established in 1948, when postwar making-up of deferred capital needs was in full swing. Fourth, the estimates contemplate, over the five-year period, a growth in consumer buying at a more rapid rate than the growth in business investment. Analysis indicates that this is necessary to maintain maximum employment and production in a growing peacetime economy, which in turn is necessary to provide incentives for a high and growing level of business investment. Fifth, the estimates contemplate programs in the governmental sector based upon the assumption that some programs, such as those for veterans, will decline. They assume moderate extension of certain accepted programs, such as social security, upon foundations already established, and also allow for some new programs in the domestic and international fields. But they do not assume an intensification of international tensions, which would necessitate a considerably higher level of activity in the government sector as a whole. By 1954, this outline of peacetime growth would lead to the government sector accounting for a smaller proportion of the total gross national product than in 1949.

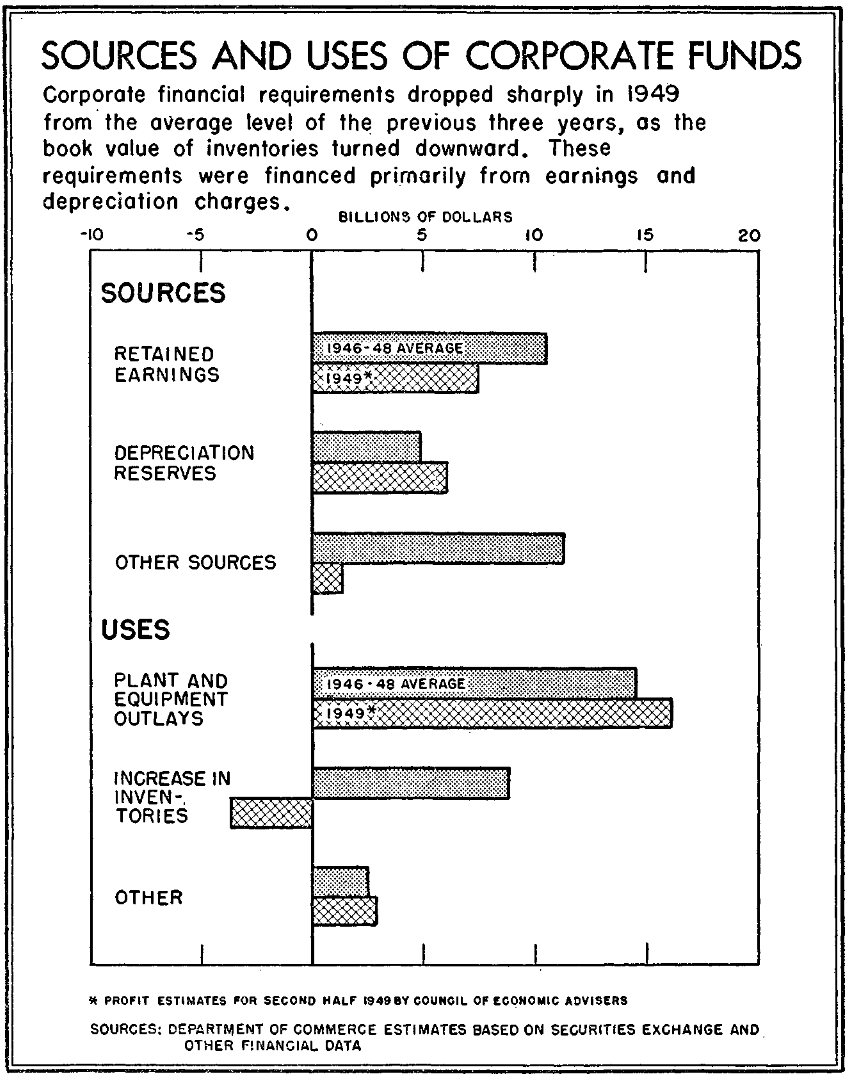
High Business Investment Needs

It has been indicated that our growth toward a 300 billion dollar economy by 1954 should afford opportunity by that year for an annual gross private domestic investment, excluding investment in inventories, ranging from 38 to 43 billion dollars. The upper figure is considerably higher than the level of either 1948 or 1949.

The realization of an adequate volume of investment between now and 1954 cannot be reconciled with a downturn for a substantial period, followed by another boom. Analysis points up the conclusion that the growth in investment should be encouraged at a fairly steady rate. We know only too well from historical experience that large variations in investment activity are inseparable from intermittent idleness and waste of our productive potentialities and a sacrifice of growth opportunities. With allowance for some backlogs of deferred expansion or replacement to be liquidated over the next few years, the growth potential of investment should be correlated with the general growth of the economy as a whole.

Very high outlays for the expansion of nonfarm plant and equipment in the postwar years appear to have brought productive capacity as a whole—with some exceptions—into a fairly workable relationship with requirements for a maximum employment economy. There has also been considerable modernization of equipment, although railroad equipment and a few other types still present a backlog of deferred replacement. Abundant opportunities exist for further modernization of productive facilities, and the upper range of the figures shown assumes that a large increase in outlays could perhaps be achieved by more rapid retirement of facilities for obsolescence. But present investment expectations of businessmen are one indication that such an increase might be difficult. For nonfarm producers' plant and equipment, investment trends should reflect a reasonably consistent historical relationship between such outlays and the growth of buying power.

CHART 21



The trend of investment in farm equipment and construction should allow for expansion, increased mechanization, and replacement in keeping with the agricultural output requirements of a fully active economy. For other private nonresidential construction—such as churches, schools, hospitals, institutions, social and recreational buildings—about the 1949 rate of outlays (which was about one-fifth above that of 1948) should be carried forward. Inventories are in a reasonably workable relationship to sales at the present time, and they may therefore be expected to increase roughly in proportion to the output of the private sector of the economy. The greatest increase above current levels of private investment is clearly required in the field of housing, because it is here that the total available supply of goods lags farthest behind the needs of the people and presents the greatest challenge to production and financial ingenuity.

For now and the foreseeable future, the problem of encouraging an adequate level of business investment assumes greater importance than is indicated by the mere quantitative relationship of such investment to the total size of the economy. A timely checking of the current downtrend in investment, followed by resumption of growth, is by no means to be taken for granted. Neither investment nor consumption can long sustain satisfactory growth unless both do; and the relatively modest growth in investment contemplated in the estimates presented above may well present even more difficulty of attainment than the larger growth set as a consumption goal. It is easier for public programs to stimulate consumer spending than it is for these programs to enlarge business investment direct. Yet we know from the experience of the 1930's that, without a large and growing volume of business investment, maximum employment and production can hardly be achieved and can certainly not be maintained.

Availability of funds for investment

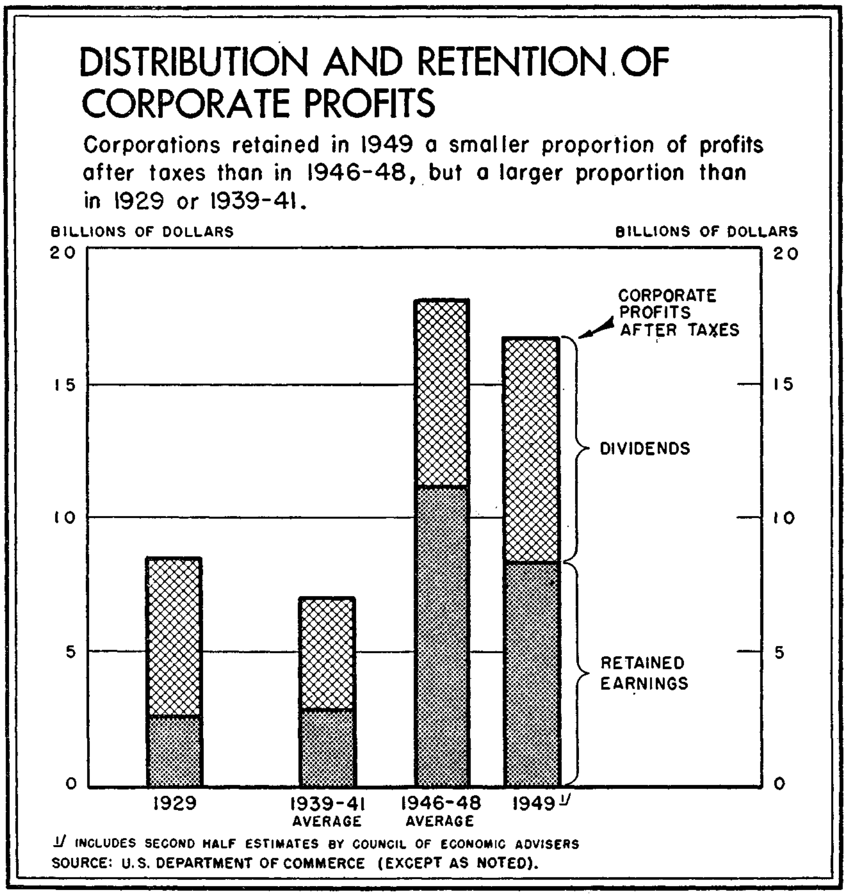
Consideration of the problem of supplying adequate funds for business investment calls for a comparison of corporate financial requirements, under conditions of maximum employment and production, with the sources of funds likely to be available to meet these requirements. Corporations account for the major share of business investment, and depend more heavily than other businesses upon outside capital.

During the period 1946–48, as chart 21 and appendix table C–34 show, corporations used an average of about 28 billion dollars a year to finance plant and equipment expenditures, expansion of inventories, and expansion of accounts receivable. These requirements were very high in comparison with prewar experience, even after taking into account the rise in sales volume and prices. They reflected not only a volume of plant and equipment expenditures nearly twice that reached in any previous year, but also an impressively large volume of funds to finance expansion of working capital.

In general, corporations during the very high investment period 1946–48 were adequately supplied with funds to finance their investment programs along conservative lines despite the high level of taxation. In fact, a striking characteristic of the period was the extent to which corporations were able to meet these unprecedented financial requirements from their own funds. During this period, corporations reinvested about 62 percent of their profits after taxes, as compared with 31 percent in 1929 and 41 percent in the 3 years before the war. (See chart 22.) This large volume of retained earnings enabled corporations to remain in a generally strong financial position in spite of the large requirements for funds. Their liquidity, as revealed by various types of liquidity ratios, compared very favorably with the prewar years. Relative to income after taxes, corporate debt at the end of 1948 was only about 50 percent as large as in 1929, and 45 percent as large as in the period 1939–41. During 1949, as was shown in Part I, corporations were generally able to improve their financial position and at the same time to step up their dividend disbursements.

The postwar experience indicates that, in a period of high employment and production, corporations experienced little difficulty in financing their expansion in a manner which left them generally in a favorable financial position. It seems unlikely that an expansion of the economy such as was outlined above would pose a more difficult financial problem. We should expect that in such an economy a higher level of business investment in plant and equipment could be attained without imposing upon corporations financial requirements as high as during the period 1946–48. The reason for this is that probably not more than 3 to 4 billion dollars annually would

CHART 22



be needed in an enlarging economy to expand inventories and customer accounts in line with sales. These figures are far below the annual average of about 13 billion dollars absorbed in rebuilding of inventories and in financing customer credit during the inflationary period 1946–48.

The main sources of funds for corporations will be retained earnings and depreciation reserves. If the economy continues to grow in line with its indicated potential, corporate profits should increase enough so that, even with a dividend disbursement ratio as high as in the late 1920's, retained earnings and increasing depreciation reserves will furnish a major part of new capital requirements. In these circumstances, the necessary outside financing would be much less than the 11 billion dollars annually secured from outside sources in 1946–48. The larger and established corporations will not face any serious problem of equity capital. Reinvested earnings should be large enough, in conjunction with new stock issues no larger than those of recent years, to improve the ratio of equity capital to debt. Provided we are able to realize a sustained period of growth, dividend disbursements may even be higher in the future than they have been in recent years. We should then expect a sizable increase in the amount of new capital forthcoming from stock issues. Indeed, late in 1949, and probably as a result of these factors, the market for new stock issues improved noticeably. Corporate managers have recently preferred to borrow funds at prevailing low rates of interest, rather than to "dilute the corporate equity capital," as they describe the issue of new stock at the price at which it would be absorbed by the existing market. If the recent movement in stock prices continues, many corporations will reverse their policy and seek outside equity capital. Others will continue to be attracted by the tax advantage of debt financing and by the continuance of low interest rates, which is assured by the Government debt-management policy.

While corporations as a whole may not experience serious difficulty in financing their expansion, individual corporations will fare unevenly in the gains of prosperity. Some will be capable of meeting temporary market adversities and financing expansion needs entirely from internal resources. Others may better this record and in addition improve their liquidity positions. Still others, however, may find internal resources quite inadequate for these purposes and will seek funds actively from external sources, in order to provide for corporate growth in line with expanding markets and at times to cushion adjustments to changing competitive trends.

Specific problem areas

Despite the generally adequate supply of funds, there are important gaps in our financial and investment structure. The prospect that total saving is likely to be fully adequate for total investment opportunity does not dispose of the problem of increasing the availability of funds for particular types of businesses, and of making them available in all regions of the country in such forms and on such terms as to promote their full and effective use. There is danger that the proportion of funds seeking fixed-return investment will continue to rise and that the economy will generate a larger volume of saving for such purposes than it can absorb, while at the same time important types of investment will be impeded by lack of risk capital. Small and new business concerns have always experienced great difficulty in securing long-term loans and in acquiring outside equity capital, and this problem has now been intensified by the larger concentration of investment funds in the savings accounts of persons of moderate income who seek fixed-return investments, and in institutions which have little interest in financing small business.

There are particular industries, such as the railroads, in which capital needs are very large in relation to earnings and which face especially thorny problems of obtaining either debt or equity capital. Special consideration must be given to certain strategic industries in which expansion desirable for national security calls for larger or more rapid investment outlays than are likely to be forthcoming from private investment.

CHART 23

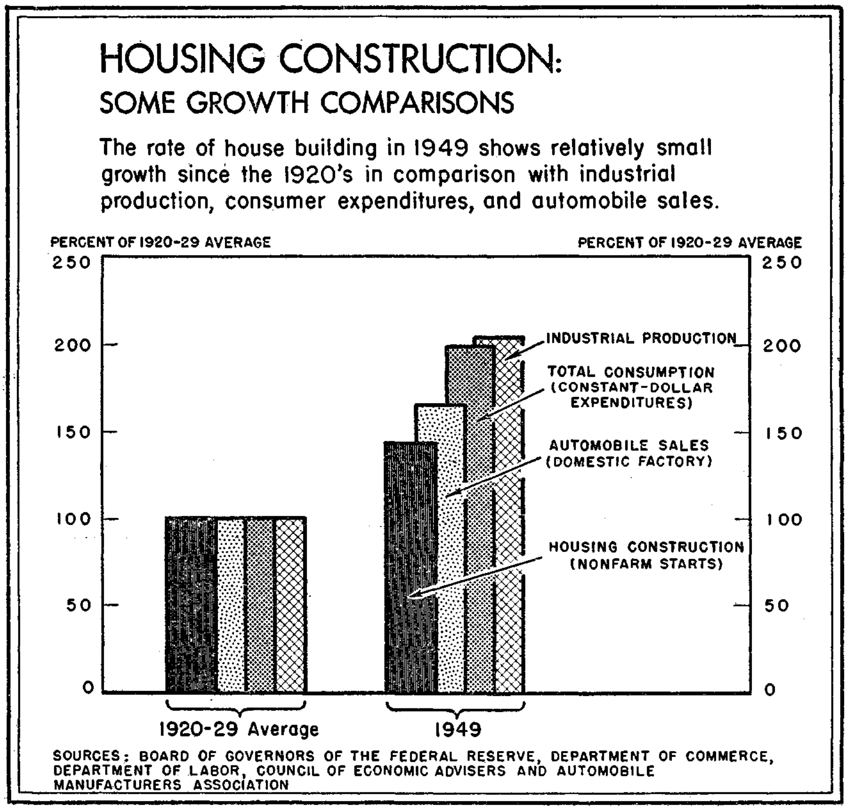
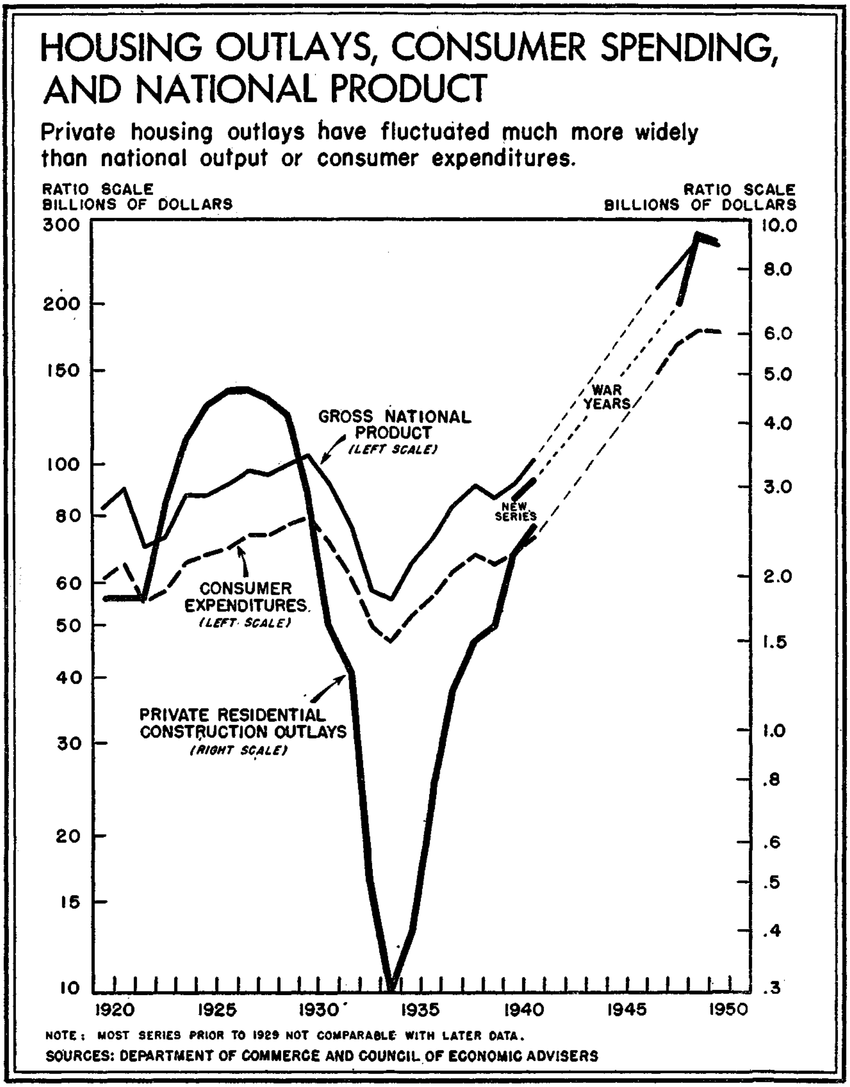


CHART 24



The housing problem

The housing shortage is still acute, and the desire of the people for more and better housing presents the largest single potential market now open for increased investment. While 1949 was a peak year for housing, the construction of new nonfarm housing in 1949 showed a much smaller increase from the levels of the 1920's than did the total physical volume of consumption, the volume of industrial production, or the purchases of new passenger automobiles. (See chart 23.) Housing has failed to keep pace with over-all economic growth in the past quarter century.

Instability in so important a sector as housing has contributed powerfully toward general economic instability. As shown by chart 24, which omits the period 1942–45 to avoid the special complications of wartime, private housing outlays have fluctuated more violently in the past three decades than either total output or consumer expenditures.

Housing production should be stabilized at very high levels. Based upon needs and resources, the objective over the next few years should be to build on the average about 1½ million new residential units annually, or substantially more than the million in the year 1949—which, while an all-time peak year for home-building, was only slightly above the level of 1925. A considerable part of this new construction should represent replacement of hopelessly obsolete housing, which should be cleared away on a much enlarged scale. Improvements and enlargement of existing houses should also require very large new investment. Allowing for some further decrease in housing costs, and for the trend toward more economical design to meet the needs of families of moderate income, but allowing also for the related facilities and community developments which such a large amount of residential construction would carry with it, this volume of housing and related improvements over the next few years would probably require an average annual investment in the neighborhood of 12 to 14 billion dollars. This is not a *forecast* of what the level of such housing investment is likely to be without special efforts. On the contrary, we face the danger of a decline rather than an increase in residential construction unless new means are developed to enable more middle-income families to obtain new housing, particularly as the backlog of postwar demand tapers off. This will require strenuous efforts to develop workable stimuli along new lines. The Council regards the maintenance of a high and growing level of private investment in housing as perhaps the most important issue in connection with the maintenance of a total level of investment high enough to support maximum employment and production over the next few years.

Adequacy of market opportunity

Adequate market opportunity for business means conditions favorable to the disposition of full output at a return providing sufficient funds and incentives in the form of profits. In the final analysis it is the appraisal of market potential which mainly controls the rate of investment. No redundancy of funds available for investment will promote a sufficiently high level of investment if this market opportunity does not exist. If it does exist, investment in general will grow with the rest of the economy and will not in general be hampered by lack of capital funds.

A large contraction in business investment sets in because those making investment decisions forecast a level of general economic activity not sufficiently high to assure profitable utilization of additional capacity. They recognize that a generally expanding economy would continue to support a high and growing investment level, but feel that the short-run outlook does not presage the resumption or continuation of expansion. Thus the first and foremost step toward solving the investment problem is to promote the environment which will encourage businessmen to make their investment decisions in the light of longer-run prospects for growth.

Our analysis of the magnitude and of a few of the probable characteristics of an economy expanding toward the 300 to 310 billion dollar level indicates that high and growing levels of business investment—and the business earnings necessary to motivate and help finance it—are entirely compatible with expansion of ultimate consumer incomes and expenditures sufficient to absorb the swelling product. If this absorption occurs, there should be no real problem of business profits failing to provide generally adequate incentives.

It is recognized that any prolonged contraction in corporate profits from present levels would spell a sizable reduction in business investment, and that an expanding economy cannot be founded upon a continually declining level of profits. But an expanding economy, associated with sufficiently high market prospects and their full appreciation by the business community, would result in a rising level of corporate profits even if profit margins should be somewhat reduced. There is ground for belief that somewhat reduced profit margins would still provide generally adequate investment incentives under conditions of an expanding market furnishing a *rising absolute level of profits.*

It should be recognized, however, that such expansion of the economy may not occur if business pricing practices are not adapted to encouraging a rising level of consumption. Pricing practices also bear directly on investment insofar as they are associated with restriction of capacity. The degree of competition is an important determinant of outlays for cost-reducing improvements of productive facilities.

A High Consumption Economy

The broad estimate that consumer expenditures in a 300 to 310 billion dollar economy would range from 210 to 225 billion dollars represents an expansion in consumption of about 22 percent, or about 15 percent per capita after allowing for population increase, over the level of 1949. This measures the market opportunity for our business system.

Expenditures for consumer durable goods

Over the past decade, despite the war, there has been a great increase in the ownership of durable goods by American families. Between the end of 1939 and the end of 1949, the number of radios in use increased from 39 million to 62 million, electric refrigerators from 14 million to 29½ million, and electric washers from 14½ million to 25½ million.

Future economic growth would maintain large opportunities in the consumer durables field. About one-third of all households still lack electric refrigerators, and a continued high rate of residential construction would create a need for all types of appliances. The number of television sets in use at the end of 1948 was slightly above a million; during 1949 almost 2½ million sets were produced, indicating the very rapid expansion afforded by this market.

More than 5 million passenger cars were produced in 1949, bringing total private registrations to 35.5 million, or an average of one car for every 4.2 persons. This compares with 26 million passenger cars at the end of 1939, or an average of one car for every 5 persons. The character of the demand for automobiles since the war, despite the mounting prices, should be sufficient warning that it is very easy to underestimate the future market. Nor does the scope of demand at this time furnish a clear guide to the demand when and if prices are reduced, or to the demand when family incomes become larger. The universality of the desire of Americans for automobiles has been thoroughly proved, and the history of the industry does not permit doubt that management, once it finds that it has exploited the market for higher-priced cars, will find ways through price reductions and through cheaper models to attract the vast potential demand not now able to come into the market for new cars.

The proportion of consumption expenditures now devoted to purchases of durable consumer goods, including automobiles, appliances, and furniture, is about 14 percent, compared with 12 percent in 1929 and 10 percent in 1939. (See chart 19, page 82.) There will be further working off of backlog demand for certain goods, but a lifting of standards of living would probably increase the share of expenditures on durable goods above that of prewar years.

Expenditures for nondurable goods

The two major items of consumption in the category of nondurable goods are food and clothing. The percentage of income spent currently for food is higher than it used to be, reflecting higher prices for food and higher quantities of consumption. Per capita food consumption is about 10 percent above the 1935–39 level. The level of 19 percent above prewar, reached in 1946, would be exceeded if the diets of low-income families were raised to an adequate nutritional level. Clothing expenditures, as a percentage of total expenditure, have shown a declining trend over the last three decades. Nevertheless, budgetary studies show that many families, particularly in rural areas, obtain no more than minimum requirements. Income gains which would lift low-income families to a more satisfactory standard of living would greatly enlarge the market for clothing.

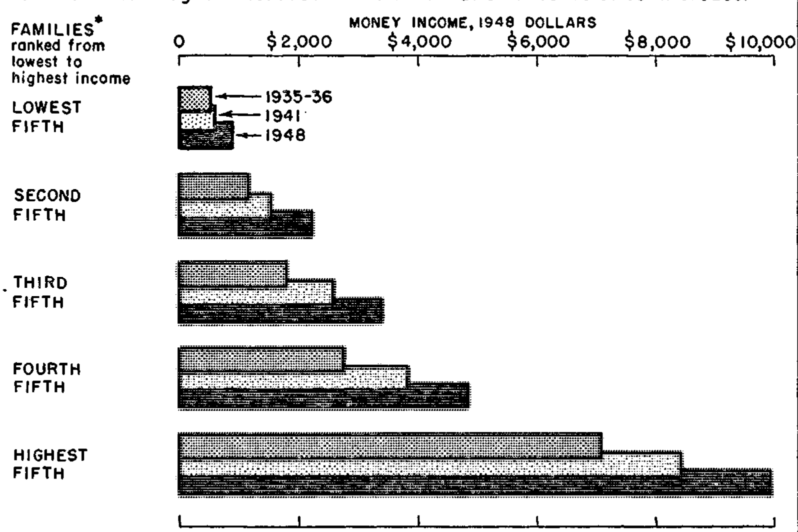
Expenditures for services

Even with the expanded consumption of durable and nondurable goods which has been outlined, the markets for these goods are not limitless. The full utilization of our productive resources requires that the enterprise and imagination which have created new products like automobiles and radios shall increasingly be devoted to the development of even newer products in an even wider variety. Beyond this, as standards of living rise, a larger proportion of the people's wants and needs turn from the basic requirements of life toward those things which add to the enjoyment of living. Services such as education, health, and recreation are an area of economic development yet in relative infancy. The expansion of these services may involve varying patterns of private and public action, but in any event they will vastly increase private employment and business opportunity for a wide range of related and supporting activities.

CHART 25

CHANGES IN AVERAGE FAMILY INCOME

The average family income of all groups has increased greatly from the prewar period. The fifth of families having highest incomes received the largest increase in dollars but smallest relative increase.



* INCLUDES SINGLE INDIVIDUALS

SOURCES: NATIONAL RESOURCES PLANNING BOARD, DEPARTMENT OF LABOR AND DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

Distribution of income

The percentage of income going to various groups does not change greatly over a short period of time. Nevertheless, the conditions of full employment during the war were instrumental in bringing about a distribution of income in the United States more favorable to lower-income recipients. Chart 25 and table 14 show the average income of each fifth of the population, from those with the lowest income to those with the highest, in two prewar years and in 1948. The greatest relative improvement since

1935–36 appears to have been in the second and third of the five brackets. The top fifth had the largest average gain in absolute amounts but the smallest percentage increases. In appraising the average income in the lower brackets, it should be noted that these brackets include many young single persons and retired persons whose income runs considerably lower than that of families of two or more. In addition, many families have non-money income, such as home-produced food or fuel, not reflected in the distributions. Nevertheless, income for many families is clearly below the level required for an American standard of living. Recent investigations by the Joint Committee on the Economic Report have shed light on the plight of these families, and on many of the social and economic conditions contributing to inadequate income.

TABLE 14.—*Money income received by each fifth of families and single persons, 1935–36, 1941 and 1948*

Families and single persons ranked from lowest to highest income	Percentage of money income			Average money income in dollars of 1948 purchasing power [1]			Percent increase in average income	
	1935-36	1941	1948	1935-36	1941	1948	1935-36 to 1948	1941 to 1948
Lowest fifth	4.0	3.5	4.2	$534	$592	$893	67	51
Second fifth	8.7	9.1	10.5	1,159	1,546	2,232	93	44
Third fifth	13.6	15.3	16.1	1,810	2,597	3,410	88	31
Fourth fifth	20.5	22.5	22.3	2,734	3,816	4,711	72	23
Highest fifth	53.2	49.6	46 9	7,083	8,418	9,911	40	18
All groups	100.0	100.0	100.0	2,664	3,396	4,231	59	25

[1] Current dollars divided by the consumers' price index on the base 1948=100 to give a rough measure of changes in purchasing power of income. (See appendix table C-8.)

NOTE.—Adjustments have been made in basic survey data for each year. See appendix table B-1 for a distribution of families and single persons by income level for 1948. Detail will not necessarily add to totals because of rounding.

Sources: National Resources Planning Board (1935-36), Department of Labor (1941), and Council of Economic Advisers (1948).

The purely social consequences of income distribution are not within the scope of this report, but it should not be forgotten that the functioning of the economic system as a whole bears upon the life and livelihoods of the people whom it is designed to serve. In addition, the distribution of income has a recognized bearing upon the functioning of the whole economy and upon its prospects for growth. A balanced growth of investment and consumption is closely related to income flow, which in turn has a bearing upon the proportion of income that is spent for consumption.

In 1948, consumer income and consumer expenditure each represented a considerably lower percentage of gross national product than in prewar years. The high tax structure necessitated by the war and its aftermath absorbed part of the income which would otherwise have been available to consumers. In 1949, the percentage of the total product represented by this type of income and expenditure moved upward slightly. This is shown by table 15.

TABLE 15.—*Selected series relating to consumption*

Series	1923–29 average	1933–35 average	1937	1939	1948	1949
Personal consumption expenditures as percent of gross national product	76.0	80.1	74.4	73.9	68.1	69.0
Net personal saving as percent of disposable personal income	4.9	.2	5.5	3.8	6.3	7.5
Disposable personal income as percent of gross national product	79.9	80.2	78.8	76.9	72.7	74.6
Per capita disposable personal income:						
Current dollars	641	408	552	536	1,302	1,293
1948 dollars [1]	888	732	920	923	1,302	1,309
Index (1948 dollars, 1948=100)	68.2	56.2	70.7	70.9	100.0	100.5

[1] Current dollars divided by the consumers' price index on the base 1948=100 to give a rough measure of changes in purchasing power of income. (See appendix table C–8.)

Sources: Department of Commerce and Department of Labor (see appendix C for basic data).

The expansion of consumer demand which will be necessary in future to sustain a high level of business investment, and to promote maximum employment and production, will hinge not only upon the proportion of total disposable income in the hands of consumers, but also upon the trend of current saving. In 1949, as table 15 shows, the rate of saving reached 7.5 percent of disposable income, compared with 3.8 percent in 1939 and about 5 percent during the 1920's. It may well be that a higher rate of saving than in the prewar period will characterize postwar prosperity, and this may create a problem of finding adequate investment outlets. Earlier in this report, however, we noted the fact that the proportion of saving to income decreases at the lower ends of the income structure. As the national income grows, a trend toward relatively greater increases in income for families in the lowest brackets of the income structure would therefore give an extra stimulus to demand for consumption goods.

Thus greater relative gains by those groups who at present share least in the benefits of our economy not only serve fair social objectives, but also tend to improve the balance in the relationship between intended saving and intended investment. Such a development contributes to the stability and growth of the whole economy, and thus is beneficial to all groups in the long run. This offers a wide area for agreement and cooperation throughout the country, as the people look to free enterprise and free government for continuous improvement in the functioning of the economic system.

IV. Needed Policies

The early reversal of the downturn in 1949 was accomplished with the aid of a composite of private and public policies. The Council has stressed the importance of policies in the business world itself, coupled with our confidence that as these policies constantly improve there will be progressively less likelihood of the drastic Government action which follows from the emergence of critical conditions.

Government should also exert an affirmative influence if we are to accomplish the objective of steady economic growth. The Government has become a large partner in the modern productive process by contributing to the development of resources, transportation, research, and the productivity of labor, all of which are essential to an expanding economy. Tax and credit programs have an immense impact upon the flow of incomes and funds, and upon the decisions of business and consumers.

The following treatment includes an appraisal of some of the measures which are significant for economic growth and stability under current and foreseeable circumstances. This treatment does not attempt to be all-inclusive. For example, other programs (such as those involving the power to deal broadly and flexibly with credit developments through the Federal Reserve System) should be made available to be used if conditions sufficiently change to call for them. Still others may need to be developed if deficiencies in market adjustments unfold.

What is recomended now might appear as a piecemeal approach, were not each piece appraised in the perspective of the current economic situation and of the general objectives defined for the years immediately ahead.

The Function of Prices

Our economy is sometimes called a price economy. This means more than that changes in particular prices influence the decisions which determine the kinds and volumes of goods which are produced. It also means that the price factor exercises so important an influence upon levels of real profits and real wages and other incomes that it vitally affects the economic balance between investment and consumption which is essential for a high level of general activity.

The current price level in general is now high enough to sustain a generally rewarding level of profits, if activity is high, and this level of profits would increase substantially if the volume of sales approaches the levels required to sustain maximum production. For this reason, there would be no justification for a general upward movement of prices, and neither the current nor shortly prospective relationship between supply and demand is likely to force general prices upward. While our economy is so complex that a few isolated upward adjustments may seem justifiable, every effort should be made to avoid them, because they will not add to stability or confidence and will make it harder to achieve a level of sales consonant with maximum production and employment.

There are some prices which are too high to permit continuance for a long period of the current volume of sales. These prices will need to be reduced or production and employment will eventually suffer. These prices are in the field of the administered-price industries where price policy is firmly controlled; but it may be expected that managers in these industries will not fail to reach for the larger market demand which will follow price adjustments.

The Council believes that in general—and noting the exceptions mentioned above—the price level is now within a range where stability should be feasible at workable levels. By workable levels, we mean those which will enable buyers, as incomes rise gradually in a growing economy, to increase their purchases sufficiently so that maximum production and employment will be achieved and maintained. We feel that, with respect to the general situation, it will be safer for the immediate future to depend mainly upon income adjustments rather than upon sweeping and widespread price adjustments to enlarge the volume of demand.

This is not to say that a long-run downward trend of some prices in those areas where technological gains are unusually great, or where productivity increases with extraordinary rapidity, is not one of the best ways of enabling these gains to be enjoyed by the whole population instead of merely by a specific group of income recipients. Such trends in some prices have appeared in the past and will appear again, and they are all to the good. Nonetheless, as a general proposition serving as a guide to economic policy, the practical dynamics of our economy indicate that a fairly stable general price level and a rising level of money income as productivity increases are more conducive to business confidence and to the expansion of enterprise than a generally declining price level.

The Council is mindful of the critical problems confronting those whose incomes have remained at low or moderate levels fixed since before the war. But without a serious and prolonged downturn throughout the economy, the price level could not conceivably be reduced to the point where these people would find themselves in a satisfactory position. And that very process of downturn would hurt many of them as much as anybody else. These people, if they are to progress, must look to income gains.

The Function of Wages

With a growing potential for national output, the only way to translate this potential into actuality is to distribute more goods. If the price level is reasonably stable, then the increasing purchasing power necessary for expanding markets must come mainly in the form of money incomes rising in accord with improved productivity. And since wages constitute the bulk of personal income, the soundest general formula, once wages, prices, and profits are in a workable relationship, is for money wages to increase with productivity trends in the whole economy.

Such a general wage principle does not, however, imply that all wages will or should move at the same rate, any more than the general desirability of a stable price level implies that individual prices should not move either up or down. What this general wage principle does imply is that wage changes should cluster around a norm determined by the over-all productivity developments of the economy. It is also recognized that there will be business concerns with productivity gains which justify wage increases above the norm, while others cannot afford to go as high as the norm. Widely divergent rates of growth in productivity in particular industries should also be reflected in shifts in some relative prices. The detailed process of adjusting individual wages and prices to productivity must necessarily be pragmatic.

Over a long time span, it appears that wage increases as a whole and productivity increases for the Nation as a whole have tended to move closely together. But this should not blind us to the fact that there have been periods when wage trends and productivity trends have gotten out of line, and this has been a factor contributing to general economic instability. Now, when we are not immediately threatened either by inflation or by deflation, management and labor have a most challenging opportunity to develop some broad economic principles for wage negotiation which take account both of the over-all national situation and of widely differing situations in different areas, industries, and businesses.

In view of the powers which reside in strong employers and in strong labor organizations, which make it possible now for one and then for the other to force adjustments which are not in accord with the interests of the whole economy, a twofold program is called for. In the first place, increasing study of what constitutes sound wage policy should bring larger conformity to it, because basically both management and labor are propelled by the desire to pursue a reasonable course. In the second place, we are exploring conference techniques, so that representatives of management, labor, and agriculture may make further progress on joint study of the conditions and actions underlying a stable and growing economy.

Aids to Business Investment

The primary influences upon business investment are to be found in the market place. If markets are broad and rewarding, funds will find their way into productive investment. And whether these markets will be broad and rewarding mainly depends upon the functioning of the wage-price system in the distribution of purchasing power.

Nonetheless, there are some special problem areas in the investment field. The rapidly growing volume of insurance and pension funds raises the problem of facilitating absorption of personal and institutional savings into productive investment, by making a somewhat larger part of these savings available to business as venture capital. The influence of direct Federal action on this problem, however, is limited. To a large extent, the solution appears to involve liberalization in State regulatory standards and valuation concepts, and in the policies of many of the fiduciary institutions themselves.

New and small businesses are at a marked disadvantage in seeking to obtain equity capital. They also find difficulties in obtaining long-term loans. The commendable efforts of the Reconstruction Finance Corporation to mitigate the financial problems of small and medium-sized concerns would be aided if the maximum maturity period on loans were increased; and if the agency could expand its capacity to provide loan applicants with technical assistance, thereby increasing the effectiveness of its lending operation and improving the borrowers' ability to repay. Also, more expeditious and less costly means should be found to provide very small business concerns with loan assistance.

In treating of investment needs, the Council has pointed out that housing investment needs stimulation more than any other type, whether measured by the opportunities which this would afford to business enterprise or by the people's needs for shelter. With a well established and nation-wide program for subsidized low-rent housing under way, the outstanding problem now relates to housing for middle-income groups. Further reductions in housing costs, and further income gains in an expanding economy, would both contribute toward the solution of this problem. Important revisions are being proposed in existing Federal Housing Administration programs, to encourage production of housing at lower rents and lower sales prices and of a size commensurate with family needs. These changes, however, will not provide a complete solution. Even with the new aids, adequate funds are not available for this kind of housing investment at sufficiently low interest rates and for a sufficiently long period of amortization, since most investors require a greater degree of security than is offered by this kind of investment. Legislation should therefore be enacted to place the credit of the Government, directly or indirectly, in back of private ventures into cooperative or nonprofit housing built under adequate standards. Since the housing shortage continues, rent control is still needed.

Although the present business tax structure has not interfered generally with high over-all levels of business investment in the postwar period, some tax adjustments offer possibilities for encouraging over the long run an adequate and regular flow of business investment. The Council hopes that before too long, general revision of the tax structure will become more feasible than it is just now.

In its Fourth Annual Report to the President, published last month, the Council stressed the contribution which a reasonably stable fiscal policy could make toward general economic stability and growth. But we recognized that drastic changes in expenditure and tax programs of Government had been necessitated by the appearance of wars and depressions. We also recognized that the large tax changes in 1948, the condition of the Federal budget, and the rapid shifts in business trends in 1949, call for some tax changes very soon. Further, some improvements in the tax structure are needed before a sound base will be established on which to rest a long-range effort to achieve more stability in fiscal policy.

The level of taxes did not prevent a magnificent record of postwar economic achievement. A valuable result of the Government surpluses in 1947 and 1948 was in helping to restrain the forces of inflation. The subsequent downturn in business activity during the first half of 1949 was not due to excessive taxation. Nor did the level of taxation prevent the upturn in business activity from coming sooner after the beginning of the downturn than in any comparable period in the past. Turning to the expenditure side, while the high outlays necessitated by the international situation complicated the inflationary problem until early 1949, the steadiness of these outlays cushioned the downturn very substantially. On the other hand, the Council at midyear 1949 did not recommend increases in public spending for the purpose of stimulating the economy, and our confidence in its internal recuperative forces has thus far proved justified.

An examination of the outlook for Federal finances is relevant to the current concern over the appearance of a substantial Federal deficit and to the justified belief that its enlargement or even its long continuance would be most undesirable.

Effect of general economic conditions upon Federal finance

The Federal cash position, measured in terms of the consolidated cash budget (see the explanatory note on page 59), shifted from an 8-billion-dollar cash surplus in calendar 1948 to a cash deficit of about 1.7 billion dollars in the calendar year 1949, and an estimated deficit of approximately 5.7 billion dollars for 1950. This shift is explained by the following factors: (1) the Revenue Act of 1948 resulted in very large reductions in tax payments; (2) the mild recession of 1949 was marked by a considerable decline in corporate profits as reported for tax purposes. This depressing effect upon receipts will be felt most sharply during the calendar year 1950, when most taxes upon 1949 corporate profits will be paid; (3) certain Government programs, such as unemployment compensation and farm price supports, rose sharply in 1949 under the impact of recessionary tendencies; (4) other major expenditure commitments, particularly for veterans' programs and foreign aid, reach a peak in 1949 or 1950 and will decline thereafter. One major item for 1950, the national service life insurance dividend, of which 2.6 billion dollars will be paid in that year, will not recur in that amount.

An examination of these causes for the deficit reveals certain trends which would be reversed in a growing economy. Along with the effect which a continuation of the current upward movement of the economy would have in reducing certain expenditures, it would also have an effect in increasing Federal revenues. This report has already discussed the secular growth of the economy since 1890, and long-range policies, especially fiscal policy, should take into account the probability that over the next few years this secular trend will continue at a rate slightly increased on account of the very large new capital investment of recent years plus the extraordinary technical improvements of the war and postwar periods. An increase in gross national product at the rate of approximately 3 percent a year would raise the annual product by 1954 to 300 to 310 billion dollars, contrasted with the 1949 level of 259 billion. The exact effect of this increase upon Federal revenues will depend upon the distribution of national income among the several groups of recipients. The effect upon the budgetary situation will also depend on the rate of expenditures.

Expenditure policy

The prime purpose of Federal expenditure is to furnish those services which cannot be provided effectively in any other way, and which are necessary to our national security, welfare, and progress. Examination of the Federal Budget indicates that outlays are reasonable by this test. Outlays for national defense and international affairs are higher than they would be in a more peaceful world, but the fact must be accepted that their present level is determined by security reasons. Growing international stability will permit a progressive decline in these types of outlays. The proposed increases in social insurance programs and in other welfare and developmental programs reflect recognized needs and conform to the clearly expressed purpose of the people.

The level of current and proposed public outlays will not impose an undue inflationary strain upon the economy as a whole. Our economy is now functioning at high levels, but considerably below maximum employment and production or full utilization of its resources, and in the Council's judgment there is no presently foreseeable prospect that a renewal of general inflation will require that Government programs be cut below essential requirements. On the other hand, we do not now believe that current and proposed Government programs should be expanded above their contemplated rate merely in order to take up the slack in employment. We should instead rely upon the recuperative forces now at work.

There is no previous experience with an economy of the size that ours has now reached, from which there may be drawn any firm rule as to the proportion of the national income which may safely in the long run be channeled back into the economic stream through the Government. But the Council's whole approach focuses upon the objective of economic expansion through the enlarging activity of consumers and of business, and this means that Federal expenditures should be held as low as the requirements of programs essential to national growth and welfare will permit.

Because so large a proportion of present Government programs is devoted to purposes which, while essential to national security and world political stability, make little direct contribution to increased standards of living, we wish to emphasize the desirability of working toward lower levels of expenditures as rapidly as international conditions permit. We also wish to emphasize the importance of constant vigilance against the dangers of waste and inefficiency everywhere and at all times. Measures of economy, however, must not be so distorted in application as to involve the sacrifice of essential objectives.

For this reason, we have expressed the hope that world conditions will make it possible to make a steady reduction in national security and other extraordinary expenditures related to the international situation, for it is here and in related activities arising from the war that there lies the greatest opportunity for future reduction in the Federal budget.

Tax policy

Current and prospective tax policy should be considered in the light of the foregoing discussion.

While general reduction in personal or corporate income taxes always has some stimulating effect upon business and consumption, such reduction at this time would enlarge the deficit, and would be justified only if found necessary to fortify business against a serious recessionary threat. At midyear 1949, in the face of a far more unfavorable business situation than now exists, the Council did not favor general tax reductions. The upturn since then makes them even less desirable in the present budgetary situation. Analysis earlier in this report indicates that there is no general lack of funds for business enterprise, and that the main influence which should be relied upon to accelerate business advance resides in adjustments within the price-income structure which will promote an increasing demand for the products which business produces. In spite of existing problems in some areas, business investment in general can go ahead on a sufficiently large scale under the current tax structure, if business managers grasp fully the prospects offered to them by the expansive quality of the economy.

Balancing the budget by attaining a surplus in periods of high business activity to offset deficits which might appear under less favorable conditions is, in our opinion, an important policy. Further, the national debt should be reduced. Business continued throughout 1949 at a reasonably prosperous level despite recessionary tendencies. Now that business is advancing again, we are sharply challenged to apply the principle of budget balancing. We cannot avoid answering the question: If a balanced budget is ever to be attained, why not at once at the current level of the economy?

Our answer is that the economy is indeed strong. We also feel that it was unfortunate that tax rates were reduced in 1948, and that if the higher rates had remained in effect they would not be such a burden that business recovery would not continue. But the tax rates were reduced, countless personal and business relationships are now based upon the lower rates, and, if taxes were now raised sufficiently to attain an immediate budget balance, the process itself would involve disturbing maladjustments. The real questions is this: to what extent may there be some tax increases at this stage of business recovery without impeding business progress enough to defeat the purpose of the tax program?

It is important that action be taken to reduce the deficit, and to move as rapidly as the need to maintain business progress will permit toward attaining a surplus to apply upon the Government debt. For this purpose, some increases in taxes may be made, without threatening the recovery of business now under way. The revision of some taxes should be sufficient to achieve a net increase in revenue, even while making certain other adjustments in taxes to improve the equity of the structure and to provide some stimulus to business investment and consumer buying.

There is urgent necessity that a review of the whole tax structure be completed at the earliest possible date, toward the end of initiating long-range improvements as soon as compelling short-range problems are disposed of.

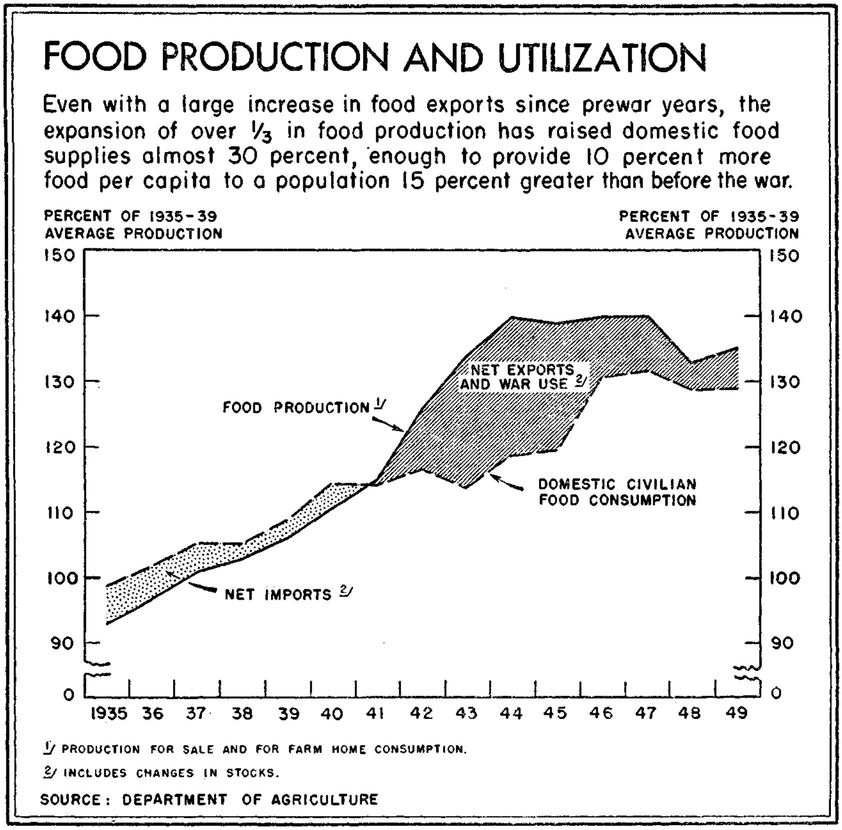
Farm Policy

Recent trends in agriculture present one of the most dramatic illustrations of the expanding consumption capacity of a growing economy. In the years immediately before the war, there were farm "surpluses"; in the post-war years, with farm output 35 percent above the prewar levels, there were shortages. Exports played an important part in this amazing shift, but the central cause was rising standards of living at home. The paramount fact about the agricultural situation today is that we shall need more total output—and not less—if we are to achieve a 300-billion-dollar economy within a few years.

The farm program must give increasing attention to the maintenance and enlargement of markets for agricultural products. We must give greater emphasis to improvements in the marketing and distribution of these products, including nutritional education and special measures to improve the diets of school children and low-income families. We must also cooperate closely with other nations in developing satisfactory techniques for maintaining a continuing flow of farm products into international trade without demoralizing world markets. The World Wheat Agreement is one example of what can be done along this line. But it is only a beginning. Our Government has recently expressed the purpose to continue to explore fully with other producing and consuming nations any feasible way of making better use of the world's supplies of food and fiber, to help stabilize world prices, and to improve world standards of nutrition.

The expansion of farm output above prewar levels has been accomplished with only a minor enlargement of cropland, and with a substantial reduc-

CHART 26



tion in the number of farm workers. It reflects in part more favorable weather. But it has resulted chiefly from widespread application of new technology. This has included new and improved machines; new varieties of crops and improved breeding of livestock; the more advantageous use of fertilizers and lime; the better control of pests and diseases; and the development of new systems of farming to apply these new techniques toward more efficient production and more conservative use of soil and water resources.

With a growing national income in real terms, consumption has grown along with production. For the 3 years 1945–47, per capita consumption of food averaged 16 percent above the period 1935–39, and population was larger. The quality and composition of diet have vastly improved. Meats and dairy products, fresh fruits and vegetables have found their way to more and more tables. The per capita consumption of eggs rose from less than 300 per year before the war to nearly 400 in 1945. Since 1946, per capita food consumption has been cut back from 119 percent to 110 percent of the prewar level. Some of this resulted from changes in the income structure relative to prices. But another important factor was the imbalance of production among different commodities, relative to the wants and needs of consumers. This was caused partly by short feed supplies in 1947–48. People would have continued to buy larger quantities of meat and milk if these products had been available.

A fully producing agricultural plant in the years ahead would not result in production increases as rapid as those which have occurred in recent years. The new technology has already made itself felt. But an economy moving toward the over-all growth objectives which have been outlined for the next few years would require an increase of 1 to 1½ percent a year in total farm output. This increase is feasible, and can be absorbed by an economy functioning at maximum employment. Domestic disappearance 5 years ahead, in comparison with the past 2 years, might be expected to increase 25 to 30 percent for fruit; 15 to 20 percent for dairy products; and 10 to 15 percent for meat, vegetables, and food fats. Tobacco consumption would probably continue to rise. Domestic utilization of cotton and wool should be much higher than in 1949. The use of food grains and potatoes may continue about stable, at least in terms of total food use.

The level of per capita food consumption involved in these estimates would be about 5 percent above the present level—still a little below the wartime peak, but 17 percent above the average for 1935–39. Even these estimates take into account the inadequacy of purchasing power which serves as a barrier to adequate nutrition for many families. Raising such families to an adequate dietary level would require increasing the supplies of meat and dairy products another 5 percent, and of poultry products, fruits and vegetables in smaller proportions. Such supplementary consumption would raise the per capita level to about 20 percent above prewar. With a 20 percent larger population, this would mean within a few years total domestic food disappearance about 45 percent above the average during the immediate prewar years. In addition, substantial possibilities for increased consumption of farm products are being revealed by research to develop and demonstrate new uses for them in industry.

The necessities of war, and trends in the immediate postwar period, have driven our farm production into a pattern which is unsuited to the requirements of the future. The acreage devoted to wheat and cotton is higher than necessary to fill prospective domestic and foreign requirements. Production of milk, meat, fruits and vegetables should be substantially expanded, if diets are to be improved and the objective of a 300-billion-dollar economy realized. Some temporary curtailment of feed-grain production may be desirable until livestock production catches up. These shifts are in line not only with the requirements for consumption, but also with the requirements for conservation. A substantial part of the acreage plowed for wheat in recent years should be returned to sod; a good deal of land in the cotton South has been used too intensively and should be turned into pasture or farmed under more conservative systems of rotation. In general, the shift of land from tilled crops to pasture and forage for livestock will help maintain the soil for the use of future generations.

The speed and efficiency with which wartime shifts in production were accomplished show that the Nation can certainly devise the methods for desirable peacetime shifts. But the commodity goals and market supports, which sufficed when more of everything was needed, are not adequate to the more complex task of combining expansion in some areas with moderate or drastic contraction in others. New methods are needed for new times.

The present price-support legislation offers the most definite assurance with respect to returns from the basic cash crops, somewhat weaker assurance for dairy products, and no certain assurance at all to other livestock enterprises except wool. Relatively more emphasis in price-support legislation should be placed upon livestock items if a positive, forward-looking farm program is to be developed.

Needed adjustments in production and consumption will require important changes in land use. Not only are these changes necessary in order to avoid persistent surpluses and to obtain a better balance of agricultural output in line with the demands potential in a growing full-employment economy; they are also needed to bring about better conservation of our soil resources. And in most instances they should, in the long run, prove more profitable for farmers themselves. Major reliance in bringing about adjustments must therefore be placed, not on price support alone, but also upon gearing together research and education, conservation payments and technical aids, and farm credit, in an aggressive program to encourage and enable farmers to make the shifts in land use that are desired.

A primary purpose of farm price supports is to achieve parity of income for agriculture. The need for support from this standpoint, however, chiefly arises out of recessionary economic developments originating outside agriculture. Farm support programs are essentially supplementary. Their benefits are secondary, compared with the benefits flowing from a prosperous and growing economy. A prosperous and growing economy would not only expand the market demand of consumers, but would also make possible effective programs for improving nutrition, expanding distribution, and developing new uses, in which there lie wide opportunities for a desirable expansion of consumption of farm products.

At the same time, a properly designed farm support program can contribute toward overcoming recessionary developments and maintaining the kind of economy in which these opportunities may be realized. It can do this by helping to maintain purchasing power in the rural areas of the economy, particularly in those areas which are the temporary victims of maladjustments like those with which many farmers are now faced.

A proper adjustment of the support program from this standpoint involves, as previously indicated, a structure of supports which will help to encourage the basic shifts needed in production, rather than to perpetuate maladjustments. It involves also the provision of greater variety in the methods of support. It has been possible for the Government to maintain prices through purchases or loans which enable farmers to hold supplies off the market. But such operations involve many difficulties of storage and disposal, especially of livestock products and other perishables.

The desirable alternative method of supporting farm returns from livestock and other perishables involves payments to farmers when market prices fall below desired levels. This method has important economic advantages. By permitting market prices of foods or other farm products to be determined by normal demand factors when supplies are abundant, it passes on to consumers the benefits of such abundance and gets larger amounts moved into consumption. Support of market prices, on the other hand, impedes this desirable consumption response. In addition, market-price support maintains an upward pressure on prices at numerous points in the economy, where costs of production of other goods are directly or indirectly affected by the prices of farm products. The reductions in prices which become possible where payments are used relieve such upward pressures and permit readjustments which may tend, over a period of time, to bring about more stable price relationships and hence to reduce the cost and the difficulty of the support program itself.

Either direct supports or payments may prove costly in certain periods, and may need to be supplemented by programs to hold down the production or marketings of commodities that are in surplus. But it is important to recognize that such restrictive measures, though they may be temporarily effective, are no substitute for a positive adjustment program to bring about enduring shifts that are needed in production. So long as there are too many farmers engaged in the wrong kind of production, the pursuit of parity of income for agriculture will not provide a complete solution. But if accompanied with measures to adjust agricultural production to the needs of a growing economy, the objective of income parity for agriculture means a better balance throughout our whole national economy. It means protection of a vital sector of the economy against the extraordinary fluctuations in income which have peculiarly affected it in the past; and it means a more stable and expanding demand in rural communities for the products of industry.

In the final analysis, programs to reach and maintain parity of income for agriculture will not fully meet the objective of adequate farm purchasing power unless they include a direct attack upon the special problem of low-income farmers. In 1948, the per capita income of the farm population was estimated at $905, compared with $1,572 for nonfarm people. During the same year, one-fourth of our 6.7 million farm families received cash incomes of less than $1,000. Although this figure omits the value of nonmoney income from home production, it nonetheless indicates the plight of these families, and their low position in the market for commercial goods and services. While not all of the low-income people on farms are farmers in a strict occupational sense, there were in 1945 nearly 1 million small holdings whose operators apparently derived their main income from the farm. In addition, more than 1½ million small family farms turned out products valued annually at between $1,200 and $3,000. These two groups accounted for more than 44 percent of the farms reported, and nearly 43 percent of the population on farms.

Many of these farmers, having little to sell, receive little benefit from price-support programs. In addition, there are some 4,000,000 hired farm workers, whose average wages, including perquisites, are substantially below the levels of most urban employment.

A frontal attack upon farm poverty involves many measures. It should include increased emphasis upon the provision of credit and other aids to small farmers in enlarging, improving, and equipping their farms. This program should be tied in closely with production adjustment measures, with soil conservation activities, and with management advice and guidance. For families whose best opportunities lie outside farming, stress should be placed upon vocational adjustment, help in locating new jobs, and financial aid during their period of training and relocation. These undertakings would be facilitated if nonfarm employment opportunities in rural areas were expanded through regional development and rural industrialization activities.

Foremost among those programs which will be of general benefit to farmers, particularly those of low income, will be further improvements in education. The consolidation and improvement of rural schools would broaden the opportunities for vocational training. Measures to improve health and housing in rural areas, and to extend to rural people a fuller participation in our social security programs, are of comparable importance.

The advancement of a prosperous and secure agriculture, measuring up to the requirements and benefiting by the richness of an economy functioning at maximum levels of employment and production, is one of our major economic tasks. That task calls for all the resources of thought and of material things that can be made available. The time to move resolutely in that direction is now.

Economic growth depends on what people do with land, water, minerals, transport, and plant and machinery. What they can do in turn is measured by the care with which they have conserved and utilized their physical resources. It rests equally upon general health standards, and upon the level and kind of education they have. Increases in our total national production to more than 300 billion dollars in 1954, and maintenance of a 2 to 2½ percent annual rate of increase in productivity over the next few years, would require expanded and improved developmental programs in the two broad areas of physical and human resources.

To attain the prosperous economy which is within our reach, plans relating to natural resources development, transportation, urban development, education, and health must be correlated. In nearly every one of these areas, construction and nonconstruction or service activities are interrelated. Soil-conservation techniques are useless unless farmers have an appreciation of their value and an understanding of how to use them. New schools and hospitals are of little consequence without trained staff personnel. Developmental and works programs, such as land reclamation, hydroelectric power development, intercity and interregional highways, and better housing, hospitals, and schools, should be viewed in long-range perspective in terms of socially desirable and economically feasible standards.

It is highly significant that achievement of the balanced economic growth envisaged earlier in this report requires a level of expenditure for the foregoing developmental activities rising at least about 20 percent above that of 1949 within five years. This increase is about the same as the potential increase in total output projected for that period of years, but is less than half the rate of growth which would be desirable if other elements in the budget were not so extraordinarily large. As economic objectives become better defined, the magnitude of these programs should be reviewed continuously to assure their maintenance at adequate levels. The discrepancy between the minimum and desirable levels of growth illustrates that, with present budget commitments for national security, progress in these programs must of necessity be limited. On the other hand, an insufficient allowance for the development of our natural and human resources would do irreparable damage, and would impair our ability to produce for peace or defense.

Physical resources

The importance of the development of our natural resources in the economic progress of our country has been so well known that the "Winning of the West" has been a favorite and romantic theme in the school histories of American children. Our pride in the ability, intelligence, and industry of our forefathers has not concealed from us the fact that the speed of economic growth has been possible because the human forces of production were applied to a bountiful supply of undeveloped natural resources.

The primitive stage in which the individual could create his own field of work and production lasted a long time. As late as the close of the nineteenth century, the single enterpriser was setting up his mill and water-wheel, the farmer was establishing himself on a productive homestead, the prospector was hunting unknown ledges, and the wildcatter was drilling shallow wells for oil or gas. Even the numerous projects for the exploitation of natural resources, which were beyond the financial capacity of such individuals, were generally small enough to be supported by capital supplied by a few persons, often by a single capitalist backer of the entrepreneur.

The twentieth century has seen the continuous replacement of individual enterprise by large corporate enterprise in the development of natural resources. The simple prospects have been exploited, and the opportunities have been increasingly in projects requiring large capital. The place of small business has grown progressively smaller in an industrial environment of 500,000-dollar oil wells, 10-million-dollar ore treating plants, 50-million-dollar hydroelectric stations, and timber factories which reproduce as well as cut down the forests. And even while large corporate enterprise has expanded its operations in the development of natural resources in the past 50 years, it has become increasingly clear that some projects which must be undertaken in an adequate program are beyond the field of private enterprise. Only the Government can meet the problems of high cost and of exceedingly long periods of amortization of investment which are usually combined in these undertakings.

This historical trend is well illustrated by our unfolding policies and programs in the field of land reclamation by irrigation. One of the first actions by the Federal Government in this direction was the passage of the Reclamation Act in 1902. Irrigation development began with the one-field ditch, became a neighborhood group project, and then moved into the stage of corporate operations, which the Government assisted where public lands were involved by furnishing free reservoir sites and free rights-of-way for canals, and by restricting land acquisition to persons buying water rights.

The Reclamation Act was passed because these aids were not adequate to enable private capital to construct the larger and more expensive projects which would extend the limits of irrigation beyond the narrow zones near the streams and would establish a water supply, despite the earlier over-appropriation of the natural flow of a river, by constructing great reservoirs. In the beginning, the moving idea was that the Government could easily finance a project which a corporation would find had little chance of attracting private investors, and that the Government could extend very long credit to the buyers of water rights. Much later, there came Congressional recognition that the establishment of a prosperous, growing community, for so many of which the reclamation programs have been responsible, brings great benefits to the state, not only in an increase in its general well-being, but also in direct financial gains affecting its revenue. The private corporation cannot realize such benefits. The Federal Government does secure them, and it may take them into account in determining whether to undertake a project the cost of which will be recovered only in part from those directly served.

Great opportunities still lie before private capital for the further development of natural resources, and Federal legislation is specifically directed, in many respects, to assisting private enterprise engaged in such projects. But the ability of the Nation to benefit as greatly from our natural resources in coming years as in the past depends also upon enormous undertakings which private capital cannot attempt. We have made a beginning of Government projects, especially in the Tennessee and other river valleys, and other possibilities are so many that they surpass the possible limit of Federal expenditure. Appropriations must be allocated between resources development and other Government purposes, and between projects affecting natural resources and those affecting human resources. Some of the factors which should influence the decisions are indicated in the following discussion.

Programs for the conservation and development of natural resources need to be expanded at a rate somewhat greater than the secular growth of the economy. The public expenditures involved are investments which result in the production of goods and specific services indispensable to economic growth, nationally and regionally. They make available, for the benefit of all the potentials which exist in our regions. For example, if the well-established trend of increasing use of electricity is to continue, the production of low-cost electrical energy will have to expand more rapidly than the increase in national product. River basin development programs can account for a considerable portion of the 6,000,000 kilowatts of additional power capacity needed annually for some time into the future. In the West, these programs contribute to meeting needs imposed by great population increases. In the more mature area of northern New York State and New England, the economic prospects can be improved by making available the low-cost power potential in the St. Lawrence seaway and power project. By the time the seaway can be completed, we may be heavily dependent upon imported ore to keep our steel industry operating at capacity. For reasons of national security as well as economic development, the seaway is an urgently needed link between the inland centers of our iron and steel industry and foreign sources of ore.

We should speed up the gathering of geologic, topographic, hydrologic, and other basic data upon which so many resources development projects rest. Forest resource and soil surveys should also be pushed vigorously.

Continued emphasis on the synthetic liquid fuels program and the under-ground coal gasification programs are desirable as a part of the Government's long-range effort to develop new techniques and alternative sources of supply in the interest of conservation of diminishing resources. Exploration for scarce minerals should also be encouraged.

About one-fourth of our cropland is being damaged at a rapid rate, while another 25 percent is deteriorating, although at a less serious rate. These lands should be placed under good management at soon as possible, while farmers generally need to give increased attention to soil-conserving techniques. Soil conservation and improvement work is not being done rapidly enough, nor upon a scale broad enough to protect the soil. About one-half of the western grazing lands are in poor condition and call for immediate attention such as seeding, fencing, provision of stock water, and control of noxious plants. More than 100,000,000 acres of public range need restorative work. Large tracts of marginal wheatland, for which adequate rainfall cannot be counted upon, should be returned to range.

A flexible long-term forest development program should aim to build up the annual growth of saw-size timber to about double the present rate. This would allow for potential needs in a prosperous, expanding economy. Cutting and forestry practices on almost two-thirds of our private forest land are detrimental to future growth.

We have standards permitting measurement of our present deficiency in highways. A good highway costs less all around than a poor highway, because of increased safety and savings in wear and tear on cars and tires. More than half our major highways were built in the 1920's or early 1930's, and have already served the major part of their useful lives. It would cost more to maintain them over the next decade than to replace them; so our choice is between building good roads and riding on them, or losing the price of good roads by riding on poor ones. Out of a needed expenditure for highways of about 4 billion dollars a year over the next decade, approximately one-half should be for replacement.

The atom represents a new resource of almost limitless opportunities, the development of which we have scarcely begun. Through use of radioactive atoms, we are pushing back the boundaries of hitherto unknown mysteries of human life and plant growth, and we are gaining new knowledge that has already improved industrial processes in textiles, chemicals, and metals. In addition to gains in medicine, agriculture, and other fields, radioactive atoms are leading the way toward new and better industrial products, better assurance of profitable business operations, and higher standards of productivity accompanied by higher returns to labor and management. Construction has begun on several experimental atomic energy power plants, which may prove to be the forerunners of a new age in the application of electric power. The precise economic significance of these developments can now be seen only dimly, but it cannot be doubted that they will exert an increasing force in the growth of the American economy and in its several regions.

Human resources

We shall fail to realize the potentials of our physical resources, unless we remember always that it is people who translate these potentials into actual goods and services. Ever-advancing health and educational programs should be recognized as the necessary foundation for the improved technology and social organization upon which economic growth depends. These developmental programs include construction of schools, hospitals, and other facilities, as well as educational and health services.

The need for improved educational opportunities is persistent. The more urgent problem is the enlargement of staff and facilities required by the postwar growth in the juvenile population. Five years from now elementary school enrollment will be 30 percent above the present level. A similar expansion of secondary school enrollment will follow. Suffering as we now do from the overcrowded classrooms and the overburdened teachers which are the nation-wide rule, we should add approximately one-third to our elementary school plant capacity within a few years, replace an additional third, and increase the number of elementary teachers more than correspondingly. We shall have to expand secondary school facilities, but not so rapidly. Another serious problem is found in the current inability of a large proportion of our most capable youth to obtain the post-high school education necessary to full realization of their economic and cultural capacity. Additional thousands of doctors and nurses should be professionally trained each year, as an essential part of improved health programs.

The disparity of financial resources among the States of the Union is such that the States with the greatest proportion of children of school age are generally lagging in their provision for elementary and secondary education, although they devote a larger part of the income of their people to this purpose than do many wealthier States with much better educational facilities. It is now widely recognized that Federal aid is required, to support enlarged educational programs which will meet the problems of hard pressed areas, and which in addition will expedite the provision of wider opportunities for higher education generally as well as the professional training of doctors and nurses throughout the country.

The need for greatly improved health services and facilities is also a matter of common agreement. The economic costs of preventable illness, of reduced physical and mental capacities, and of premature aging are such that public expenditures in improved health are as much sound economic investments as they are a major contribution to individual well-being.

To meet desirable standards, the Nation should double its present acceptable hospital facilities by 1960. This would mean more than 900,000 additional hospital beds. Public health service units should be made available in the more than 1,000 counties which now do not have them on a full-time basis, and services in many existing units should be strengthened. Improved access to competent medical attention should be provided for the millions who are now without it. Vocational rehabilitation and medical research activities need expansion. Federal aid is essential to the achievement of these standards in many areas of the Nation, as well as for expanded training of medical and public health personnel.

The timing of developmental programs

Critical problems arise with respect to the flexibility and timing of these programs. How much variation from year to year might be desirable and feasible in these programs, in order to contribute in some measure to the stability of the general economy? Even more troublesome has been the problem of the extent to which these programs may be shaped to the varying needs of different parts of the country.

The Council believes that these programs for the development of basic physical and human resources should be primarily along lines of long-range steady growth. By this approach, it should be feasible to arrive at determinations, partly but not purely economic in character, as to what part of the resources of a growing economy should be allocated to these fundamental objectives. This should contribute more to the stability of the general economy than the treatment of these programs mainly as compensatory devices. The economic outlook now—with neither inflation nor deflation clearly in prospect—presents as good a time as any to develop these programs systematically and in close accord with the long-range needs of the country. The Council believes that this is the sounder approach, not only from the viewpoint of general economic policy, but also from the viewpoint of the sound management of the Federal budget.

Economic trouble spots

Despite the high levels of employment throughout the Nation, there are some areas with quite heavy unemployment, and with far less than maximum levels of production and business activity. This presents a challenge because there cannot be maximum employment and production throughout the Nation so long as some areas are relatively depressed; and there is always danger that economic dislocations in spot areas may spread if they are not remedied.

For more than a year, there has been a noticeable concentration of unemployment and distress in particular areas. According to the end-of-December reports, 12 of 100 labor market areas of major importance had an estimated 12 percent or more of their labor force unemployed. In addition, this percentage is known to have prevailed in numerous smaller labor market areas.

At midyear 1949, a program was initiated to provide aid to these trouble spots through modification, within the limitations of existing laws, of procedures governing Federal procurement, construction, and lending operations. Action along these lines should be continued. However, the more persistent and fundamental aspect of the problem is the long-term or chronic unemployment so prevalent in many distressed areas. It should be recognized that some New England textile areas, the cut-over section in the Northern Lakes States, and various coal mining districts in Pennsylvania, Illinois, and Indiana, have been in difficulty for 20 years or longer. This calls for even more determined efforts, broader in scope and longer-range in character.

The search for solutions to these area problems is the joint responsibility of Federal, State, and local governments, working with the private groups concerned. Integrated programs of action need to be worked out to meet the unique situation in each depressed area. The possibilities of more vigorous retraining, lending, and capital development activities, should be examined. These actions should contribute to permanent solutions, and not only alleviate current difficulties.

Advance planning and program flexibility

Advance planning of developmental programs is necessary, if they are to be directed more fully toward long-range economic objectives for the Nation as a whole and for specific regions. In addition, such advance planning will make such programs more effective in some of the economic trouble spots which exist even in times of general prosperity. And if, despite all efforts, a dangerously inflationary or deflationary situation should develop, advance planning will make it easier to adjust developmental programs accordingly without loss of time or waste of funds. Such planning would not be inconsistent with a decision to defer projects in periods of threatening inflation, and it would assist their acceleration if that should become necessary to halt serious deflation.

The following table summarizes the present status of advance construction planning for such projects as highways, various community facilities, and dams and other stream improvements.

TABLE 16.—*Status of plans for a public works reserve*

[Billions of dollars]

Item	Estimate of construction in 1950	Blueprints on hand, Dec. 31, 1949	Blueprints in process
State and local [1]	4.1	3.0	3.0
Federal	1.9	1.5	3.0
Total	6.0	4.5	6.0

[1] Based on data provided by the General Services Administration.

At the present time, State and local backlogs of drawings and specifications do not exceed 3 billion dollars. This is less than 6 months' work at the level which should be maintained over the next few years. The Congress has renewed authority for the Federal Government to aid State and local governments in building up their shelves of construction plans, and this work should be pushed vigorously.

One major weakness is in the broad field of river basin development. Existing programs, several involving hundreds of millions of dollars, lack consistency and balance. In most of our major river valleys, we do not now have satisfactory means for preparing and agreeing upon integrated programs of development, including watershed land development as well as construction along the stream. Thorough reexamination of the problems and presently authorized programs in a number of our major river basins would be desirable. This is especially true of the Missouri Basin. In addition, there should be continuing efforts to improve policies and methods of program formulation, to assure that objectives for river basin development are consistent with our national economic goals.

The preparation of advance plans requires consideration of the suitability of various programs for possible acceleration, both Nation-wide and in specific areas. Examples of projects and programs which are susceptible to prompt expansion include improvements in city streets, sewer- and water-line extension, school building additions, and maintenance and repair of public buildings. Nonconstruction programs, including research, recreation, and public health services, are also susceptible to flexible expansion. In rural areas, soil, range, and forest conservation work are examples of the more flexible type of development programs. Public housing, hospital, and major highway construction requires more time to get under way, but is still available within limits. Federal technical assistance for State and local planning of nonconstruction as well as construction projects, would go far toward making sure that such assistance as the Congress might make available in time of need would be fitted in with carefully considered long-term needs and opportunities, nationally and in special areas.

Successful advance planning of developmental and works programs requires continuous efforts to coordinate the planning activities of the Federal agencies concerned. Furthermore, it may well be desirable to provide for a greater degree of discretionary authority over the timing and placing of public development expenditures, as an aid in stabilizing the economy nationally and in particular areas. This subject is being studied by the Council.

Social Security

In the 250-billion-dollar economy of today, the social security programs are still adjusted largely to the 70-billion-dollar economy of 1935—the year when the Social Security Act was adopted. The interests of the Nation require that these programs now make an about-face and, instead of looking backward, look forward to the 300-billion-dollar economy that we can achieve within a few years and to the still larger economy which should exist by the time that most of those who are now working reach retirement age.

In its Annual Report to the President published last month, the Council pointed out that social security programs should be measured primarily against what a strong economy can afford to do. Workers are more productive when they live in the assurance of protection against foreseeable hazards, rather than in dread of their incapacity to cope with them. Social security programs also serve to cushion the effects of recessionary trends whenever these may appear, because old-age payments constitute a steady flow of income, and because unemployment insurance benefits and assistance payments rise as other forms of income decline.

Unemployment insurance

Unemployment benefits are now replacing an average of only about 35 percent of the wage loss of covered workers, and the limitations on coverage and duration greatly reduce their total effectiveness. In November 1949, public unemployment benefits were being received by about two-thirds of laid-off workers, and represented compensation for only 20 to 25 percent of the Nation's total wage loss due to unemployment. In some of the areas with severe and long-continued unemployment, only about one-third of the laid-off workers were receiving benefits at the end of 1949.

The need for strengthening the Federal-State unemployment insurance system through the establishment of minimum Federal standards is urgent. Benefits should replace at least 50 percent of the wage loss due to unemployment up to a maximum of $30 a week for single workers, with additional amounts ranging up to a total of $42 for workers with three or more dependents. Coverage should be expanded to include employers with one or more employees; and benefits should be made payable for at least 26 weeks of unemployment. To guard against the danger that prolonged unemployment may strain the solvency of the trust funds of individual States, a Federal reinsurance system should be established. This would assure that no State is forced into disproportionate taxation which would further aggravate its economic problems.

Old-age, survivorship, and disability protection

The inadequacy of current systematic protection of the aged is set forth vividly in this single contrast: the Old-Age and Survivors Insurance system is now paying $26 a month to single workers and $41 to couples, at a time when a minimum food bill alone for a retired couple is about $45 a month. Furthermore, of 11.5 million persons in the country over 65 years of age, only about 2.3 million are receiving public insurance benefits. Only 650,000 families are recipients of survivors' insurance benefits, and no social insurance protection is provided for families whose wage earners are disabled for reasons not connected with their employment.

The Old-Age and Survivors Insurance program should be enlarged to approach universal coverage, and the benefit level should be raised enough to permit the aged worker a real choice between retirement and continued work, and to provide widows and children and the disabled with a healthful standard of living without dependence on public relief.

Employer-employee pension plans may serve as a legitimate private supplementation to Government social insurance programs. Too great a reliance on private plans, however, may interfere with desirable mobility of labor. Furthermore, private plans provide true protection only if accrued and current pension liabilities are fully reflected in trust fund accumulations. Only public and nearly-universal social insurance programs can be financed in a manner adjusted to the overall needs of the economy. It is incumbent upon the Government to develop a sound and adequate social insurance structure which, with continuing improvements as the Nation's productivity increases, can satisfy basic needs for individual security.

Health insurance

The gap in social insurance resulting from our continued failure to provide a national system for the prepayment of the costs of medical care also creates hardship in many cases and is responsible for the fact that millions of Americans remain without adequate medical care. Health insurance, with the same nearly-universal coverage as Old Age, Survivors, and Disability Insurance would make an all-important contribution to the Nation's health, with resulting long-range benefits to productivity and income.

Public assistance

The inadequacies of the insurance system have thrown a disproportionate load upon the relief agencies. Public assistance for the aged, the blind, and dependent children on a means-test basis has outstripped social insurance received as a matter of right, whether measured by level of benefits or by number of recipients. In a large number of communities, however, only inadequate public funds are available for the needy individuals who do not fall into the special categories for which Federal aid is available. The public-assistance program should be bolstered by the extension of Federal grants-in-aid for needy families not now eligible under the Federal-State program. In the allocation of the public assistance grants, the differing financial abilities of the States should be taken into account.

Social security costs

The Council in its Annual Report to the President last month pointed out the distortion which results when the future cost of old-age benefits is measured against the current size of the economy. For whatever method of financing may be employed, the fact remains that the goods and services consumed by those who retire some decades hence will be provided by the economy of that time and not by the economy of today.

The following table illustrates, for the next quarter century, the probable growth of the total aged population and of the numbers eligible for and receiving retirement benefits under proposed legislation. The estimates are based on our belief that many aged individuals will not retire voluntarily in an economy with abundant job opportunities. Accordingly, the number of individuals receiving benefits is estimated to be well below the number eligible under the insurance system.

TABLE 17.—*Estimated proportion of the aged population eligible for and receiving old-age insurance benefits, 1950–1975*

Year	Population aged 65 years and over					
	Total (millions)	Eligible for benefits upon retirement of earner [1]		Retired and receiving benefits [1]		
		Number (millions)	Percent of total aged population	Number (millions)	Percent of total aged population	Percent of total eligible
1950	11.5	3.5	30	2.0	17	57
1955	12.9	6.9	53	4.1	32	59
1960	14.4	9.0	62	5.9	41	66
1965	15.8	11.1	70	7.7	49	69
1970	17.2	13.0	76	9.5	55	73
1975	18.7	14.9	80	11.2	60	75

[1] Assumes prompt adoption of administration program and intermediate population and labor force estimates.

Source: Federal Security Agency, Social Security Administration.

Under the broadened social insurance coverage illustrated above, and with the benefit levels proposed by the President, ranging up to a family maximum of 150 dollars a month, the total cost of old-age insurance would approach 8½ billion dollars 25 years from now. Existing and presently proposed programs of insurance for survivors, the disabled and the unemployed, and for the payment of the costs of medical care, together with the public assistance programs of the Federal, State, and local governments, might require an additional 14 to 16 billion dollars in benefit payments. Thus the total costs of all presently recommended programs in the fields of social insurance and public assistance, including the costs of State and local governments, might range up to 25 billion dollars a quarter of a century from now, or 20 billion dollars above the current level.

This is a very large figure. It should be viewed, however, in the light of the total national income and production which would flow from a growing economy. The rate of growth which would result from fairly constant maximum production and employment would mean a total national output of 500 to 600 billion dollars 25 years from now, or in the range of 300 billion dollars above the present level. The prospective increase of 20 billion dollars in social welfare costs would thus represent less than 7 percent of the total increase in national output. This would be only a moderate proportion of its increasing income for a prosperous democracy to devote to the aid of those least able to protect themselves against economic risks. Furthermore, these costs should not be regarded as entirely new costs. Much of the expenditure would occur in the complete absence of social security, but its burden would then be distributed unevenly among relatives, friends, medical practitioners, and creditors.

International Economic Policies

For some time, the broad long-range purpose of American international economic policies has been to expand international trade and investment, and thus to contribute to our own economic well-being and to peace and freedom throughout the world. The immediate postwar situation, which has forced us to adopt extraordinary programs of foreign grants, should not divert us from this long-range purpose. Expanding trade and investment between the United States and other countries will aid world political stability and reduce the need for extraordinary grants. The problem is no longer a long-range one of moving gradually toward a purely economic goal. It is an urgent problem of both security and economics.

The problem arises from the intensity of foreign demand for our goods and services, which since the war has vastly exceeded what foreign countries could finance by selling goods and services to us or by attracting private United States capital. The surplus of our exports over our imports of goods and services in the four postwar years 1946–49 has totaled 31 billion dollars, and even this amount was inadequate to meet foreign needs. This excess demand for American goods has been general, and by no means confined to Europe. As appendix table C–36 shows, about half of our export surplus in the postwar period has been with countries other than those of Western Europe and their dependencies. In 1949, dollar deficits were a world problem.

Two years ago, difficulties created by the war were regarded as at the root of the payments problem. Although it was recognized that many specific factors were involved, some of which would be permanent, it was obvious that the immediate necessity was to expand production in foreign countries above prewar levels and to eliminate their internal inflationary pressures and the overvaluation of their currencies. Great progress has been made along these lines, but further steps are now necessary if the European countries are to become self-supporting at satisfactory standards of living, thus eliminating the need for further large extraordinary aid from the United States.

The dollar problem

The problem of overcoming the shortage of dollars with which to pay for American goods must be attacked from several directions.

One method is to increase our total imports of goods and services, and total Western European exports. This was one of the principal objectives of the devaluation of the British pound sterling in September 1949, which was followed by devaluation of many other currencies. It is too early to determine the effects of these devaluations, but certainly they alone will not provide an expansion of world trade sufficient to overcome the dollar shortage.

We, as well as others, have barriers to imports which we have the power to remove or reduce. With the maintenance of vigorous domestic demand, the value of our imports could be substantially increased in the coming years with benefit to our standards of living and without injury to domestic industries. Despite recent tariff reductions, imports are still hampered by tariffs which may safely be reduced by reciprocal trade agreements negotiated in the conferences to begin next September. Burdensome customs procedures should be modified. Other legislative restrictions upon imports of goods and services should be limited or eliminated as far as practicable, except to the extent that they are required for our national security or other domestic objectives; and they should be made consistent with the proposed charter for the International Trade Organization. This charter, which provides a code of rules and a mechanism for dealing with international trade problems, has been negotiated and placed before the Congress for approval.

Important though these measures are, a solution which placed the entire burden upon increasing American imports between now and the end of the European Recovery Program would not be desirable from the point of view of foreign or domestic policy, even if it were feasible. The cutting off of our present net contribution to the resources of foreign countries, by eliminating our export surplus in less than 3 years, would mean severe limitations on their domestic development or living standards. Both alternatives would involve serious dangers of political instability in many parts of the world which would be harmful to our national security. In this country, so sharp a rise of imports within a few years might create difficulties for particular industries, and also have some generally unfavorable economic effects.

Nor should the solution be sought in a drastic reduction of American exports. This would be disastrous for many foreign countries throughout the world if it occurred before their requirements could be supplied from other sources. It would also have a serious effect upon the markets for many United States products, and would aggravate our problem of agricultural surpluses. In the fiscal year 1948–49, we exported to Europe 21 percent of our total raw cotton production, 21 percent of our leaf-tobacco production, and 26 percent of our total wheat and wheat-flour production.

The Point Four Program

In January 1949, the President proposed what has become known as the Point Four Program to assist the underdeveloped areas of the world in raising their standards of living and creating an environment favorable to the maintenance and development of freedom and democracy. The expanded flow of capital under the Point Four

Program would create new international markets. A substantial flow of dollars, which the underdeveloped countries could spend where they choose, would provide the countries of Western Europe with the opportunity of finding new outlets for the export of capital goods and other products by an expansion of total world markets, rather than by a self-defeating struggle for present limited markets. Thus, the export of capital under the Point Four Program, which is a basic element in our foreign policy, would contribute greatly to the supply of dollars needed by foreign countries to purchase essential supplies in the United States.

The Point Four Program proposes, in the first instance, to furnish technical assistance and to expedite the flow of capital to the countries which have made little progress in development. Legislation to provide technical assistance, and to provide guaranties to private capital against risks peculiar to foreign investment, has been recommended and is under consideration by the Congress. The investment of private capital is being encouraged through the negotiation of treaties to assure private capital against discriminatory treatment. It is also desirable to revise certain provisions of the tax laws dealing with the taxation of income from foreign investment.

The present volume of requests for soundly based loans from the International Bank for Reconstruction and Development and the Export-Import Bank has been limited, because development plans of many underdeveloped countries have not been translated into sufficiently concrete projects. The United States should provide positive assistance to the underdeveloped countries in formulating such projects, through its technical assistance programs and through its support of those of the United Nations. At a later time, it may be necessary to increase the lending authority of the Export-Import Bank so that it can increase substantially its guaranty and direct lending activities.

In the underdeveloped countries, there is an enormous potential demand for the products of Western Europe and of the United States which will become active as their resources are more efficiently used and the standards of living of their people raised. It is the purpose of the Point Four Program to activate these powers of economic growth. In doing so, it will also expand the opportunities for world trade. Here lies the opportunity for the countries of Western Europe to escape from the limitations of existing world markets in which they are now confined, and within which they find little room for adjustment. Our own policies under the Point Four Program, and the business policies of Western Europe, should be directed to permit them to participate in this expansion of world trade. They will then find an outlet for their increasing production, and will begin to create a new source of dollars to support their purchases in the United States.