

# The Annual Economic Review

January 1951

A Report to the President

By the

COUNCIL OF ECONOMIC ADVISERS



LETTER OF TRANSMITTAL

COUNCIL OF ECONOMIC ADVISERS,  
*Washington, D. C., January 9, 1951.*

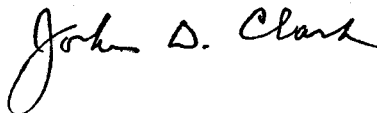
The PRESIDENT:

SIR: The Council of Economic Advisers herewith submits a report, the Annual Economic Review: January 1951, in accordance with section 4 (c) (2) of the Employment Act of 1946.

Respectfully,



*Chairman.*





# Contents

	Page
I. THE BROAD FEATURES OF 1950 . . . . .	33
Recovery from the business recession . . . . .	33
The period of partial mobilization . . . . .	34
The period of intensified mobilization . . . . .	39
II. GUIDES FROM THE PAST . . . . .	43
Conversion from peace to war, 1940-45 . . . . .	43
Magnitudes of expansion . . . . .	43
Sources of expansion . . . . .	45
Shifts in resource use . . . . .	49
Inflationary pressures . . . . .	51
The relevance of World War II experience . . . . .	52
Conversion from war to a peacetime economy, 1945-50 . . . . .	53
The general pattern of developments . . . . .	54
Labor participation and business investment . . . . .	57
Incomes and demand . . . . .	59
The implications of our current prosperity . . . . .	61
III. THE MAGNITUDE OF THE TASK AHEAD . . . . .	66
The general nature of the task . . . . .	66
The size of the national security build-up . . . . .	67
Expanding production to meet the strain . . . . .	70
Increased labor participation . . . . .	70
Expansion of productive facilities . . . . .	72
Obstacles to expansion . . . . .	76
Production goals for the end of 1951 . . . . .	76
Impact on civilian supplies . . . . .	77
Inflationary pressures . . . . .	77
How much defense can our economy support? . . . . .	79
IV. ECONOMIC POLICIES FOR DEFENSE . . . . .	84
Three requisites for economic mobilization . . . . .	84
The need for comprehensive programming . . . . .	84
The need for speed . . . . .	85
The need for public support . . . . .	86
Maximizing our productive strength . . . . .	87
Industrial expansion . . . . .	88
Basic resources . . . . .	90
Manpower . . . . .	92
Adjustment of agricultural production . . . . .	96

	Page
IV. ECONOMIC POLICIES FOR DEFENSE—Continued	
Promotion of economic stability . . . . .	97
Mobilizing our financial resources . . . . .	99
Taxation . . . . .	102
Debt management . . . . .	107
General credit policy . . . . .	107
Selective credit controls . . . . .	108
Materials controls . . . . .	110
Policy for profits, prices, and wages . . . . .	113
International economic policy . . . . .	119
Economic aid to foreign countries . . . . .	119
Control of commodities in world trade . . . . .	122
Commercial and financial policies . . . . .	123
V. DETAILS OF ECONOMIC TRENDS IN 1950 . . . . .	125
Employment and production . . . . .	125
Employment . . . . .	125
Unemployment . . . . .	127
Production . . . . .	127
Prices, wages, and profits . . . . .	129
Prices . . . . .	129
Wages . . . . .	133
Profits . . . . .	137
Money and credit . . . . .	139
The flow of goods and purchasing power . . . . .	143
Personal income, consumption expenditures, and saving . . . . .	143
Business investment and finance . . . . .	149
International transactions . . . . .	156
Government transactions . . . . .	159
Summary: The Nation's Economic Budget . . . . .	164

APPENDIXES

A. STATISTICAL TABLES RELATING TO EMPLOYMENT, PRODUCTION, AND PURCHASING POWER . . . . .	169
B. THE DISTRIBUTION OF INCOME AND SAVING IN THE UNITED STATES . . . . .	221
C. THE NATION'S ECONOMIC BUDGET . . . . .	231

## I. The Broad Features of 1950

**T**HE AMERICAN ECONOMY at the end of 1950 presented a far different picture from that which would have been projected from trends at the start of the year. Twice there occurred the sharply defined changes in direction or speed which come from the shock of armed conflict. The outlook for 1951, and the appropriate national policies, will rest to a greater extent than for some years past on Federal activity stemming largely from international developments. Whatever occurs, however, will start from the economy at the close of 1950, and the policies to be followed should make full use of the experience already gained.

The economic history of 1950 divides into three distinct parts: the period of recovery from the recession of 1949; the period of expansion of the defense program following the Korean outbreak on June 25; and the more intense period following the beginning of major Chinese hostilities in late November.

### RECOVERY FROM THE BUSINESS RECESSION

The hesitant business recovery, which began in August 1949, grew into a vigorous and sustained upward movement early in 1950. Industrial production increased more than 10 percent from February to June, and by then surpassed the postwar record level established in 1948. Employment followed a parallel course. It furnished sufficient jobs, not only to absorb more than one-fourth of the 4.7 million who were without work in February, but also to match increases in a labor force which rose to new levels.

The final part of this Review discloses in detail the degree to which each important factor in the economy supported the rapid recovery to a high prosperity level in June. Personal incomes, enlarged by the veterans' insurance refund of 2.6 billion dollars and by increasing wage payments, fed a growing volume of consumers' expenditures. Residential construction starts, which had declined less than seasonally during the winter, sprang upward in March beyond the peak month of other postwar years and proceeded at an unprecedented pace throughout the second quarter. Investment in new plant and equipment, after a larger than seasonal decline in the first quarter, expanded briskly in the second quarter. Businessmen both reflected and contributed to the ebullience by indicating their purpose to undertake still greater programs of plant expansion.

This rising level of business activity in the early months of 1950 was not based upon transitory causes which might have been expected to

terminate expansion toward midyear. The payment of the veterans' dividend, which some observers overstressed, contributed to the recovery, but was not the basic factor in recovery. Nor did the upward movement have the ephemeral quality of an inventory boom. Producers and merchants were cautious about accepting the bounding market as a firm foundation for a reversal of their inventory policies. Manufacturing inventories (seasonally adjusted) did not exceed the September 1949 level until May 1950, and the increase in value from January to June was only 3 percent. The increase in value of retail inventories during the same period was 5 percent. In both cases, inventories were expanded less rapidly than sales.

Rising prices have often accompanied sustained periods of business expansion following recessions. They were not to be interpreted as a portent of coming inflation, when the price rise was within the moderate limits recorded during the first half of 1950. It was not until the end of April that the weekly wholesale price index began to mount with any vigor. The total rise, from 151.1 in the first week in January to 157.4 in the last week in June, was about 4 percent. The index of industrial prices rose less than 3 percent during the same period. The volatile index of wholesale prices of farm and food products opened the year near the lowest point since 1946, and these prices increased more during the first half-year than the wholesale prices of manufactured goods. The slower-moving index of consumers' prices rose only 2 percent.

The changes in money supply and in bank credit during the first half of 1950 were moderate. The increase in the privately-held money supply was inconsequential, and the addition of 1.8 billion dollars to the loans of all commercial banks was a rise of only 4.2 percent. There was, however, an increase of 11 percent in outstanding instalment credit. Nearly all of this occurred in the second quarter, indicating one point in the economy where an inflationary potential might be developing. Residential mortgage credit was also rising rapidly.

This rapid business recovery brought a speedy change in the fiscal condition of the Government. Treasury revenue from excise taxes and from taxes upon the wages of the growing body of employed workers began to expand. Improving conditions also reduced demands upon the Treasury for the farm-price-support program and for unemployment insurance benefits. In combination, these shifts resulted in a small budget surplus in the first half of the year.

#### THE PERIOD OF PARTIAL MOBILIZATION

The shock of the initial involvement in Korea fell upon an economy which was experiencing a high level of prosperity, with few slack resources or signs that the boom forces were leveling off. There was prompt and universal recognition by the American people that a great defense effort must be made. This meant that there would be imposed, upon an extended

economy, military demands for goods and for manpower which had to be met by diverting factors of production from civilian uses.

The first result took the form of those mass movements which occasionally upset economic analysis based solely upon statistical data or assuming a regular pattern of economic behavior. There was a rush by consumers to buy fantastic quantities of certain goods, even though such goods were being produced under conditions which assured the continuance of ample supplies for many months. Local stocks of sugar were exhausted; merchants were forced to limit purchases of nylon stockings; household linens flowed out of the shops and into the homes; automobile tires were eagerly seized; meat was crowded into deep-freeze units. Such movements, however short-lived they may be, continue to influence the economy long after the originating incident has disappeared.

Although the supply situation did not warrant such panic buying, consumers were not wholly irrational. The goods they bought were important household commodities, the limitations upon which had been most sharply felt during the days of World War II shortages. The buying did not represent any flight from the dollar; rather it was an effort to anticipate the needs of the future. Such buying would probably soon subside, and sales would settle down when consumers found ample supplies in the shops and began to use up what they had bought beyond their immediate needs.

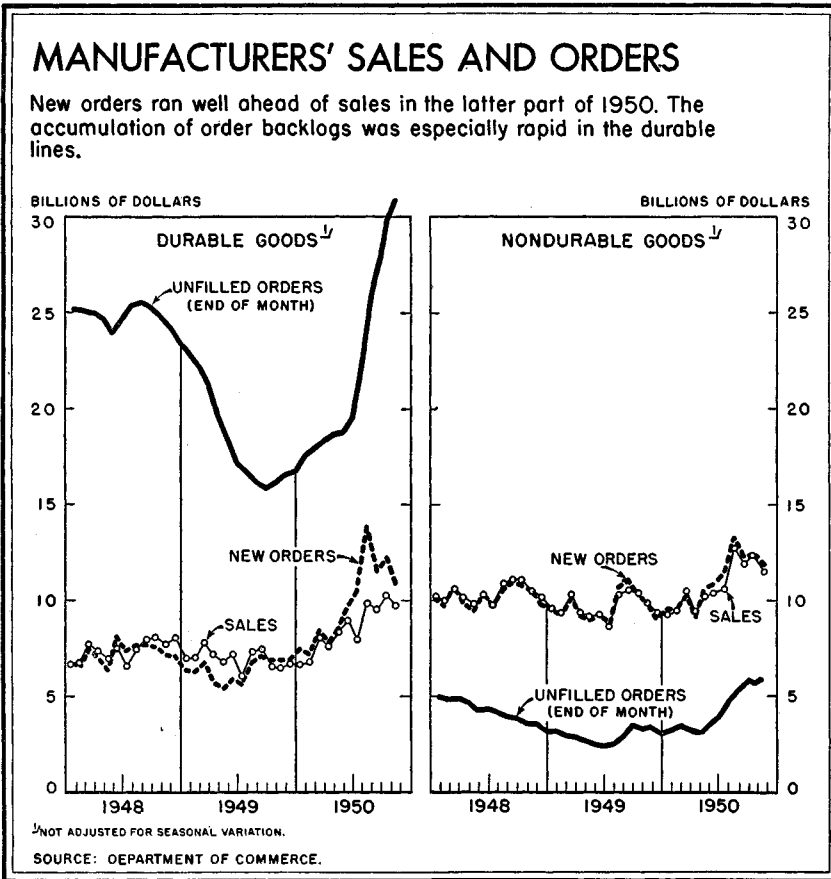
The outburst of consumer buying was neither sufficiently great nor sustained to require Government intervention to prevent demoralization of markets. Nevertheless, it had lasting effects upon economic conditions. The consumers' price index made the unusually large jump of 1.4 percent between June 15 and July 15, as retail food prices moved upward. The rise in consumers' prices was followed by a round of wage adjustments, many of them voluntary, that before the end of the year gave wage increases to millions of workers in manufacturing and other nonagricultural industries.

The July bulge also caused merchants to flood manufacturers with orders for goods to replenish inventories which had been held at conservative levels. (See chart 2.) Manufacturers in turn entered the markets for raw materials with large demands. Speculative buying of futures at rising price levels began in the commodity exchanges. The upward pressures on raw material prices became a persistent inflationary factor throughout the second half-year.

While the heavy buying of nondurable goods was running its course, a more enduring trend of buying appeared in the markets for consumers' durable goods, especially automobiles and household appliances. Incidental to this, there were heavy liquidations of personal savings and an accelerated growth of instalment credit. Instalment credit continued to increase rapidly until action was taken to curb it.

Building operations were at a very high level when the Korean blow was struck. Then every builder began frantically to search out and buy all

CHART 2



materials needed for the completion of his 1950 operations, most of which he would normally have purchased as the work progressed. The multiplied demand for building materials drove the regular market prices upward rapidly, and generated irregular markets in which commodities exchanged hands at still higher prices. This excited buying eventually subsided. But it left its mark in the continuance of much higher prices of building materials generally, although lumber prices declined temporarily.

Other business investment was immediately affected by the booming markets, and by the expectation that a greatly enlarged defense program would assure their continuance. Expenditures for new plant and equipment in the third quarter were substantially larger than those in the second quarter, while plans were hastily enlarged for far greater expansion in the fourth quarter of 1950 and in 1951. The effect upon additional investment in inventories was immediate. Between July and October, manufacturing and retail inventories increased 5 billion dollars.

The financing of new business investment by bank loans is a normal process in our economic structure. It has contributed greatly to our economic growth, but may at times lead to difficulty by contributing to inflation. In the four-month period, July to October, the loans of all commercial banks increased more than 5 billion dollars, or 11 percent.

The central bank authorities became concerned over inflationary dangers, and in the latter part of August increased discount rates at the Federal Reserve Banks and initiated open-market operations to make it less attractive to the banking system and other lenders to sell Government securities for the purpose of expanding loans. The responsibility of the Federal Reserve to support the operations of the Treasury in refunding large maturing issues of securities limited the use of the general central banking instruments of credit restraint, and business loans of banks and other lenders continued to increase to new high records under the pressure of the strong inflationary forces in the economy.

The fiscal operations of Government did not contribute to inflationary forces in the third quarter of the year, except insofar as anticipations influenced the plans and conduct of consumers, workers, and businessmen. The third quarter is one of relatively low revenue receipts by the Treasury, but there was a modest budget surplus in that period of 1950. Budget expenditures for the Defense Department were less than in the third quarter of 1949, and were slow in rising despite large increases in appropriations. Government contracts to purchase have economic effects long before payments are ultimately made by the Treasury. But even these effects were limited, since the business world received far fewer orders than it had been led to anticipate from speculations in the daily press and trade publications.

The force which directly sustained the rapid advance in economic activity during the third quarter was civilian demand, buttressed by rising civilian income, but without any extraordinary increment from Government sources. Producers were making goods for civilians, and not for defense, when they pushed up the industrial production index 6.6 percent between July and August, and continued to carry it forward, although less rapidly, during the next two months.

The effect of the Korean outbreak, and of the resulting burst of buying by consumers and by business firms, was a sharp rise in the prices of industrial raw materials, farm products, and foods. Many of these prices became more stable by the end of July. But a general advance of the index of wholesale prices of industrial products continued, although with decreasing rapidity, until Thanksgiving Day, when they were 9 percent above the level of the last week in June. Retail prices advanced more slowly, but this was merely a postponement of inflation, since the retail price level ultimately reflects earlier changes in wholesale prices.

In considering at midyear appropriate domestic economic policies to meet the new situation, assumptions had to be made about the size and character

of the defense program. The assumption then adopted was that the defense program would move forward in stages, with defense expenditure reaching a peak rate in two years. It followed that, for the first twelve months, the diversion of productive resources would not require drastic readjustment of the civilian economy. The initial program of the President to stabilize the economy was based upon this hypothesis.

The principal legislation requested and enacted to deal with the new outlook included additional military appropriations, higher taxes, and increased control powers. Additional appropriations of more than 15 billion dollars for building up the armed forces, increasing military assistance to Europe, and enlarging stockpiles were requested in the course of the summer and were approved. The President, in his first legislative proposal in July, recommended an increase in taxes of 5 billion dollars. In response to this request, the Congress enacted a tax measure imposing additional rates on individuals and corporations to add about 4.7 billion dollars to the annual revenue. In November, the President recommended an excess profits tax, and signified his purpose to request broader tax legislation in January.

The principal powers requested by the President, in recommending the enactment of the Defense Production Act of 1950, were to allocate materials and limit their use, to limit credit to consumers and for new construction, and to furnish direct and indirect financial assistance to business expansion. Following the passage of the Defense Production Act of 1950, including authority to control prices and wages, official action was centered upon establishing selective controls. These have the great advantage of striking directly at the point where it is desirable to apply restraint. The Federal Reserve Board moved immediately to require larger down payments upon automobiles and other consumers' durable goods than those in many instalment contracts, and to shorten the period for full payment. A month later the Board tightened its requirements. The affected goods were largely those in the manufacture of which it is necessary to use raw materials required for the defense program.

The Federal Reserve Board and the Federal Housing and Home Finance Administrator established regulations requiring larger down payments and shorter periods of amortization in the construction and sales of new houses. The Secretary of Commerce promulgated rules limiting exports of specific commodities in short supply which were either directly required in defense production or were of great importance to the domestic economy. The National Production Administrator prohibited the use of building materials in structures for amusement and for a few other purposes. One of the first orders of the Administrator prohibited the accumulation of excess inventories of certain essential commodities. Vigor was shown in the exercise of authority to establish priorities. A basic regulation established priorities for purchases for defense. Such regulations, however, have the defect that they take a part of an inadequate supply and leave all other users to battle more furiously for the remainder. To remedy this defect

with respect to some important scarce raw materials, orders were issued to limit the amount which manufacturers might use in their operations.

Evaluation of the group of controls established during the five months following the attack in Korea runs into the difficulty that causal relations are very hard to establish in the economic world. Of some controls, such as those restricting exports, it may be said with confidence that they had positive effect in reducing the total demand for certain goods. Of others, such as the regulation of the terms of instalment credit, it can be said that the expansion of instalment credit was virtually halted. But one cannot know how far this was caused by the tighter credit terms, and how far it was due to other influences affecting the purposes of consumers.

Price increases of raw materials and commodities at wholesale, which got under way in the summer of 1950, were checked near the end of the third quarter. For six weeks before the blow from China, the wholesale price index advanced very slowly. The course of prices of basic raw materials changed from an upward rush to a series of fluctuations. Wages, in contrast, continued to rise as new contracts were signed in many industries. A large number of these contracts included provisions for adjustment of wages to further changes in the cost of living.

#### THE PERIOD OF INTENSIFIED MOBILIZATION

The initiation of heavy hostilities by China in late November blasted the hope that the Korean campaign could be brought quickly to a close. The support of China by the Soviet Union disclosed dangers of incalculable magnitude, and made necessary a vigorous increase in the speed and size of defense preparations.

The most important of the immediate changes in the Government defense program was an increase of almost 100 percent in the draft calls ordered by the Department of Defense for January and succeeding months. The plan for procurement for the armed services required substantial upward revision. Additional funds were requested of the Congress in December to finance the initial phase of the revised procurement program, and were provided. There was no great change in the placement and scheduling of orders before the end of 1950.

Industrial production in December remained close to the level established during October and November. Employment, when seasonal adjustment is made for the customary additions to the labor force and jobs incident to the holiday trade, was likewise steady. Yet national income and consumers' income continued to rise under the impact of rising prices and rising wages.

Wholesale prices of industrial products, which had moved slowly for nearly two months, immediately pressed upward at the same fast rate at which they had advanced in July and August. In the four weeks

following the Chinese intervention the index rose more than in the preceding eight weeks, and more than in the four weeks following the Korea attack. Wholesale prices of farm and food products, after a sharp rise in the first week in December, were stable for two weeks and then bounded upward again.

The market conditions under which wholesale prices advanced rapidly in December were very different from those of July and August. Christmas buying by consumers was little if any greater, in unit volume, than in 1949. Wholesale price rises in December seem to have been very largely the result of two factors: first, an effort by sellers to increase prices before they could be frozen by price controls and, second, the evaluation by businessmen of the pressure on prices which would flow from an accelerated defense program, and a continuing upward trend of money incomes. An inflationary spiral of rising costs of production, rising prices, rising wage rates, and still again rising costs was soon under way. (See chart 3.)

This new impetus to inflationary forces in December was not related to any deficit financing by the Treasury. A substantial budget surplus and a larger cash surplus was accumulated during the month. This rounded out a period of five months over which there was a net surplus, and a calendar year in which the Budget was close to a balance. Bank credit, on the other hand, continued to add to the inflationary pressure at an accelerating rate. Outstanding business loans of commercial banks in 94 leading cities, which had expanded at an average weekly rate of 160 million dollars since the end of June, increased more than 700 million dollars in the three weeks following the China attack.

The important positive measures taken by Government during December to stabilize the economy were quick action upon a corporate excess profits tax bill, which was made ready for final enactment before January 3; an extension of the rent control act; an order of the Federal Reserve Board increasing member bank reserve requirements; additional allocation and limitation orders by the National Production Administrator affecting specific materials, and in some cases specific uses; and an order establishing a Government monopoly in importing rubber.

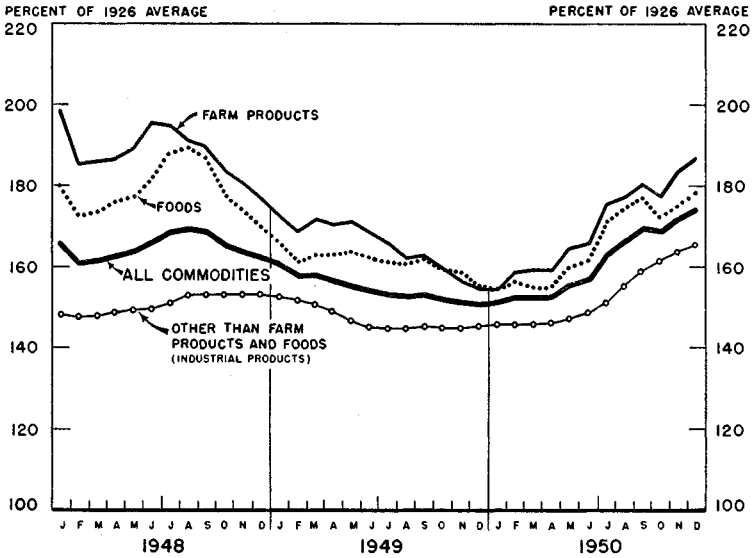
Other measures were preparatory. The President issued a proclamation on December 16 declaring a national emergency, and immediately thereafter established the Office of Defense Mobilization to which he assigned control and direction of the exercise of the powers given to the President by the Defense Production Act. Before the end of the month, the Director of the new agency was coordinating the plans and operations of the several government offices under his jurisdiction.

The Economic Stabilization Administrator hastened the work of organizing a staff to administer price and wage controls, the need for which promised to be far greater under the accelerated defense program than before. When the major automobile companies increased prices on their

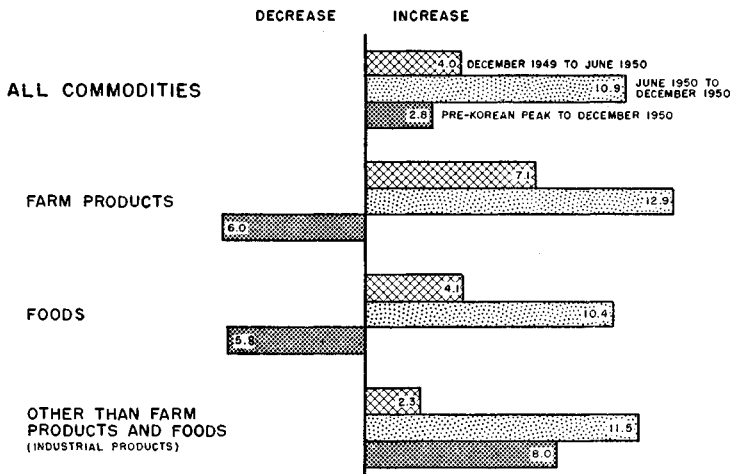
CHART 3

# WHOLESALE PRICES

Wholesale prices, after a moderate advance in the 1st half of 1950, rose rapidly and on a wide front in the 2nd half of the year to new record levels. During the year farm prices scored the largest increases, with food and industrial prices not far behind.



## PERCENTAGE CHANGES



SOURCE: DEPARTMENT OF LABOR.

new models, the Administrator issued his first mandatory order fixing prices at the December 1 level until March 1, 1951. This was followed by an order, in compliance with the statute, prohibiting wage increases for the same period. These orders had limited effect upon the inflationary forces that were affecting wholesale prices and the cost of living. But they were in a sense preparatory to much more extended action. The Administrator scheduled a series of conferences with producers of a number of basic industrial commodities to consider means of holding down prices of their products until his organization was prepared to administer more extensive price and wage controls. This procedure closely followed the early course of action to control prices in 1940-41. The precedent was further adopted in appeals to businessmen to follow, voluntarily, a price policy which the Administrator outlined in a formal statement.

At the end of 1950, the national economy was subject to forces of inflation far more powerful than those which arose following the original outbreak in Korea. Originally the advance in prices, which had slowed down during the mid-autumn, was accelerated under pressures which promised to continue until curbed by positive action. The outlook is that to these pressures there will soon be added the direct effect of the rapidly expanding military program, with its increasing draft upon productive resources which have thus far continued to serve civilian needs. Clearly it will be necessary to resort to more direct action than has thus far been taken to prevent inflation from continuing its destructive spiral. The policies now needed are treated more extensively in a later part of this Review.

## II. Guides From the Past

THE ECONOMY at the end of 1950 is the foundation on which we must build for the task ahead. But this economy was not built in a day; and the experience of more than one year can contribute much to our understanding of the job to be done. The five years between 1940 and 1945 witnessed a gigantic conversion from peace to war. The work immediately before us now, measured by defense goals already defined, is of smaller magnitude. These goals are not based upon the prospect of inevitable total war; they are a part, rather, of our continuing efforts to achieve a durable peace. Nonetheless, as the Nation now embarks upon a program for conversion to defense, it would be folly to ignore an experience into which so much effort was poured only a few short years ago.

The record of economic development between the cessation of hostilities in 1945 and 1950 is also of large significance today. That record exceeded expectation in reconverting from war to peace, without the prolonged dislocation of postwar periods in earlier times. The managerial and labor skills, the private financial mechanisms, and the public policies which smoothed and accelerated this transition, are national assets which should embolden us now as we face an even harder task. Moreover, these five years have brought our economy to unprecedented levels of strength, judged by every index of business activity and by all of the human and other resources which enter into our total power. We are far abler than a decade ago to assume the heavy burdens now confronting us. Yet the very fact that our resources are now being more fully used than they were in 1940, makes more difficult in some respects the problem of redirecting a large part of our resources to national defense.

Thus the history of the past decade, in war and in peace, should encourage and guide us in the months and years ahead. If we evaluate this experience carefully, it can contribute immensely to the shaping of policies for the future.

### CONVERSION FROM PEACE TO WAR, 1940-45

#### *Magnitudes of expansion*

The first major United States defense appropriation was requested in June 1940, at the time of the fall of France. The estimates presented to the Congress in January 1941, were described by the President as a budget for "total defense." The total of defense spending authority requested by that time was 29 billion dollars, or nearly 30 percent of the total national

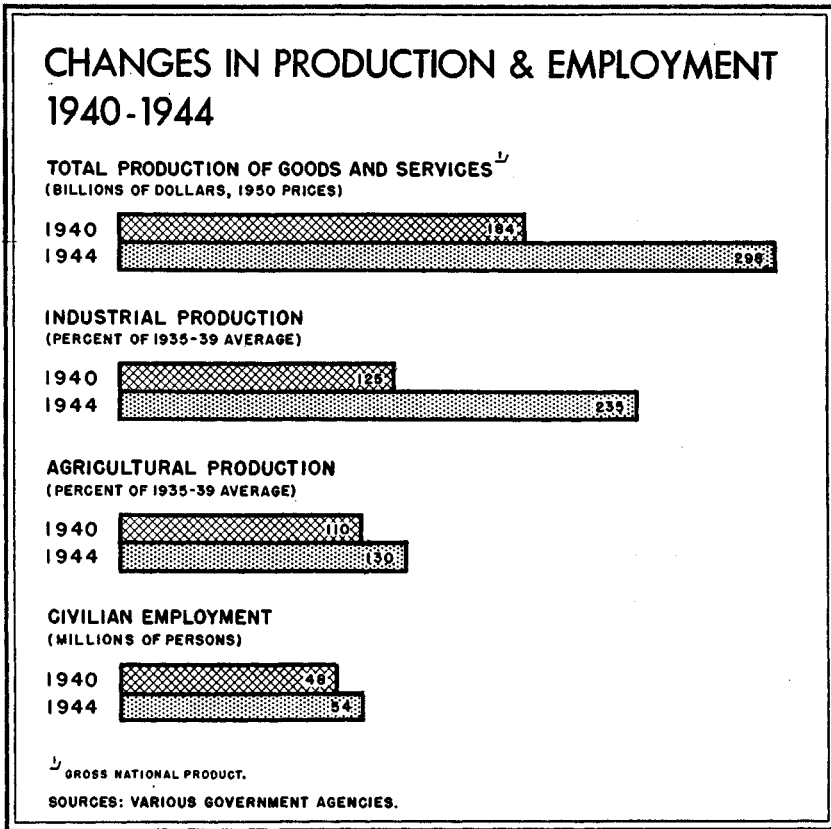
output of the preceding twelve months. During the following year, 46 billion dollars were added, bringing the total to 75 billion dollars over a period of 18 months in terms of the prices then prevailing. In 1950 prices, this was roughly equivalent to about 115 billion dollars. The budget presented in January 1942, one month after Pearl Harbor, was called "a budget for a Nation at war in a world at war." From that date forward, the only limitations on our war efforts were the intensity of our purpose, the skill of our planning, and our physical capabilities. The dollars were made available as rapidly as they could be used.

The results were stupendous. The dollars were used to train, feed, house, and clothe 12 million men in uniform, and to provide them and the armed forces of our allies with munitions of war. Victory was the final measure of success. The economic dimensions of this effort, however, were shown by the growth of Federal war expenditures. The 1941 rate was nearly  $2\frac{1}{2}$  times the second half of 1940 rate, and the rate in 1942 was over 3 times the 1941 rate. Total war expenditures in 1944 were 135 billion dollars, or nearly 13 times greater than the rate during the second half of 1940. These comparisons are all stated at the 1950 price level, in order to make them more meaningful.

Expenditures for munitions production more than doubled in 1941, and in 1942 were  $3\frac{1}{2}$  times their 1941 level. In 1944, they stood at about 85 billion dollars (in 1950 prices), or more than 13 times the annual rate in the second half of 1940. This 1944 outlay represented production of 96,000 aircraft, 18,000 tanks (nearly 30,000 had been produced in 1943), more than 30,000 ships and nearly 2 million tons of aircraft bombs. It supported the landings on the Normandy beaches and on the Pacific islands, and made good the tremendous attrition of full-scale combat. Had necessity dictated, it could have been still further increased.

But understanding of what took place would be superficial, if one looked at the military effort alone. Behind this effort was a build-up of the economic strength which underlies striking power. This build-up was ample in scope and unparalleled in size. Total national production in 1941 was about 15 percent greater than in 1940. (See appendix table A-10.) In 1942, it increased by nearly 15 percent again. In 1944, the peak year of war production, total national output was about 60 percent above the 1940 level. The surge of industrial output was even greater. The index of industrial production rose 30 percent in 1941 above the previous year, and rose a further 23 percent in 1942. It reached its peak in 1943. In that year, and again in 1944, it stood about 90 percent above the 1940 level. Agricultural output increased nearly 20 percent between 1940 and 1944, despite a substantial reduction in the farm labor force and continued shortages of many farm supplies. The rise in total output not only supplied the primary military effort. It was also sufficient to service vital industrial expansion, and actually to achieve some general improvement in the basic consumption standard of those employed at home. In short, a

CHART 4



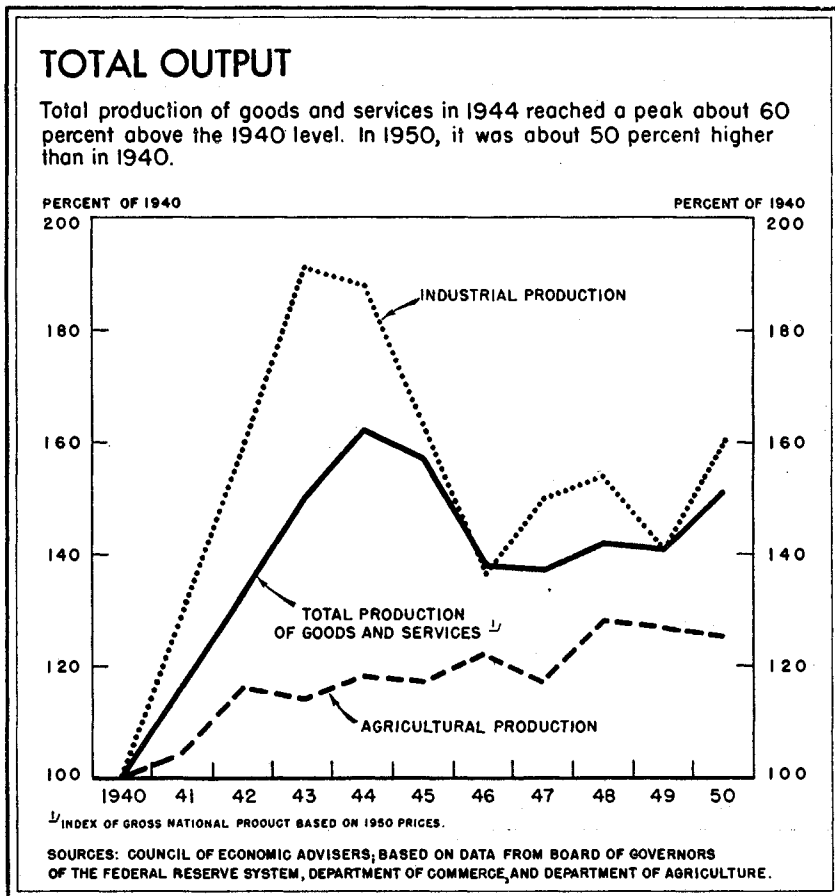
major productive effort enabled us to grow stronger, not only on one vital front, but on several vital fronts. This conclusion is clear, even though there are statistical difficulties in comparing peacetime output with war output. (See charts 4 and 5.)

*Sources of expansion*

The mainspring of this growth was an economy which possessed great power and resiliency. Although total production rose by 60 percent between 1940 and 1944, the level from which it started was very high by the standards of any other country in the world. The years of common action to combat depression, and to help those groups and areas which had been hardest hit, had built new sources of strength into the economic structure.

From 1940 onward, the basic sources of expansion were three: the absorption of unemployed manpower and other idle resources into production; the expansion of productive capacity through enlarging plant and facilities; and the recruitment of new workers—for example, more women—into the labor force. Each of these three sources played a major role in the final result.

CHART 5



They operated concurrently, and their contributions to the expansion of output cannot be separately measured.

Between 1940 and 1944, the total number of people in the armed forces and civilian employment combined rose by 17.3 million, or about 35 percent. Of this increase, 10.9 million went into the armed forces, and 6.4 million were drawn into civilian employment. To supply this increase, 9.9 million, or well over half, came from the increased participation of the population in the labor force and normal growth, while 7.4 million were absorbed from the pool of unemployed which existed in 1940. Thus the expansion of the labor force was more important than the reduction of unemployment in meeting our manpower needs.

From the standpoint of timing, the major increases in civilian employment came during the years 1940-42. The largest growth in the armed forces occurred during the next two years, particularly during the twelve-month period from mid-1942 to mid-1943, when 5 million men, or over 40

percent of the total increase, were put in uniform. This timing eased the job of preparing for all-out war production.

The enlargement of labor effort did not come only from increases in the number of workers. Between 1940 and 1944, average working hours in manufacturing industries rose from 38.1 to 45.2 hours a week, or by about 19 percent. In construction, they rose from 33.1 to 39.6, or nearly 20 percent; and in bituminous coal mining, they rose from 28.1 to 43.4, or nearly 55 percent.

This tremendous increase in labor input was devoted largely to the production of finished munitions, civilian goods, and essential supporting services. A substantial fraction, however, especially up to mid-1943, was devoted to enlargement of plant and facilities for the production of munitions and basic materials. During the five-year period from mid-1940 to mid-1945, investment in industrial and industrial-service facilities totalled nearly 57 billion dollars (in 1950 prices), or nearly  $\frac{4}{4}$  percent of total national output. Of this total, over 16 billion dollars worth were put in place in 1942 alone, the peak year. This represented nearly 7 percent of total national output.

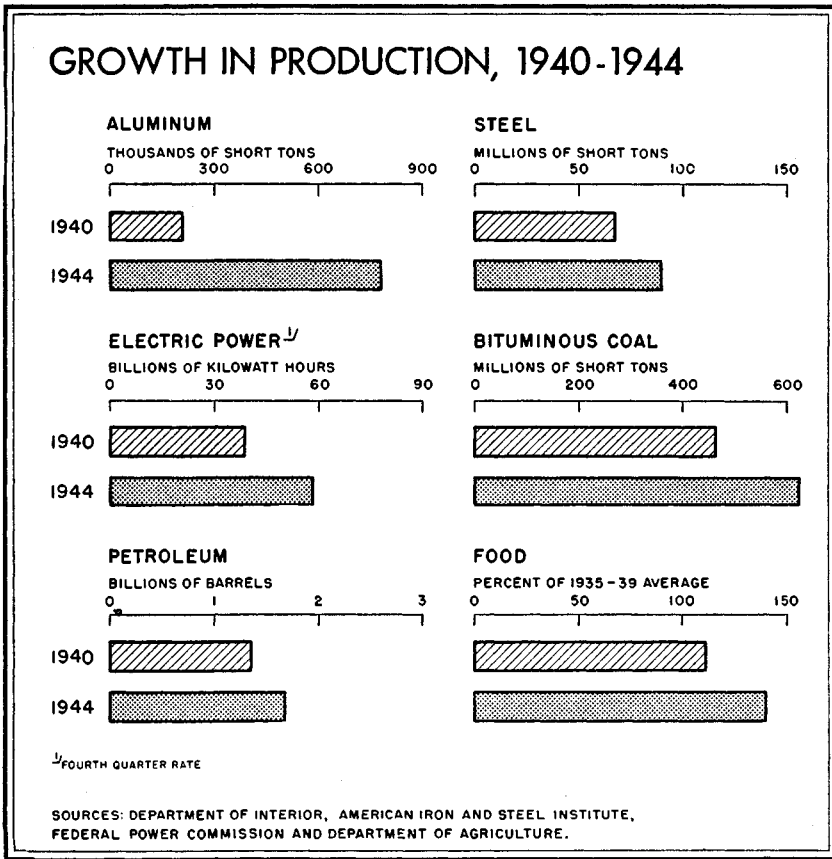
The great emphasis in this investment program was on facilities for the production of ordnance, aircraft, ships and chemicals (including synthetic rubber). These categories alone accounted for almost 60 percent of the total outlays for war industry facilities during the five-year period. The factory space devoted to aircraft production was increased 13-fold from January 1940 to March 1944.

Other very large programs were undertaken for the expansion of basic capacity in metals and metal products, machinery and electrical equipment, and petroleum and coal products; these categories accounted for another 24 percent of the total. Rough estimates indicate that, between 1939 and the end of 1945, the total capacity of all manufacturing industries was increased by as much as 30 percent. In individual industries, the increase in capacity was 12 percent for steel, over 50 percent for nonelectrical machinery, and 70 to 75 percent for chemicals and electrical machinery. Electric generating capacity increased by more than one-fourth. In an even shorter period, aluminum capacity increased nearly six-fold. In a number of less essential industries there was little or no increase in capacity, and there were serious lags in maintenance and modernization.

As shown in chart 6, these expansions of capacity supported very large increases in output. Between 1940 and 1944, steel production rose by nearly one-fourth; power output by about one-half; and aluminum production nearly quadrupled.

Direct Government financing played a major role in the World War II expansion program. Nearly 72 percent of the total war industrial facilities of the period were built with public funds. The major reason for this was that such a high proportion of the facilities constituted special types needed for direct war materiel output, offering only limited prospects of economical

CHART 6



postwar use. The facilities built for ordnance, aircraft, and shipbuilding, for example, accounting in all for a little over half of total public and private outlays, were more than 90 percent Government-financed. In the expansion of basic industries such as steel and machine tools, Government and private industry put up about equal shares, while the transport and utility expansions were financed predominantly from private sources.

Policies were developed to support expansion in ways which were orderly, least disruptive of community life, and most compatible with our enterprise system. Recruitment and training programs, special transportation arrangements, day nurseries, special arrangements for part-time work—these and related policies were devised to secure maximum participation in the labor force. Investment policies, including direct Federal loans, loan guarantees, and accelerated amortization, were devised to secure maximum participation by private business in the needed expansion of capacity.

### *Shifts in resource use*

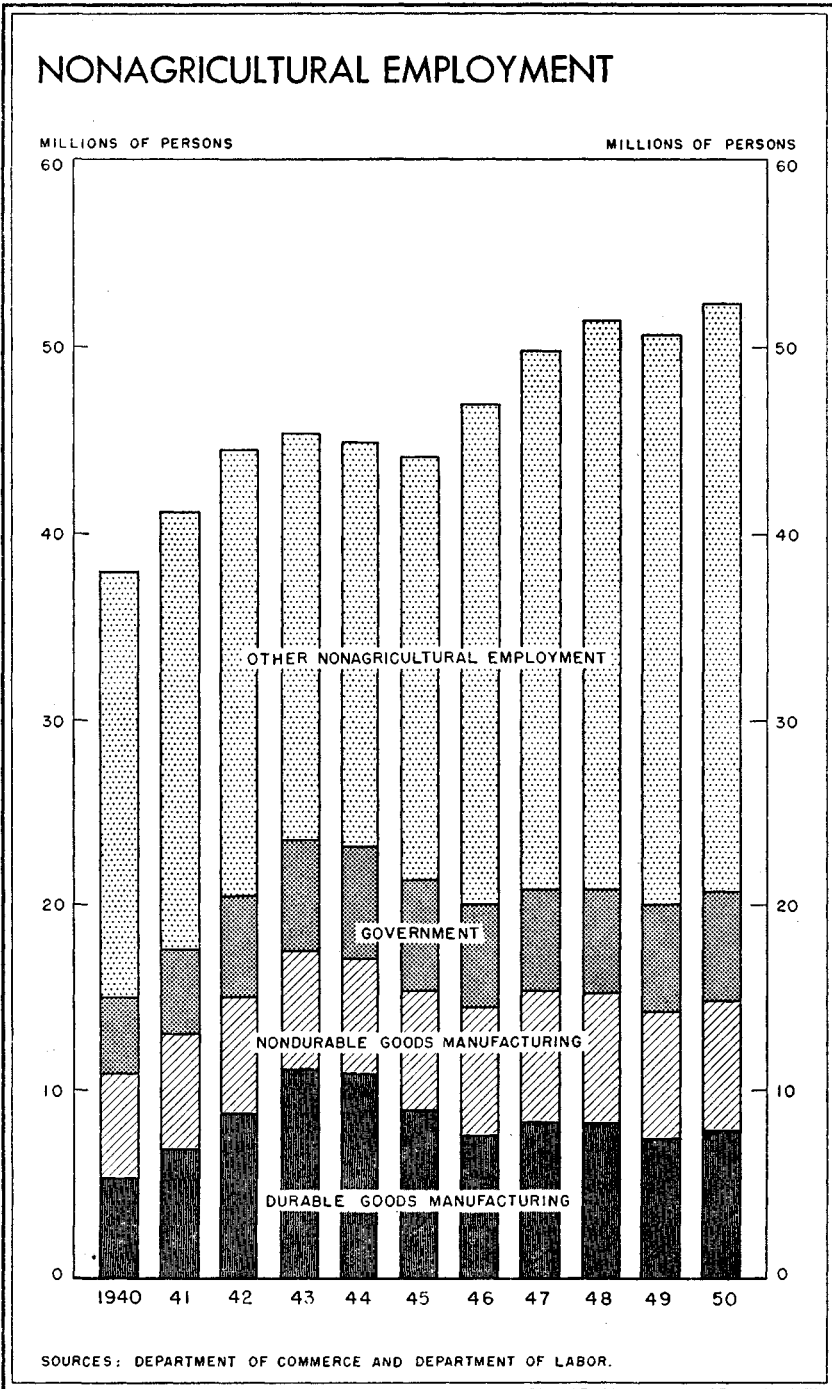
Despite the great increase in total output between 1940 and 1944, it was not possible merely to superimpose the war program on our civilian economy. Massive shifts in the use of resources were required. The size and difficulty of these shifts were only partially indicated by changes in the broad components of the labor force or of total national output, because many shifts were within major components, and virtually all major segments of the economy showed some expansion.

In 1940, Federal defense expenditures absorbed about 2 percent of the total national output of 184 billion dollars (all of these figures are based on computations in terms of 1950 prices). In the first quarter of 1941, the percentage was about 7; in the first quarter of 1942, it was about 20; and in the first quarter of 1943, it was over 40 percent, or close to the wartime peak. In the peak war year 1944, war outlays absorbed about 45 percent of a total output of nearly 300 billion dollars. Civilian consumption in the aggregate rose somewhat in every war year except 1942, being nearly 15 percent higher in 1944 than in 1940. Per capita food consumption grew considerably, although the more equitable distribution meant declines in consumption for many. Nonetheless, there were marked and unfavorable changes in the range and quality of available consumer goods, which cannot be adequately accounted for in the statistics. Furthermore, there were many individuals and families whose tax payments rose substantially more than income, and whose standards of living declined markedly. As a proportion of total output, consumption declined from about 70 percent in 1940 to about 50 percent in 1944.

War demand for particular types of materials, facilities, and skilled manpower was great enough to require the virtual elimination of production of a number of durable consumer goods. Total production of all consumer durable goods was cut by about one-half between 1941 and 1944. From relatively small quantities at the beginning of 1940, direct military consumption of steel rose to more than 40 percent of total supply in 1944, and of copper and aluminum to two-thirds or more.

On the manpower side, only agricultural employment and domestic service showed major and steady declines between 1940 and 1944, falling by nearly 2 million. Construction employment rose by nearly a million—almost doubling—between 1940 and 1942, and then was cut back even more as the expansion of facilities was sharply contracted. All other major areas of employment remained fairly stable, or showed increases, throughout the five-year period. By far the major increase was in the metals, metal-working, and other durable-goods industries chiefly devoted to munitions production. Employment in the durable-goods industries expanded from 5.3 million in 1940 to 10.9 million in 1944. This was equivalent to nearly 60 percent of the total increase in nonagricultural wage and salary workers between 1940 and 1944. (See chart 7.)

CHART 7



### *Inflationary pressures*

These very great increases in employment, working hours, and production generated similarly large increases in incomes—even with adjustment for increases in prices and wage rates. Disposable personal income (in 1950 prices) rose by nearly 45 percent, or roughly 55 billion dollars, between 1940 and 1944; income before taxes rose even more. (See table 1.) During the same period, the supply of consumer goods and services increased by less than 15 percent, for while total production expanded by 60 percent, or nearly 115 billion dollars, Federal war expenditures absorbed the whole of the increase, and the declines in private investment and net foreign investment were not sufficient to permit a greater expansion of consumption.

The inflationary pressure caused by incomes rising so much faster than civilian supplies was only partially counteracted by taxation. With government expenditures rising much faster than revenues, and with restricted civilian supplies, there was necessarily a very great increase in personal savings. They rose from about 5 percent of disposable personal income in 1940 to nearly 25 percent in 1944. In 1944 private saving, both personal and business, totalled more than 60 billion dollars (in terms of 1950 prices).

TABLE 1.—*Production and private income and expenditure, 1940 and 1944*  
[Billions of dollars, 1950 prices]

Item	1940	1944
<b>Production:</b>		
Total production of goods and services (gross national product).....	184.4	298.5
Total war production.....	4.6	135.0
<b>Income and expenditures:</b>		
Disposable personal income.....	133.0	189.9
Retained business receipts <sup>1</sup> .....	21.2	27.8
Total retained private income.....	154.2	217.7
Personal consumption expenditures.....	127.2	144.3
Gross private domestic investment.....	27.6	12.1
Total private domestic expenditures.....	154.8	156.4
Total excess of private income (+) or expenditures (-).....	-6	+61.3

<sup>1</sup> For definition, see appendix table C-3.

Source: Based on data in appendix table A-10.

At no time during the war period, however, were taxes and funds earmarked for savings sufficient to offset inflationary pressures. Between 1940 and 1944, the index of consumer prices rose by 25 percent, and the index of wholesale prices by nearly one-third. The bulk of these increases occurred before the inauguration of general price control in 1942, but strong upward pressures nonetheless persisted, making the task of maintaining stable prices one of continuing difficulty. Furthermore, when the war ended and controls were removed, the very large volume of liquid savings accumulated during the war was a major inflationary factor in the reconversion period.

### *The relevance of World War II experience*

This résumé of World War II experience has points of relevance to the large though different defense effort now being undertaken. It indicates that the economic aspects of mobilization, whether partial or complete, are not confined solely to servicing the military front. Policies must be directed toward achieving that balance between strength on the home front and strength on the fighting front which provides the greatest total strength in terms of the strategy of the contest. The résumé underscores the importance of expanding production. But it also shows clearly that a magnificent increase in production could not avert the necessity for cutbacks and reallocations of manpower, materials, and equipment to new purposes. And although the Nation started its defense effort at a time when there were many slack resources, this did not prevent the rapid gathering of inflationary forces.

To meet these problems, many and varied policies were adopted and made effective. Government expenditures, financial aids, and tax incentives contributed to the rapid expansion of total output. By the end of 1943 they were setting the pattern of final demand for over 40 percent of national output, and largely guided the necessary shifts in manpower. Direct allocations of materials, and prohibition of nonessential uses, assured the availability of resources to meet these primary needs. Increased tax rates, savings campaigns, and rationing helped to restrain the pressure of civilian incomes on limited supplies. Direct price control and wage stabilization gave necessary support to these policies, and at the same time kept the remaining pressures from breaking out of bounds. It is a major question, however, whether inflationary pressures could have been contained successfully over a longer period without higher taxation.

It is of high significance that, even with this necessary intensification of public controls and centralized action, the great records of wartime production were achieved in large measure without destroying—and in fact, by enlivening—the dynamic initiative of enterprise all over the country. This not only helped us to win the war; it also left us in a strong position to move forward when hostilities ceased.

The value of this experience is not lessened because the problems we now face are somewhat different from those which confronted us after 1940. Experience is useful, not only in dealing with identical situations, but also in dealing with new variations. Besides, there are numerous important points of similarity between what we must now do and what we did after 1940. That experience should be studied and drawn upon now. More detailed reference to its pertinence will be undertaken in the policy section of this Review.

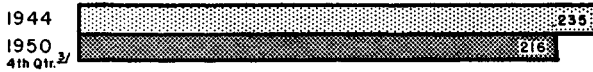
CHART 8

## CHANGES IN PRODUCTION & EMPLOYMENT SINCE 1944

### TOTAL PRODUCTION OF GOODS AND SERVICES<sup>1/</sup> (BILLIONS OF DOLLARS, 1950 PRICES)



### INDUSTRIAL PRODUCTION (PERCENT OF 1935-39 AVERAGE)



### AGRICULTURAL PRODUCTION (PERCENT OF 1935-39 AVERAGE)



### CIVILIAN EMPLOYMENT (MILLIONS OF PERSONS)



<sup>1/</sup>GROSS NATIONAL PRODUCT.  
<sup>2/</sup>ANNUAL RATE, SEASONALLY ADJUSTED.  
<sup>3/</sup>SEASONALLY ADJUSTED.

SOURCES: VARIOUS GOVERNMENT AGENCIES.

### CONVERSION FROM WAR TO A PEACETIME ECONOMY, 1945-50

In the Midyear Economic Review of last July, the Council undertook an analysis of developments during the preceding five years. This survey outlined the unparalleled height of peacetime productive power to which the American economy had ascended. The survey also revealed new magnitudes and modes of private economic behavior and public policy, which suggested new limitations on the applicability of traditional cycle analysis. The mildness of the 1949 business recession, and the speed and vigor of the recovery, led the Council to suggest that new factors of stability had been built into the structure of our system, and that this would contribute to further dynamic growth.

The tasks now confronting the Nation suggest a further appraisal of these five years in a somewhat different perspective. The economic situation now is vastly different from what it was in 1940, when we began so vigorously to build up military strength and to adjust the rest of our economy to this primary task. In consequence, the Nation is now in a novel situation as it

faces a defense emergency. This, in turn, has great bearing upon what we now need to do, and upon the speed and facility with which we can adjust to the accomplishment of new goals and the assumption of new burdens.

### *The general pattern of developments*

The dominant feature of the beginning of the reconversion period was a precipitate decline in war expenditures. From their peak of about 135 billion dollars in 1944 (in 1950 prices), these expenditures dropped to only about 25 billion dollars in 1946, or by more than 80 percent. They declined still further in 1947.

Despite this drastic contraction of the major single segment of demand, the total output of the economy fell by only about 15 percent between 1944 and 1946. By the end of 1950, after the moderate setback in 1949, total output stood close to the 1944 level. (See chart 8.)

Industrial production, weighted so heavily during the war by munitions output, has varied much more sharply than total output. From a 1943 peak of 239, the index of industrial production fell to 170 in 1946; or by nearly 30 percent. Since 1946, except for the 1949 setback, the index has climbed steadily, and by the end of 1950 was within 10 percent of its wartime peak year. (See chart 9.) Except for the industries which had concentrated on munitions production, virtually all types of industrial output at the end of 1950 were substantially above wartime peaks. In view of the record of expansion and modernization of industrial facilities during the postwar years, basic industrial capacity is now well above the 1944 level.

Agricultural production as a whole did not decline at all from its wartime levels, and in both 1949 and 1950 was well above those levels. Furthermore, there were substantial shifts in types of farm output, toward higher-value livestock products more nearly in accord with the pattern of consumer demands at high levels of incomes.

The physical volume of total new construction in 1950 was more than 15 percent above its 1942 wartime peak.

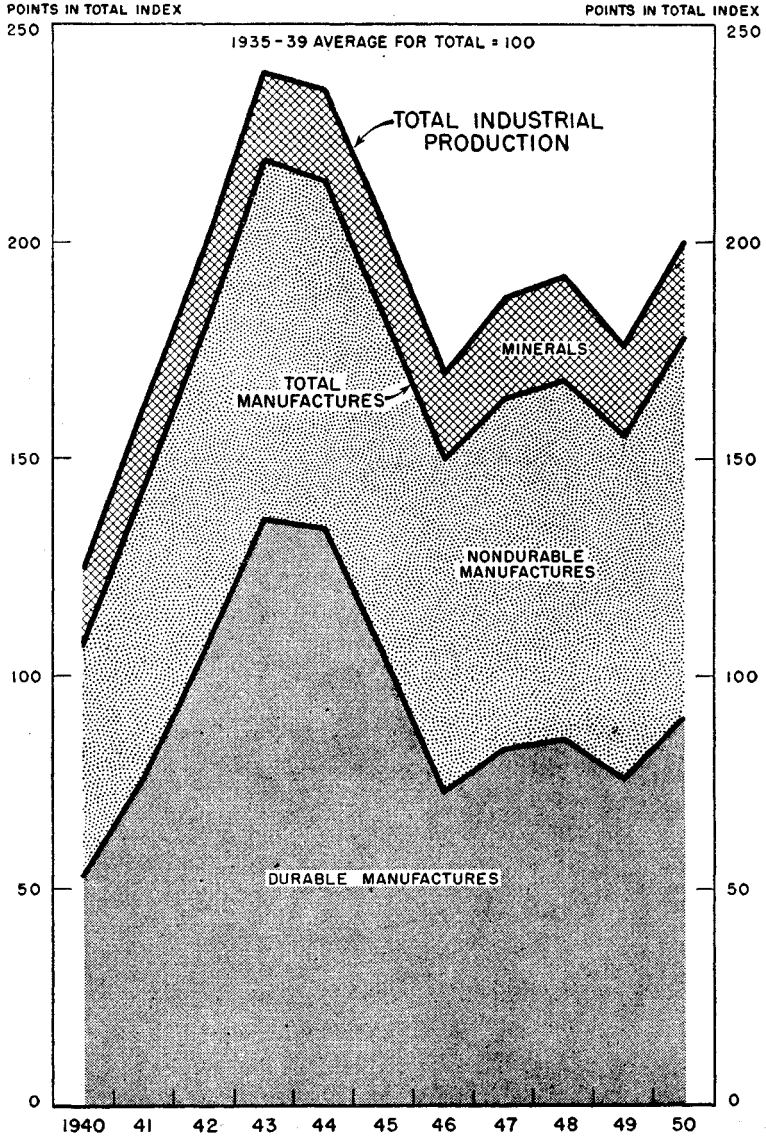
Thus in some areas of basic importance to long-term economic growth and to the steady improvement of living standards, production in 1950 was substantially above its wartime levels. Even though total output was probably no greater, it was attained with far less strenuous utilization of plant and manpower. The capacity to produce was much greater.

The pattern of output in 1950 was predominantly adjusted to the needs of a prosperous peacetime economy. Total civilian consumption was one-third above the 1944 level. It absorbed about 70 percent of aggregate production, compared with about 50 percent in 1944. (See chart 10.) Residential construction in 1950 totalled 12.5 billion dollars, or nearly ten times the 1944 level (in terms of 1950 prices). About 6½ million new passenger cars, or 11 billion dollars worth, were produced in 1950, compared with practically none in 1944. A completely new product, television,

CHART 9

# INDUSTRIAL OUTPUT

Total industrial output rose about 90 percent from 1940 to the wartime peak in 1943, when it was very heavily weighted by munitions production. During 1950, although below the wartime peak, it was 60 percent above the 1940 level, and was rising rapidly.

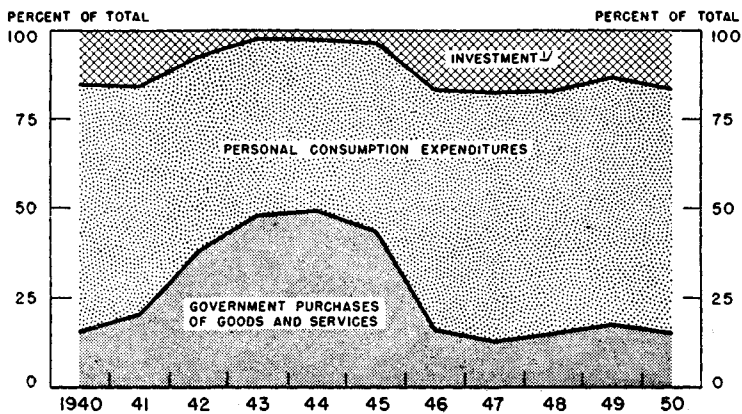
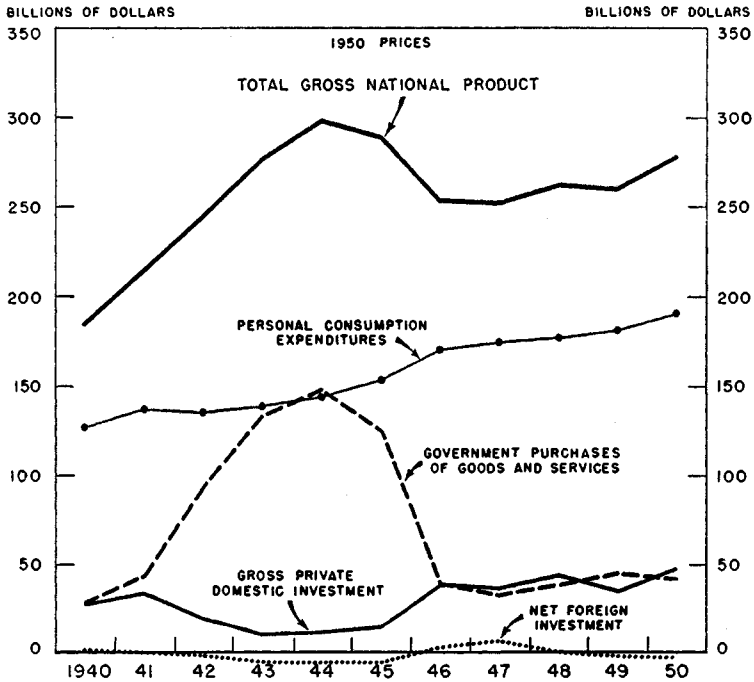


SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

CHART 10

## CHANGING SHARES IN NATIONAL OUTPUT

The record of the past decade shows the growth and changing pattern of the economy under the impact of World War II, the conversion to peacetime, and the postwar resumption of expansion. Real consumption has expanded steadily to new all-time highs, while total output in 1950 was only moderately below the wartime peak.



∩ GROSS PRIVATE DOMESTIC INVESTMENT AND NET FOREIGN INVESTMENT. SEE UPPER PART OF CHART FOR DOLLAR VOLUME OF EACH ITEM.

SOURCE: COUNCIL OF ECONOMIC ADVISERS.

was being produced at a rate in the neighborhood of 2 billion dollars a year. Throughout the civilian economy, new peacetime records were being established.

#### *Labor participation and business investment*

Between 1944 and 1946, the total labor force (including the armed forces) declined from 65.9 to 60.8 million, or by about 5 million. Over this same period, the decline in the armed forces was about 8 million. Thus there was an increase of about 3 million in the civilian labor force, although many women and older people left the labor force, and many veterans resumed their education instead of looking for jobs. After 1946, both the total labor force and the civilian labor force steadily increased. By late in 1950, the total labor force was close to the World War II peak year, 1944. The civilian labor force was higher than in 1944 by well over 8 million, or more than 15 percent; and civilian employment was also higher by more than 6 million, or more than 10 percent.

Throughout most of the postwar period, with the exception of 1949 and the first half of 1950, unemployment was little if any above what might be regarded as a normal peacetime average, between 2 and 2½ million, or 3½ to 4 percent of the labor force. This level of unemployment, however, was substantially above the 1944 average of 670,000 or 1.2 percent of the labor force.

Average weekly working hours, however, have declined substantially. In manufacturing, they fell from their 1944 peak of 45.2 to 40.4 in 1946, or by about 10 percent. After that, they remained between 39 and 41. In other industries, declines of smaller magnitude took place. The eight-hour day and the five-day week became widely established as an acceptable balance between work and leisure under going wage rates and aggregate demand for labor. Thus there was a substantial decline in the intensity of labor effort during the postwar period, measured by degree of participation in the labor force by women and older people, by volume of unemployment in relation to the total labor force, and by length of the work week.

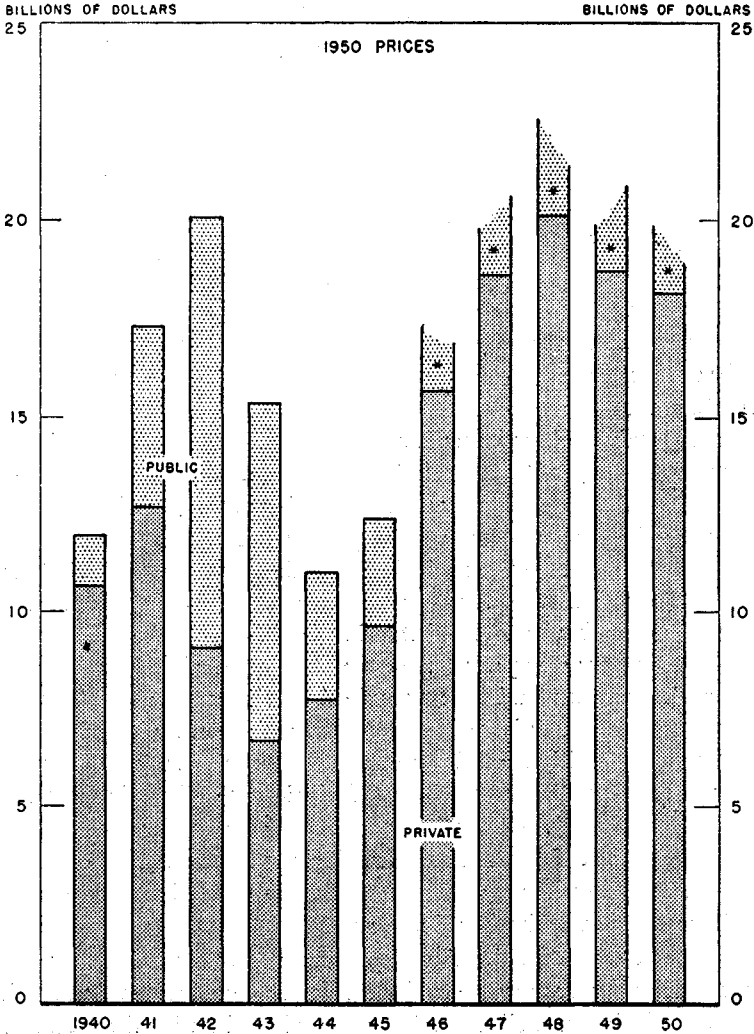
With continuing high employment and intensive investment in modernization and expansion of productive facilities, there has almost certainly been a substantial improvement in productivity. Although statistical measurements in this field are necessarily lacking in precision, it seems likely that output per man-hour for the economy as a whole has increased by at least 10 percent during the past five years.

Business investment has been a major cause of this rise in productivity. Outlays during the postwar years for nonfarm plant and equipment have totalled over 90 billion dollars, or 7 percent of total national output. (See chart 11.) These expenditures rose substantially in every year until 1949, when there was a slight drop, and again increased sharply in the second half of 1950. This very large volume of investment was devoted not only to the

CHART 11

# NONFARM PLANT AND EQUIPMENT OUTLAYS

The total physical volume of private and public facilities investment reached a wartime peak in 1942, which was equalled in 1948 by private investment alone. Government outlays for productive facilities accounted for a large share of the total from 1941 to 1943. Private outlays in 1950 were 90 percent of the wartime peak for total outlays, and 52 percent above 1940.



\* PUBLIC OUTLAYS NOT AVAILABLE AFTER 1945, BUT ARE BELIEVED TO REPRESENT ONLY A VERY SMALL PORTION OF THE TOTAL.

SOURCES: COUNCIL OF ECONOMIC ADVISERS; BASED ON DATA FROM DEPARTMENT OF COMMERCE, SECURITIES AND EXCHANGE COMMISSION, AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

enlargement of plant and equipment, but also to extensive modernization programs. These activities have established a base for further increases in productivity, and have greatly enlarged our capabilities for the tasks ahead.

Steelmaking capacity is about 8 percent greater now than it was at the end of 1944, despite the retirement of much obsolete capacity just after the war. Capacity for refining petroleum has increased about 28 percent in the same interval, and electric utility generating capacity has risen nearly 40 percent. Much more rapid growth has occurred in some important industries such as chemicals and electrical machinery, which are estimated now to have capacities about two-thirds larger than at the end of the war.

Changes in the production of individual basic industries have differed markedly. (See chart 12.) Output of crude petroleum at the end of 1950 was more than 75 percent above the 1944 level; of electric power, more than 50 percent; and of steel, nearly 15. Aluminum production, however, was moderately below the wartime peak, and coal production had fallen nearly 20 percent.

Some estimates indicate that the over-all capacity of private manufacturing industry increased about 27 percent between the end of 1945 and the end of 1950, compared with 31 percent during the period 1939-1945. In absolute terms, the expansion was probably larger in the five postwar years than during the war.

Since the Federal Reserve Board index of manufacturing production is only now approaching the peak registered during the war, it might appear that present capacity could support very much more than the present level of output. But these possibilities should not be overrated in the face of the mobilization task before us. The over-all estimate of expansion of capacity during 1945-50 refers to the pattern of output of the past few years, and is less relevant to the considerably different pattern of output needed in the build-up of economic mobilization. Moreover, a significant part of the reported postwar increase in private industrial capacity for production of civilian-type goods did not represent a net addition to total capacity; it was secured by reconversion of war facilities. Finally, some existing capacity of the less essential types may not be fully utilized in the next few years, as manpower and materials are necessarily diverted elsewhere.

#### *Incomes and demand*

In the years from 1945 to 1950, the volume and pattern of private demand again became the main influence upon the volume and pattern of production. This was true although, by prewar standards, government programs remained large. Civilian consumption and private investment accounted for about 86 percent of total national output in 1950, compared with about 52 percent in 1944.

The deficiencies accumulated during a decade of depression and incomplete recovery followed by five years of war, and the new wants generated by high employment and high incomes, were tremendous. These high

incomes, together with more than 150 billion dollars of wartime liquid savings, gave an additional impetus to an economy released from the needs of war, comparable to the impetus imparted by the great volume of defense appropriations from 1940 onward. As peacetime incomes and consumer spending continued to rise, business adjusted its investment plans to what were gradually recognized as permanently greater markets.

The expanding scope of business investment in productive facilities has already been outlined. The production of housing and durable goods for consumers was even greater. The still larger output of nondurable goods and services showed a slight but steady upward trend, despite the increasing absorption of consumer savings and incomes by housing and durable goods. By 1950, total consumer expenditures, together with residential construction, amounted to about 203 billion dollars, or in the neighborhood of 40 percent above the 1944 level.

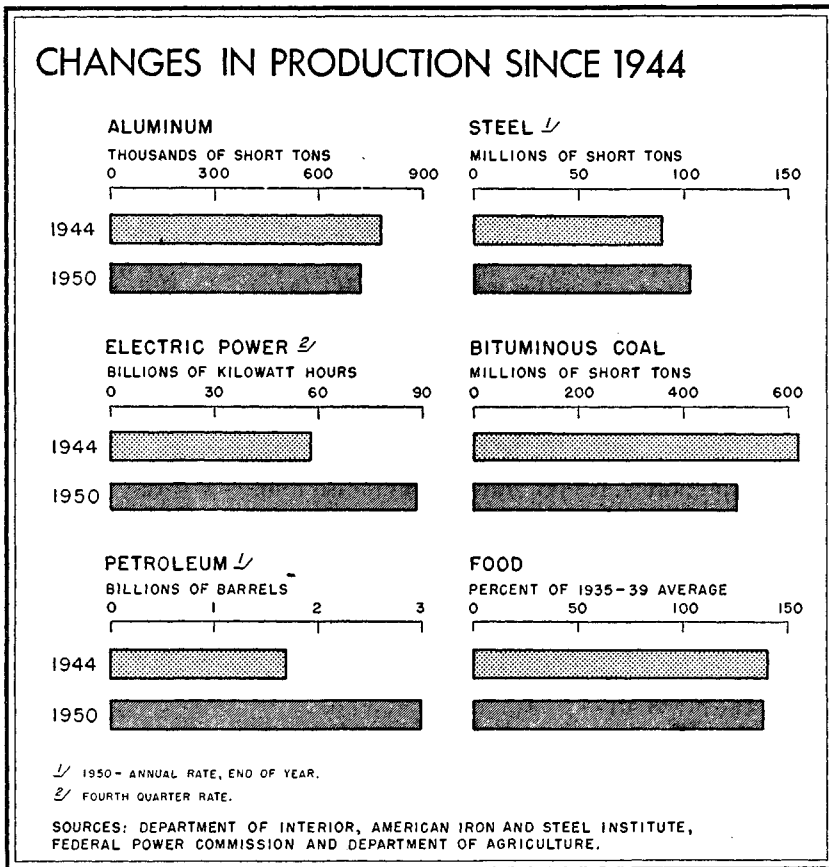
During 1946–50, residential construction and output of durable consumer goods together totalled roughly 160 billion dollars (in 1950 prices), or 12 percent of total national output over the whole period. Some 21 million passenger cars were produced, and the total number of passenger cars on the road rose from about 26 million at the end of 1945 to about 40 million by the end of 1950. Between 4½ and 5 million new housing units were put up, raising the total stock of housing by nearly the same amount.

The high and rising level of total production was necessarily accompanied by high and rising incomes. Both in the aggregate and in composition, the output available to consumers after 1945 was much more nearly in accord with the demand arising from those incomes than it had been during the war. By the first half of 1950, there were reasonable grounds for believing that we could look forward to a period of orderly economic expansion.

True, there had been considerable periods of time between 1945 and 1950 which were characterized by strong inflationary pressures, notably after the hasty abandonment of controls in 1946. This inflationary experience stemmed from many causes. But particularly, it indicated that financing too large a proportion of a war burden through borrowing, and too small a portion through taxation, leads to dangerously excessive purchasing power in the postwar period when the cashing-in of wartime savings adds to the purchasing power generated by current production.

There were times when the consequences of these inflationary pressures seemed to threaten a major and sustained economic reversal. But even when the first manifestations of deflation appeared in 1949, the underlying factors of strength appeared to be predominant. Many stabilizing factors—both private and public—had been developed to make the economy more shock-resistant. The Council accordingly urged business to move ahead confidently with its investment planning, and did not advocate the sharp shift in Government policies which a more pessimistic appraisal of the situation would have called for. The recovery in the first half of 1950, before

CHART 12



the stimulating effect of the developments in Korea, was vigorous and extensive.

*The implications of our current prosperity*

Having reviewed five years of war and five years of peacetime prosperity, the central question arises: What economic strength, actual and potential, do we now have to throw into the scales on the side of human freedom? This question may be approached, first of all, by comparing our economic situation now with our situation in 1940 when we commenced in earnest to serve as the arsenal of democracy.

We now stand at the close of a decade of intensive economic growth, while in 1940 we were just emerging from ten years of depression and partial recovery. Our total national output, in real terms, is more than 50 percent higher than it was ten years ago. Our industrial output is 70 percent higher. Our agricultural production is 25 percent higher. Our labor force is larger by more than 8 million people, and the actual number

at work and consequently absorbing training and skill is nearly 13 million higher. (See chart 13.)

Production in the durable goods industries, from which the bulk of munitions output comes, has increased more than 80 percent. Steel capacity is about 103 million ingot tons, compared with about 84 million at the end of 1940; aluminum capacity is about 2½ times as great; electric power capacity has expanded by 70 percent; and oil refining capacity by 40 percent. Actual production in certain of these industries has expanded even more: steel by more than 50 percent, power by about 130 percent, and petroleum by about 120 percent. (See chart 14.) We have 4 percent more freight cars and nearly 80 percent more trucks in service, and both these types of transport equipment have improved markedly in effective carrying capacity. Stocks of consumer durable goods are substantially greater in proportion to the population. At the same time, however, it must be recognized that with respect to certain natural resources, such as high-grade iron ore, copper, sulphur, mercury, and high-grade saw timber, we are not in so favorable a position as we were ten years ago.

CHART 13

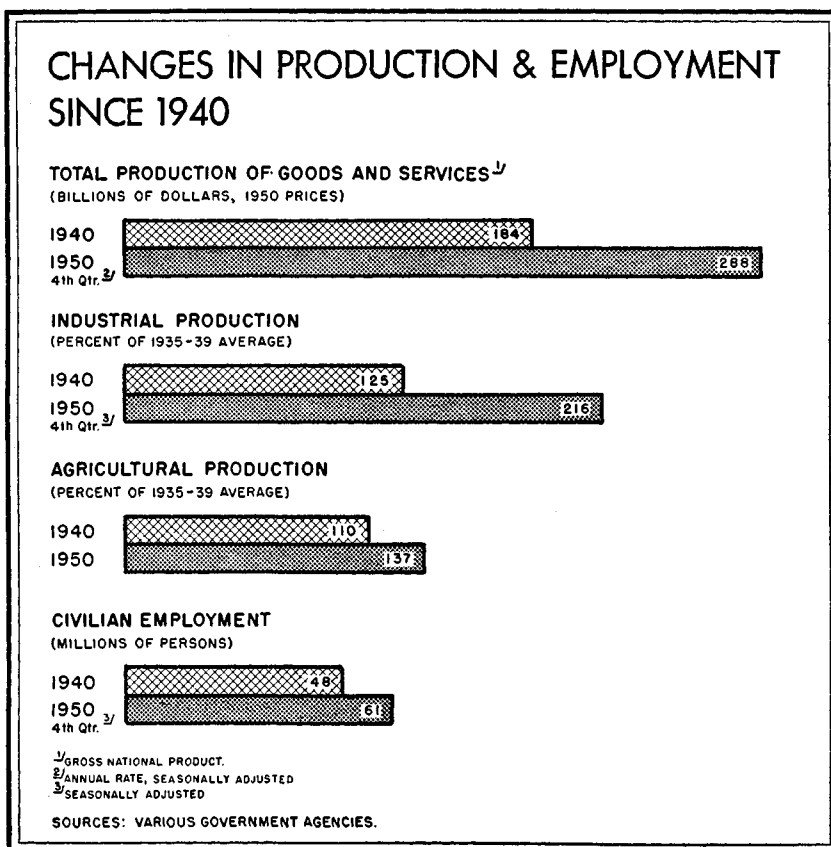
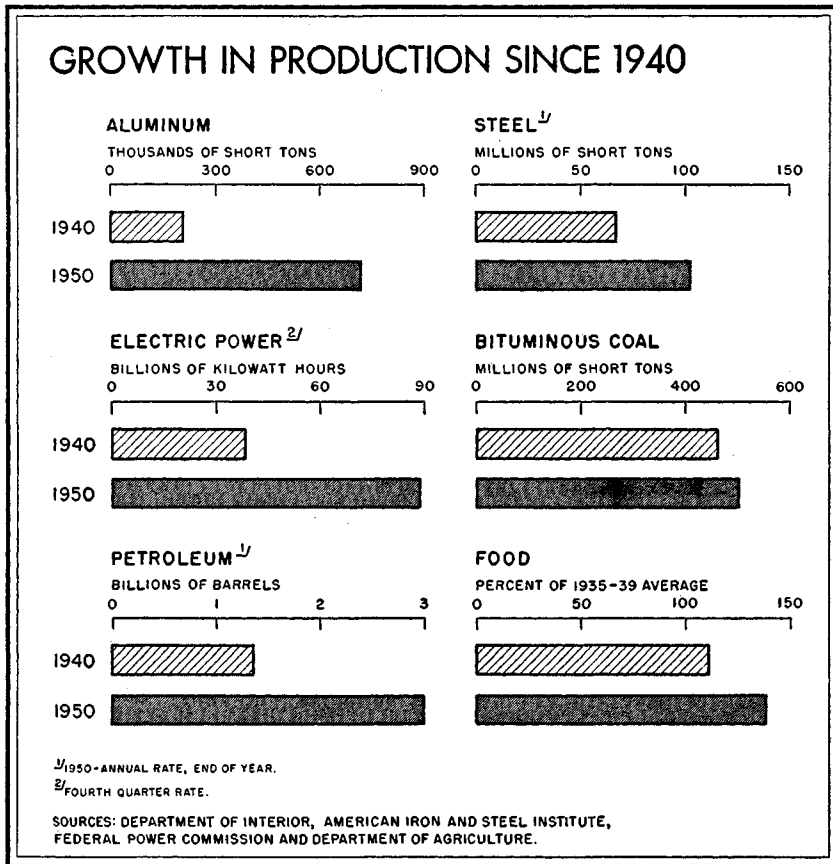


CHART 14



By almost every available measurement, our current productive strength has far surpassed that of a decade ago. Total per capita output of consumption goods in 1950 was roughly 30 percent higher than in 1940; in the case of consumer durables alone, per capita output was probably about three-fourths higher.

We are also far better equipped than ten years ago in our supply of many of the facilities for maintaining our national security or for fighting if we must. We have a substantial reserve of plants and equipment for increased production of military items. The privately-owned United States merchant fleet now totals about 1,200 vessels of about 14 million dead-weight tons, compared with a tonnage of about 10 million at the beginning of 1940. In addition, there are 2,200 Government-owned vessels, most of which are in the national defense reserve fleet. Our military bases and training facilities are far greater than in 1940. These provide a source of greater immediate strength; in addition, they mean that the resources which we had

to devote to the expansion of such facilities during the period after 1940 are now free for other uses.

Not only is our economy enormously stronger than ten years ago, but on top of this we are in an excellent position to expand our strength. It is true that we have fewer unutilized resources of manpower and basic industrial plant than in 1940; but this disadvantage—if it be called that—is at least partially compensated for by the fact that present plans do not call for so gigantic a military build-up as was undertaken successfully during World War II. Thus we have a larger proportion of our resources available, as well as larger absolute amounts, to devote to the further build-up of our economic strength in the years ahead.

Moreover, there is still substantial slack in our economy when measured against the efforts which we should now exert. In addition to the roughly 600,000 to 700,000 persons per year who will be arriving at working age through normal population growth, we can increase the effective strength of the civilian working force substantially by recruiting and training more secondary workers, and by lengthening the work week by several hours without jeopardizing health or morale.

More important than manpower, in which we cannot exceed in number the forces arrayed against us, we have reserves of technology and inventiveness which have been the major sources of our superior industrial strength throughout this century. No one can calculate precisely how much we can add to production through the further practical application of already achieved scientific knowledge and already demonstrated ingenuity. But no one can doubt that our resources in this direction are enormous, if we use them to the full in the factory and on the farm.

We expanded total output by about 60 percent during the war years between 1940 and 1944. Expansion by about 25 percent over the next five years—which would represent a less intensive effort, although starting from a period of less slack—would give us the supplies for both an enormous defense effort and a strong supporting economy, if these supplies were distributed efficiently according to priority of need. We could do far better than this, with an intensified effort on all fronts.

So much for our assets. Yet it cannot be denied that the conversion to defense problems is in some respects more complicated than in 1940. This is because we are now so much closer to the full utilization of our currently available productive capacity than we were ten years ago. For example, it was easier in some respects after 1940 to bring unemployed people into defense work, than it will be in the months ahead to shift them from peacetime employment to defense work (although even here the skilled and currently employed worker will almost certainly prove more productive than one who had been idle for a long time). The slack in the economy, for a substantial period of time after 1940, meant that the step-up of over-all production resulted in a widespread improvement in living standards, especially among those who had been partially or completely idle. On the contrary

now, because of the fullness of the living standards which we have recently been enjoying, the vast increase in the defense "take" will certainly mean for a considerable period of time the abandonment of yearly gains to which the population had rightfully been accustomed in an expanding peacetime economy. Further, there will be need for sacrifice of some benefits now enjoyed, as well as of others that had been held in prospect. In short, we must now make a sharp and drastic switch from some types of highly rewarding activity to other types of activity. This is more difficult in some ways, and calls for more drastic policies of some types, than the drawing of idle resources of plant and manpower into defense production.

But despite all this, one salient fact remains of transcendent importance: Our total resources and productive power are far more adequate to serve whatever task may confront us than they were in 1940. The expanding defense program, now getting under way, will require sacrifices of goods and services by the people, measured against what they have recently been enjoying. But a defense program of this size, or considerably greater size, would still leave the people with a higher general standard of living than they had before World War II or during the course of that war. If, under these circumstances, the fact that we have less slack in the economy than in 1940 is used to support the argument that we consequently can less afford to meet whatever burdens our national security may require, that would be tantamount to saying that the great prosperity and economic strength which we have achieved is a handicap rather than an asset.

A few years ago, it was said correctly that the Soviet Union would gain immensely if there should be a depression in the United States. Such an event would have weakened us immeasurably. It would be a grim irony indeed if our prosperity had made us weaker for the tasks ahead than if we were in a recession or mild depression. It is true that we must now show the courage and vigor to convert employed strength to new purposes instead of drawing upon unemployed strength. But our prosperity could be a liability rather than an asset only if we had become soft and fat in becoming prosperous. That has happened to other civilizations before; but we cannot afford to let it happen to the United States. We must beat many of our plowshares into swords; but let us start with the confident realization that we have more real power than ever before to do so.

## Part III. The Magnitude of the Task Ahead

### THE GENERAL NATURE OF THE TASK

**I**N 1940, the array of our enemies included the two greatest industrial nations in Europe and the Far East. In winning the war against them, some people say that we may have overestimated their economic potential and consequently their military strength. But even if this be true, it is of small significance compared with the gains we derived, in setting our production targets, from not *underestimating* our opponents.

It is true that, at the present time, the aggressor nations do not even approximate the actual and potential industrial strength of the United States alone—and far less, of the United States and the free nations associated with us. Steel capacity is often cited as a vivid illustration. The current capacity of the Soviet Union and its satellites is estimated to be about 25 to 30 million tons. That of the United States is about 103 million; and that of Western Europe about 60 million. Undoubtedly, measured by many other indexes as well, and by skilled manpower and technical know-how, our margin of current superiority is large.

But the economic strength of the Soviet Union is both great and increasing. It is concentrated upon building up those sectors of the economy which support military effort. Toward this end, the Soviet Union is willing and able to compress and degrade the people's living standards, below levels conceivable in this country. Technical ability has been revealed to do new and difficult things. And because the Soviet Union demobilized to a far lesser extent than did the Western Nations at the close of World War II, its present striking power is formidable.

Confronted by this threat, the general nature of our economic task in support of our primary defense build-up is three-fold. In the first place, and of first priority, our economy must provide the manpower and materials to achieve a large and very rapid increase in the immediate military capabilities of ourselves, and to aid in building up the strength of our allies. Second, we must achieve as rapidly as feasible an expansion of our industrial mobilization base, sufficiently large to enable us to swing rapidly into full-scale war production if necessity should require. And third, really as a corollary of the other two propositions, we must service our industries and our civilian population with enough goods and services, not to maintain them in peacetime grooves, but at least to maintain them strong enough

to support quickly or in the indeterminate future any intensification of the military effort which circumstances may demand.

These three objectives cannot all be fully served. Consequently, the allocation of great but nonetheless limited resources among these three purposes is the task of economic and military mobilization—whether partial or complete. This task is in some respects more difficult than in a total war, because the outbreak of hostilities of that kind removes some of the imponderables from the scene. In the current situation, these imponderables still remain. We do not know whether the ultimate test will come, or when it will come, if it comes. Yet in apportioning our total resources among these three purposes, there must be some guiding strategy as to which among various contingencies should be given most weight. This is true because the apportionment of our resources which would be best on one hypothesis, would not be best on another. While we must retain enough flexibility to adjust our strategy rapidly if conditions change, there is no such thing as getting fully ready for a variety of conflicting hypotheses.

The initial hypothesis must result from an appraisal of the international situation, which in turn governs the speed and scope of the primary military build-up. That must be determined by those directly responsible for international and military policy, subject of course to the President and the Congress.

While that basic military determination in the very nature of things can never be complete or final, its status at any particular time provides the frame of reference within which economic policies must be formulated. In this framework, the effects of the military effort must be analyzed and programs formulated for the best use of resources to mesh our economic strength with imperative military needs.

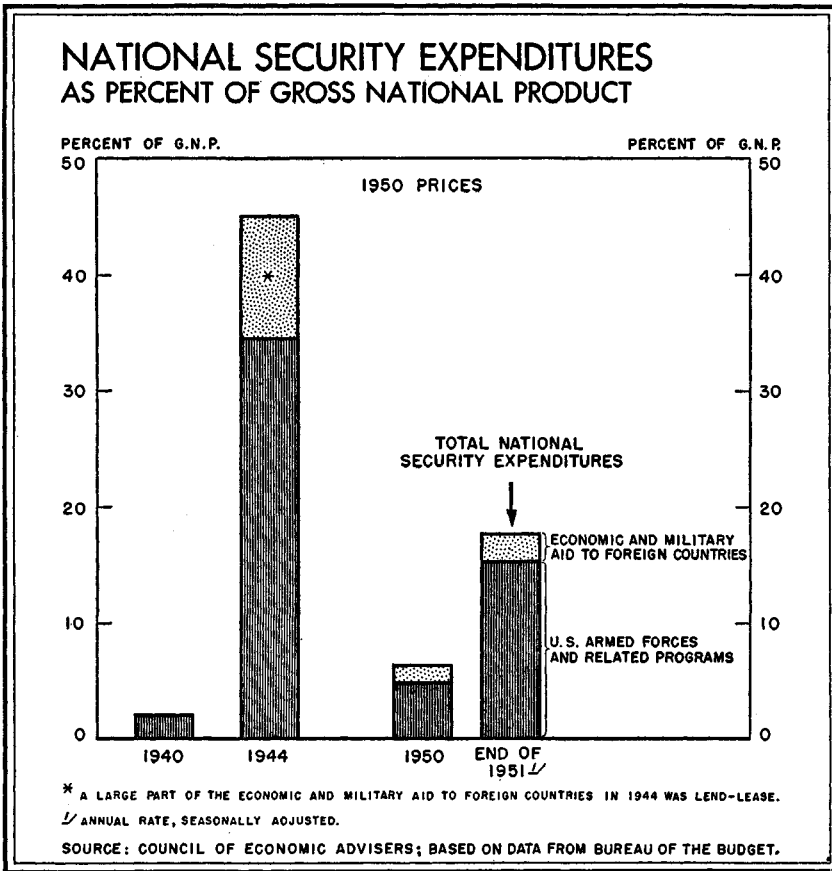
The size and scope of the primary military build-up, which provides the central frame of reference for economic analysis and programs, has now been determined, at least for the time being. This permits the Council to turn to an examination of the economic aspects of the new job before the nation.

#### THE SIZE OF THE NATIONAL SECURITY BUILD-UP

New obligational authority already granted or anticipated for national security programs at the time of the President's Budget Message this January will probably total much closer to 150 than to 100 billion dollars for the fiscal years 1951 and 1952 combined. The amounts for each of the two fiscal years will probably be roughly equal. These funds are intended to achieve as rapidly as possible a virtual doubling of our strength on the ground and in the air, and an increase of more than one-half in our naval strength. The funds are intended also to provide military and economic aid to friendly nations abroad; to enlarge the atomic energy programs; to expand our industrial mobilization base; and for stockpiling and other purposes.

The very large volume of obligational authority already granted or in

CHART 15



prospect has already had a major impact upon the economy—far more than would be indicated by the moderate increase in expenditures which has so far occurred. Expenditures, however, are the most useful indication of the size and speed of the continuing procurement effort, and of the proportion of total output going to defense.

Federal expenditures on all these national security programs totalled about 18 billion dollars in the fiscal year 1950, the last full year before the Korean outbreak. At the present time, they are running at an annual rate of somewhat more than 20 billion dollars, and by the end of the calendar year 1951 they should attain an annual rate between 45 and 55 billion dollars, or from 25 to 35 billion above the rate a year earlier. The procurement effort, twelve months from now, should enable this volume of expenditures to be expanded very rapidly if necessary. In addition to these direct Federal expenditures, there will be major investment programs by private industry to build or convert the facilities necessary for defense production.

These dollar figures represent present plans. Depending on events, it

may become necessary to increase them substantially. Attainment of present plans would mean that, between the end of calendar 1950 and the end of calendar 1951, the proportion of total national output devoted to expenditures on national security programs would increase from less than 7 percent to possibly as much as 18 percent. This compares with an increase from about 4 percent in the last quarter of 1940 to 16 percent by the last quarter of 1941, and to about 38 percent by the fourth quarter of 1942. In terms of relation to total output or absolute increases in defense expenditures, the acceleration of effort now under way is substantially below that achieved in the first year after Pearl Harbor. (See chart 15.)

This effort will nonetheless impose a substantial strain on manpower, materials and facilities. In terms of manpower, the present target is to increase the total strength of the armed forces by nearly 1 million men within a few months. Procurement objectives have so far been scheduled in detail sufficient only to permit the roughest appraisal of the total number of administrative and industrial workers that may be required. But this total is unlikely to be less than 4 million persons by the end of this year, and may well be considerably more. Thus the minimum manpower now estimated to be required by the additions to our national security programs totals about 5 million, or nearly 8 percent of the average 1950 labor force; and this total may be very much increased. A considerable proportion of this additional personnel must, of course, be drawn from other industries.

Because military procurement schedules have not yet been developed in full detail, and because of the need to relate purchases of basic materials for the strategic stockpile not only to our own military procurement and essential civilian need, but also to those of friendly nations abroad, assessment of the probable drain on basic materials over the coming twelve months is very difficult at the present time. In the case of steel, for which there is no stockpile objective and where supplies are far less tight internationally than they are for a number of other basic materials, the direct requirements of national security programs as presently known are unlikely to exceed 10 percent of total supply by the end of this year. Indirect needs for the expansion of essential industrial and transportation facilities, however, will increase this percentage substantially. In the case of materials like copper, aluminum, rubber and wool, however, national security requirements are likely to be substantially greater, ranging up to one-fourth, one-third, or more of total supplies.

The direct requirements of our national security programs do not, of course, include the total additional burdens that will be thrown on the economy by our present needs. There must be an expansion of productive facilities not only for the production of munitions, but also for the production of basic industrial materials and services. The creation of an industrial mobilization base which would on the one hand be adequate for a very rapid expansion to all-out military production if that should become necessary, and on the other hand support a long-continuing effort of the present size

without impairing our strength, is a task which is as challenging as the direct defense effort itself. The size and character of this task is discussed in the following section.

### EXPANDING PRODUCTION TO MEET THE STRAIN

In earlier Reviews, the Council has stressed that even in peacetime the effective operation of the American economy is based on continued growth; and that when growth does not occur, it is because of undesirable influences which threaten stability as well. These influences require corrective action in ordinary peacetime, and the principle of growth is even more applicable in times like these when we urgently need every bit of our strength.

The basic sources of our capacity to grow are two: manpower and productive facilities. In neither case is sheer quantity the only consideration. Training, quality, and the skill with which manpower and facilities are organized to achieve our objectives, are also vitally important in the job ahead.

#### *Increased labor participation*

The size of the present targets for national security programs is not sufficiently great to call for an all-out labor effort of the peak World War II magnitude, nor to give absolute guides as to the extent to which we should seek to draw into the labor force additional people beyond those who would enter on the basis of normal population growth. Nor is the extent to which we should rely on lengthened working hours, as an alternative to expansion of numbers, determined in the present situation. If, however, our national security programs are to be fulfilled, and if, in addition, we are to increase our productive strength and maintain civilian consumption at reasonable levels, it is clear that a labor input substantially above the level of the past few years will be required.

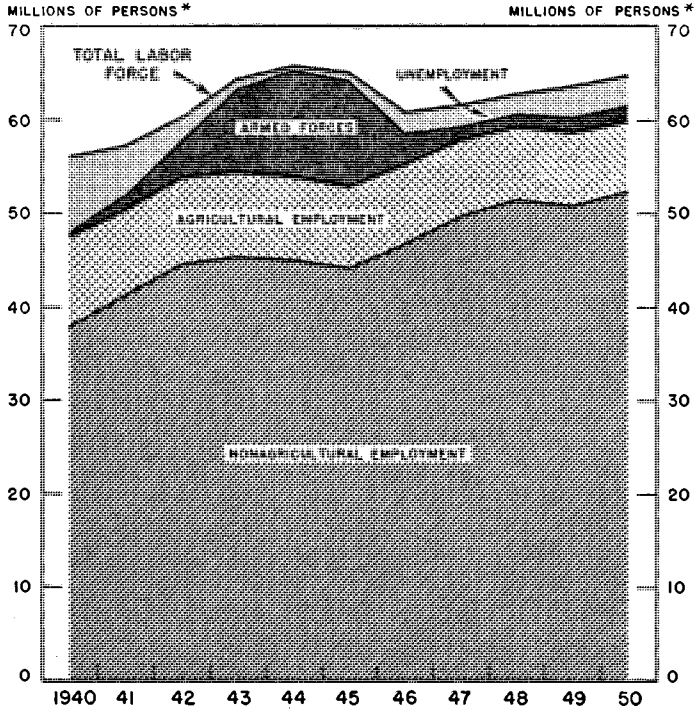
In the present situation, it appears generally desirable to place greater emphasis on increased numbers rather than on lengthened working hours. This would mean a larger trained working force should full mobilization be forced upon us, and would forestall the fatigue and lowered productivity that come from working many extra hours over prolonged periods. But at least in the case of highly skilled labor in important industries, it is clear that longer hours will be required in order to produce essential goods. The balance which will in fact be struck among these two sources of increased labor effort, and the degree to which the total labor effort will in fact be increased over the coming year, cannot be forecast, nor influenced by government policy with precision.

It is useful, however, to examine alternatives as a basis for appraising our productive capabilities. An average increase, for example, of 2 hours in weekly working hours throughout the economy, which would be feasible, could lay the basis for an increase in total output in the neighborhood of 5 percent, apart from any changes in productivity. Likewise, an

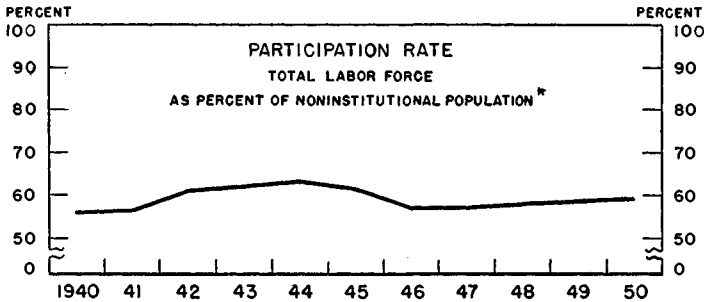
CHART 16

## LABOR FORCE UTILIZATION

The total labor force in 1950 was within 2 percent of the peak year in World War II, when over 11 million men were in the armed forces. Total civilian employment, however, was 10 percent above the wartime peak year.



A larger percentage of the population is in the labor force today than in 1940; however, it is considerably lower than the prevailing rate during World War II.



\*14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF COMMERCE.

increase of 2 million persons in civilian employment would permit an expansion of output by roughly 3 percent. A substantial fraction of such an increase could come from a reduction in unemployment, and from the normal annual growth of 600,000 to 700,000 in the labor force. Changes such as these in the intensity of labor participation in production would still be substantially below the wartime peaks. Average weekly working hours in 1944 were 45.1. The average labor force participation rate then was 63 percent, compared with 58.5 percent in 1950, and with the roughly 60 percent for the end of 1951 implied above.

The lengthening of working hours and rapid expansion of civilian employment, together with conversion difficulties, would tend to have an unfavorable impact on productivity. Such evidence as is available, however, suggests that there would probably still be some rise in over-all productivity, although perhaps at a somewhat lower rate than in past peacetime periods. (See chart 16.)

#### *Expansion of productive facilities*

As a result of the programs to expand capacity during World War II and during the postwar period, and because our present defense production targets are smaller than those of World War II, we find ourselves in 1951 facing a quite different set of needs for facilities expansion than was the case in 1940. While the creation of an adequate industrial mobilization base will call for a considerable amount of new and enlarged capacity to produce munitions, that type of investment will probably be substantially smaller than in the years 1940-43, when we had to build up our munitions capacity from scratch. Short of total war, investment of other types should remain on a much higher level than during World War II. This is necessary if we are to carry a very heavy burden of primary defense for an indefinitely long period, and at the same time maintain our productive capital for necessary growth of output.

The high desirability of expanding general industrial strength for the long pull, however, should not prevent us from putting first things first. For some time to come, we cannot afford unrestrained and indiscriminate use of resources for investment any more than for consumption. Over the coming year, the prospective shortages of materials, skilled manpower, and specialized facilities call for a selective pattern of investment, giving major emphasis, in addition to munitions facilities, to the expansion of capacity for the production of those basic industrial materials and services which are of crucial importance both to a wartime economy and to an expanding peacetime economy. Where expansion programs require several years to complete, it is even more important to start at once.

The steel and electric power industries present two outstanding examples of the problem under discussion.

*Iron and steel.* The determination of objectives for the expansion of iron and steel production illustrates the extent to which economic issues

turn on the general strategy of the national defense program. For example, if total war in 1951 were regarded as inevitable, it would probably be an inefficient use of resources to start further substantial increases in steel capacity now. It would be better, under that assumption, to use the available steel for making weapons instead of for building more capacity; and to rely on enormous cutbacks in civilian use of steel to release enough steel for war purposes.

But our primary defense strategy does not now rest on the inevitability of a total war in 1951 or in any other year. On the contrary, that strategy rests on a sufficiently rapid build-up of military strength—substantially short of total mobilization—to deter aggression, while at the same time creating an industrial mobilization base which would facilitate rapid achievement of maximum military effort if that should become necessary. This strategy, which contemplates a substantially increased military burden of indefinite duration, must also allow for the servicing of industrial and consumer needs at a considerably higher level than would be permissible in an all-out war emergency.

The principal drain on resources involved in an expansion of steel-making capacity is the use of steel itself. If the quick adjustability of our economy to full-scale mobilization in case of need would of necessity be impaired by plowing some steel back into expansion of steelmaking facilities, such expansion would be at best risky. But if the necessary steel can be borrowed from uses not essential to mobilization, there is a strong case for the expansion of capacity. If we do become involved in a major conflict, it seems certain that a larger steel capacity would stand us in greater stead than the equivalent amount of steel in the form of additional automobiles or commercial buildings.

The prospective steel requirements for munitions production and essential industrial uses are not so large as to call for elimination of so many of the major ordinary peacetime uses as was the case during World War II. While we shall have to reduce drastically the production of automobiles and other consumer durable goods over the next several years, and similarly curtail less essential types of public and private investment in construction and equipment, we still shall be able to devote sizable quantities of steel to such uses. The cost of a steel expansion program is a slightly greater reduction of such types of output over the next few years. On the other hand, the consequences of not expanding capacity adequately would be the indefinite prolongation of a serious steel shortage requiring elaborate and irksome controls.

The rate at which we ought to expand steel capacity cannot be precisely determined. In part it must depend on the maximum rate at which iron ore supply can be assured—a problem discussed below. It depends also on the balance between major types of steel consumption—notably public and private investment, and consumer durables production—and other

activities which we should like to achieve. The cost in terms of resources of the expansion of capacity must also be considered. We should not propose as an objective the meeting of all demands for steel four or five years hence on an unrestricted basis, even if we could determine just how much steel that would take. It would be an extravagant use of resources to build up a capacity capable of eliminating in short order the backlogs of steel demand which will have been incurred in the next few years, in addition to meeting the long-run normal demand. In the type of long-run economic situation we must contemplate, all resources will be scarce; for the present we should attempt only to bring steel production up to the point where it will not be a principal deterrent to economic expansion, nor require the indefinite continuation of comprehensive controls.

Our analysis indicates that we should aim to bring steel capacity up to about 120 million ingot tons within 3 or 4 years, or sooner if feasible. This takes account of such considerations as the increase in aggregate production we should be able to achieve; the amount of output that would be available for other uses; the probable use of steel in defense production; and the rate at which it would be feasible and desirable, given the probable volume of future demand, to increase stocks of goods and equipment in the hands of consumers, business, and government. Some types of requirements, notably steel for automobile production, are projected at rates somewhat below 1950; while other types, like industrial machinery, exceed the 1950 level.

The cost of the additional blast furnaces, steel furnaces, and finishing facilities would total about 2 to 2½ billion dollars, in terms of present prices. This amounts to about 12 percent of total business plant and equipment expenditures in 1950. The finished steel requirements for the expansion would total 3 to 4 million tons, or ⅓ to ¼ as much steel as was used in automobile production in 1950, or two to three weeks' output of the steel industry at the present rate of production. The copper requirements would represent about 5 percent of current annual supply, and aluminum requirements 2 to 3 percent. An expansion of steel capacity from the present 103 million tons to 120 million, therefore, does not appear to involve any drain on our resources which we could not fairly easily offset by moderate further curtailment in some less essential uses over the next few years. The steel industry has already made application for accelerated amortization on approximately this amount of expansion.

A much more difficult and pressing problem than expanding steel capacity itself is that of maintaining and expanding the supply of iron ore without which steelmaking facilities are useless.

There is, first, the immediate need for more ore-carrying boats on the Great Lakes. Stocks of ore at lower Lake points are so dangerously low that some blast-furnace shutdowns may occur this winter and next. Several of the necessary boats are already under construction, and additional ones should be started as rapidly as the ways are vacated. In view of

prospective shifts in ore sources, these vessels should be convertible for use on the salt water of the lower St. Lawrence River.

Recent estimates indicate that we shall also be hard pressed, for several years at least, to mine and import enough iron ore to keep our expanding steel industry operating near capacity. In 1950, our ore consumption was about 109 million long tons. A steelmaking capacity of about 120 million tons would call for about 130 million long tons of ore a year to keep it busy. Output of the Lake Superior mines can be maintained at present levels for only a few years longer. Thereafter, supplies from that source will fall off fairly rapidly, and we shall have to rely more and more on imports (principally from Venezuela and Labrador, and to a much lesser degree from Chile, Brazil, and Liberia) and on refined low-grade ores such as taconite. The St. Lawrence seaway project must be begun immediately if imported iron ore is to be economically available in quantity in our inland steel centers by 1956, when the flow of Mesabi ore will almost certainly have begun to dwindle.

*Electric power.* The case for accelerated expansion of electric power capacity is even more compelling than in the case of steel and iron ore. Present supply falls even more seriously below the demands that would arise in a full-scale war, and any major curtailment of less essential civilian uses is more difficult than in the case of steel.

The over-all national power generation capacity, under average hydro-electric conditions, was about 67.5 million kilowatts at the end of 1950, representing an increase of almost 10 percent during the year. The reserve margin came up to about 12 percent of load in 1950, having been restored during the past few years from a dangerously low level. According to recent estimates of planned public and private expansion, about 7½ million kilowatts of new capacity will be added during each of the next three years, representing a somewhat faster rate of expansion than has prevailed since the end of World War II. The annual rate of investment outlays involved will approach 3 billion dollars, covering generating equipment and also new and enlarged transmission and distribution facilities.

At the present time, electric power is in short supply in the Pacific Northwest, in the Tennessee Valley area, and some other regions. The supply is expected to become increasingly tight throughout the country as demands will increase faster than the expansion of capacity now planned. Reserves will fall more and more below safe and desirable margins. Already the reserve margin has practically disappeared in the areas where the power shortage is most acute. Expansion of programs in atomic energy, chemicals, aluminum and other metals related to the defense effort will impose an additional load of 4 to 4½ million kilowatts on our power facilities.

In the face of this situation, government policies must be adjusted to the need to make capital, materials and workers available to the utility enterprises to which we must look for the major expansion of electric power capacity. Public hydro-electric projects take more time, but devel-

opment of additional public power capacity in the Pacific Northwest, in the Tennessee Valley area, at Niagara Falls, along the international section of the St. Lawrence River as a part of the seaway and power project, and elsewhere, can provide more than 6 million additional kilowatts of capacity within 5 or 6 years.

*Relationship between military and industrial planning.* The foregoing effort to specify investment and expansion needs is sketchy. More precision will emerge through the more comprehensive study and planning now under way as to the general size and major classifications of investment and capacity expansion. This will result in programs compatible with maximizing our total strength by achieving the wisest allocation of our resources between military and civilian use, and among various segments of the civilian economy. This more comprehensive industrial planning is linked with the current effort to develop primary military requirements in more detail. For only to the extent that these primary requirements emerge, can the rest of the economy be most effectively enlisted in their support.

#### *Obstacles to expansion*

The preceding discussions of labor effort and investment in productive facilities have necessarily taken little account of the bottlenecks in individual materials, in key facilities and in skilled manpower that will certainly occur over the coming twelve months. These and other difficulties of a conversion period will tend to slow down the rapidity of expansion. Such bottlenecks could become serious in the case of individual items and in individual localities. There is no way, however, in which to measure in broad terms their impact on production. Nor does the experience of World War II, or the present size of military plans, offer any basis for believing that individual bottlenecks will become of such general importance as to impede the broad expansion of output.

#### *Production goals for the end of 1951*

Under the Employment Act of 1946, the Council is called upon to define "needed levels of production" for the economy as a whole, as a primary guide to economic policy. This we have done each year. In the face of current circumstances and problems, we feel that maximum production for 1951 should bring an annual rate of output of about 310 billion dollars, at 1950 prices, by the end of the year. While this rate of growth is much higher than the average rate of growth sustainable in more normal times, it is not above the reach of our resources as we now should use them.

The total increase would be about 20 billion dollars, or about 7 percent, above the annual rate at the end of 1950. Roughly 15 billion dollars of this total gain could be expected to come from increases in employment and working hours, and the remainder from increases in productivity. The degree to which over-all productivity is likely to increase during a period of conversion, with major shifts in type of output and with many new

workers being brought into the labor force, is necessarily uncertain. The amount here assumed is somewhat lower than appears to have occurred in past peacetime periods.

#### IMPACT ON CIVILIAN SUPPLIES

Even with the large increase in total output which has been estimated as attainable, the expanding defense program will have a major impact upon consumption and living standards. If the total output and national security programs discussed in the preceding section are realized, some reduction in total per capita consumption may take place, and very sharp cuts in the production of individual items of consumption will be required, at a time when total employment and working hours had increased substantially.

Defense needs for basic materials and skilled manpower can be expected to force particularly sharp cutbacks in some areas. Production of passenger cars and other metal-using durable goods may well have to be cut by percentages ranging from one-third to well over one-half below the record levels of the second half of 1950.

It will be impossible, from the viewpoint both of total resources and particular supplies, to avoid sharp cutbacks in many types of private investment in order to service the defense program. Already, steps have been taken to cut back investment sharply in certain less essential areas. During this year, housing will have to be cut back substantially and less essential types of construction by much more. These cutbacks, and others which must follow, should lead to a considerably lower level of total investment in 1951 than in 1950. In short, both consumption and general investment must be restrained to service the primary defense program more rapidly than total output can be expanded. The pattern of investment in 1951 must be very selective, so that cutbacks in less essential areas can be combined with the maintenance and in some cases expansion of investment required for the achievement of an adequate mobilization base. If private judgment and Government policies are used with sufficient skill to effectuate this balanced realignment of investment, even a larger defense effort in future years would be more bearable. Thus the problem of mobilizing our economic strength for the long pull rests very heavily upon the programming and execution of realistic investment goals geared to priority of needs. Allocations, tax programs, and various incentives should be shaped to the nature of this problem.

#### INFLATIONARY PRESSURES

The expansion of our total national output, with selective emphasis upon vital lines of production, will help to ease the immediate burden of our enlarged defense objectives. In the longer run, production, and more production, is the most fundamental economic remedy.

But production alone will not be enough to solve immediate problems. In the course of this year, as already indicated, national security programs will increase their take of the total output of the economy from about 7 percent to possibly as much as 18 percent. The increase will be much greater in the case of particular types of materials, skilled manpower, and facilities. Since it is manifestly impossible to increase production at this rate, and according to this pattern, there must be a large-scale diversion of resources from less essential uses to those having the highest priority. The total volume of goods available for private consumption and investment must be cut. This gives rise to major problems of materials control, and to intense inflationary pressures.

While the supply of goods that buyers want will be cut back, consumer and business incomes will be sharply rising. During the course of 1951, there will be a general expansion of income resulting from the increase in production required to meet our defense objectives. Longer working hours and more employment will result in an equivalent expansion in wage and salary income, even without allowing for overtime pay, upgrading, and wage and salary increases. Gross farm income will also rise as production increases, apart from any allowance for upward price movements, as will corporate profits. While, even under the current tax structure, increased taxes will absorb some of the increase in incomes generated, disposable personal incomes would, without prompt and substantial new tax action, increase much more than the supply of consumable goods.

Further increasing the dangers arising from the pressure of expanding incomes against limited civilian supplies is the fact that consumers already have more than 150 billion dollars in liquid assets, which can in large measure at their discretion be thrown into the markets for goods; and corporations have almost as high a volume of liquid assets as at the end of the war. Actual and anticipated shortages of particular materials and goods, and concern about continuing price rises, will, unless counteracted, greatly reinforce the desire to spend money and to acquire tangible goods.

These facts would represent a very seriously inflationary prospect for the coming year even if the past six months had been a period of reasonable economic stability. Yet the economy is now, and has been for some time, in the throes of a serious inflation. Between June and December of 1950, this general inflation raised wholesale prices 11 percent and consumer prices by about 4½ percent. Average hourly earnings rose about 4 percent between June and November, and corporate profits before taxes were about 28 percent higher in the fourth quarter than in the second. The rise in consumer prices occurred despite a generally adequate supply of consumer goods. Price rises, in considerable measure speculative, spread out from the primary commodity markets through the cost structure generally, communicating upward price tendencies to a wide variety of products. Wage increases were granted in many industries in amounts substantially above the rise in the consumer price index. Neither the increase in primary commodity

prices nor the wage increases of 1950 have fully worked themselves out through the price structure of intermediate and final commodities; and many classes of workers have been left behind in the wage advances of the past six months.

If price and wage increases such as have characterized the last six months were permitted to continue, consumers would be induced to draw heavily on their holdings of liquid assets—either to protect their standard of living and the real value of their savings, or for speculative reasons. The ability and incentives of business concerns to enter such a movement to convert liquid assets into goods would be even greater.

This leads to the conclusion, which will be amplified in the policy section of this Review, that anti-inflation weapons must be employed more widely and more rapidly than in the period from 1940 to 1942. The measures now being planned and put into effect by the Economic Stabilization Agency are a reflection of the urgency of the task.

The main reason for the seriousness of the inflationary problem, however, is not that we are now weaker but rather that we are now stronger than we were then. Being more fully prosperous now, we have less room to undertake new burdens without generating inflationary pressures. If we were unwilling to convert the strength underlying this greater prosperity to meet the new challenge now confronting us, that strength would become a liability rather than an asset. But if we are willing to channel that strength—of tools and manpower and skills—we shall find ourselves now better able than ever before, and far more able than in 1940, to measure up to the responsibilities imposed upon us by world events.

#### HOW MUCH DEFENSE CAN OUR ECONOMY SUPPORT?

While a defense effort of the size now under way will sharply alter the character of the functioning economy, there can be no question that this effort to achieve national security is well within the power of our resources and our skills. It is a far smaller effort than we have made in the past with far fewer resources and skills; and it is a far smaller effort than we could safely and effectively make in the future if our national safety should so require. It is an effort of a magnitude which will involve sacrifices and restraints and changes in customary ways on the part of all of the people. These changes may be great, when measured against the habits of peacetime. But they are mild indeed when measured against the issues at stake, or against what the American people have done in their earlier history at times when the national interest has taken clear and universal precedence over personal pursuits.

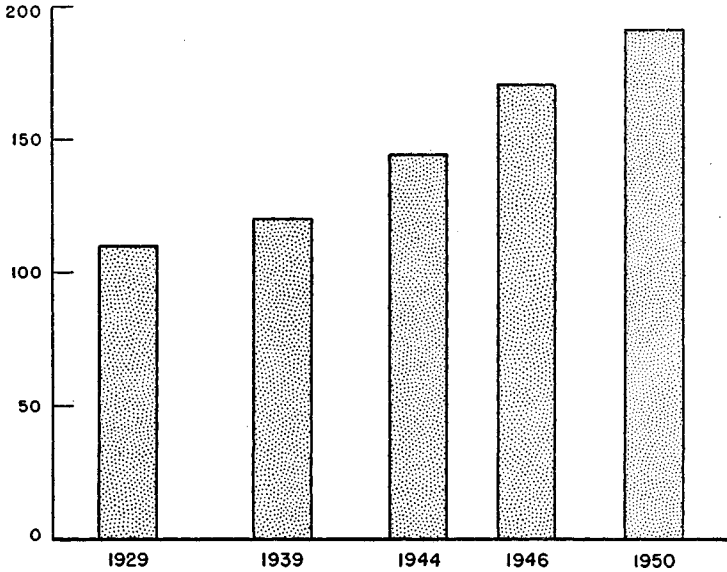
Deep as some of the needed cuts may appear, they could hardly be described as austerity. Per capita consumption at the end of 1951 would be far greater, perhaps by more than one-fourth, than in 1940, and even further above 1929. (See chart 17.) By the standards of any other country

CHART 17

# PERSONAL CONSUMPTION EXPENDITURES 1950 PRICES

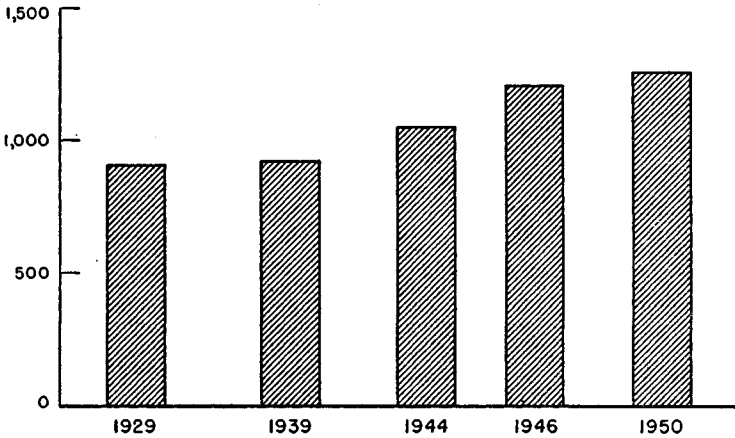
## TOTAL CONSUMPTION EXPENDITURES

BILLIONS OF DOLLARS



## PER CAPITA CONSUMPTION EXPENDITURES

DOLLARS



SOURCE: COUNCIL OF ECONOMIC ADVISERS.

in the world, such consumption levels could only be described as luxurious. Moreover, consumers are currently better stocked with household equipment and automobiles than ever before. At the present time, there is one automobile for every 3.8 persons in the United States, compared with a ratio of one to 4.8 in 1940. Our housing standards, though far from being fully satisfactory, are substantially better than at the beginning of World War II.

Although over-all consumption levels will be high, many individuals and families will suffer much sharper cuts in their standards of living than would be indicated by the aggregate figures; and the general range of consumption goods will be much more restricted than in recent years, and less in accord with consumer wants. This is the necessary meaning of higher taxes and restrictions on the use of basic materials.

The defense program will impose many restraints upon economic activity as well as upon personal consumption. But the restraints upon consumption will require sacrifice, not real hardship, and the restraints upon business activity will have no results justifying the complaint that the program is beyond the capacity of our economy.

The expanding defense effort which has thus far been defined may, of course, have to be greatly expanded in future, or level off. Later on, this Review will make some reference to the economic consequences of a larger defense effort. At this point, suffice it to say that a leveling off of the rate to be reached at the end of the calendar year 1951 would impose in succeeding years lesser and not greater strains upon the economy. This is because the economy would gradually "build up" to meet the new burden. By way of rough illustration, if the labor and investment efforts which will be essential to accomplish the targets for 1951 are achieved and maintained, total national production at an annual rate should rise by about 25 percent within five years. This would bring us about 60 billion dollars above the current level, which would be enough to absorb a yearly defense effort at the levels to be reached at the end of this year, to maintain and expand our productive plant, and at the same time to bring per capita consumption for a growing population at least up to the level achieved in 1950.

Under current international conditions, however, economic analysis cannot stop short with an appraisal of the impact of the present defense targets. It must also help to appraise what the economy can sustain and support in terms of its actual and potential resources, and to shed light upon what variations in this program—whether upward or downward—would still be compatible with the maintenance of the strong economy required to support the military effort.

This further responsibility is particularly apparent at a time when there is an entirely appropriate debate throughout the nation on this very question of what our economy can afford to do. The viewpoint is sometimes expressed that if the military build-up should advance above some stated size,

it would within a few years "bleed our economy white," and thus accomplish through our own actions the purposes of the Soviet Union.

On this point, we can draw upon our own experience in World War II. We devoted as much as 45 percent of our total output to defense purposes and, far from wrecking our economy, we continued to build its basic productive capacity. The consequences were revealed when hostilities ended. In the light of this, the American people can certainly not take the position that the allocation of as much as 18 percent of our much larger resources to national security will reach or even near the limits of what we can do if necessity demands. Economies have not been wrecked because the people decided to do with fewer new pleasure cars and elaborate mechanical amusements, or wear their topcoats for longer or get healthier by eating less.

This point is so important that the illustration needs to be made more concrete. Let us suppose that, by the end of the calendar year 1952, international conditions made it desirable for us as a nation to be devoting 25 percent of our total output to national defense. It should be feasible with increasing efforts to expand total output by the end of 1952 by close to 15 percent, or roughly 40 billion dollars above the present level. At this level of production, the allocation of one-fourth of our total output to national security—if this should become necessary—would by no means be inconsistent with maintaining our fundamental economic strength and productive power. Marked changes in the composition of output would be required, but nonetheless it would permit the maintenance of satisfactory standards of living, although production of housing and many types of consumer goods would have to be more sharply restricted than presently contemplated. However, a large number of families and individuals would undergo a more marked reduction in living standards than would be indicated by the over-all figures.

To achieve these results, if this should become necessary, would require harder efforts and more sacrifices than we are now being called upon to make. But this larger effort, if it should prove imperative, would neither wreck nor bankrupt the American economy. It would still represent a much smaller effort than was achieved during World War II. Hours of work would not be as long; the percentage of the population of working age serving in the labor force would be smaller; and the output of civilian durable goods and of housing would be restricted to a much smaller degree.

An effort of this size would still leave us with enough resources to improve and enlarge our industrial capacity, and to maintain reasonable standards in education, health, and housing. The over-all level of consumption would be lower than the 1950 peak level, but it would still represent a high standard of living. Even on a per capita basis, the level of consumption by the end of 1952, under these assumptions, would be far higher than in 1944.

Much of the discussion of "what our economy can stand" has involved a misuse of economic analysis, and has led to dangerously erroneous conclusions. Every economy, even the most powerful, has ultimate limits upon

what it can support; but in the case of our economy, these ultimate limits are not threatened.

The tests now confronting us are not so much tests of our economy as they are tests of our moral fiber and cohesiveness as a nation. They are tests not so much of our material capacity as of our courage and vision.

We have what it takes to purchase reasonable security in a troubled world, but we cannot buy it cheaply. The way to protect ourselves is to build up our strength; and there are no bargain price tags on aircraft, tanks or guns. Giving up other things will be involved, because we cannot have our cake and eat it too. But we must stop eating so much cake, when the aggressors are arming so many divisions.

## IV. Economic Policies for Defense

### THREE REQUISITES FOR ECONOMIC MOBILIZATION

**T**HERE are three indispensable requirements for an efficient economic mobilization, whether partial or total. The first need is for a thoroughly comprehensive and unified programming operation, to balance competing requirements against available supplies. Such programming is essential to all policy, whether designed to direct resources to the highest priority uses or to avoid disruptive inflation. The second need is for utmost speed in accomplishing defined objectives. The third need is to conduct the economic mobilization program with a determination and fairness which elicit general support from a public kept fully informed of the nature of the program and its implications.

#### *The need for comprehensive programming*

Economic mobilization means a vast and rapid shift in the use of our resources, to which every policy must be attuned. This shift is executed throughout the economic system. But in the very nature of a defense emergency, the Government must outline the basic needs and project the major policies to satisfy them. The essentiality of a complete and always current programming operation does not depend upon "full mobilization." The importance of a clear definition of *what* needs to be done does not depend upon *how much* needs to be done. In some respects, partial mobilization requires an even greater clarification of objectives than full mobilization.

The definition of all major requirements necessarily draws its frame of reference from the primary military program, because it is the military build-up which is at the core of the whole effort. More and more precision should be sought, as rapidly as feasible, in the definition of what our primary defense goals are at any particular time. And for the purposes of economic adjustment to these primary goals, requirements in terms of manpower and materials are obviously more important than requirements in terms of dollars. This emphasis is not inconsistent with realization that primary military objectives must remain reasonably fluid, and that for security and other reasons they cannot be revealed in full even where they have become crystallized.

But it would be dangerous to assume that all other aspects of economic programming can be delayed until primary military programming reaches any particular point. There is an interrelationship between the two, which

requires to a considerable degree that they move forward simultaneously towards ever-improving clarification. Nor is it true that the other aspects of economic programming consist solely in saying that whatever is not taken for military purposes is available for other uses. These other uses must in turn be subjected to constant programming, because some of them promote our security and others do not. Our security in the long run depends upon how we divide available resources between maintenance and improvement of our national plant and tools on the one hand, and ultimate consumer needs on the other. Within the industrial structure, it depends upon what kind of activities we carry forward vigorously and what kind we cut back. Above all, there should be a balance of how much we seek to achieve through cutbacks and restraints, as against how much we seek to achieve through expansion of total production.

The early experience during World War II afforded eloquent proof that the greatest obstacle to over-all efficiency was the slowness in developing a useful and comprehensive programming operation, and locating it ultimately at one point of authority. The Council now urges that the first steps already taken in this direction be carried as quickly as practicable to their logical conclusion. This does not mean that detailed operations cannot be parcelled out; but it does mean that the ultimate "budgeting" of our resources for defense should be centralized. Budgeting, which is a process of reconciliation of competing requirements, cannot be done in several separate places.

#### *The need for speed*

Speed is of the essence in economic mobilization. This sound principle should not be confused with the question of the size of targets. Speed does not mean, for example, that we should as rapidly as possible achieve total mobilization; that is a matter of grand strategy. Nor does it mean that mobilization should not proceed in an orderly fashion, with speed concentrated first on the earlier steps and later on the subsequent steps of the program. But speed does mean that decisions as to targets should be reached as quickly as possible, and that every effort should be made to attain whatever targets are decided upon as rapidly as the basic program calls for.

In economic mobilization, tardiness has a cumulative effect because of the interrelationship among all the parts. Delay at one point generates even more delay at succeeding points. Indecision at one point promotes apathy at another. As an apt illustration, there may be debate as to when the Government should apply price controls over a given commodity. But once the Government has announced or intimated that it is going to do so, delay in accomplishing the result can only add fuel to inflation, speculation, and an enervating let-down on the part of the general public. Conversely, demonstrated celerity at one point awakens others more fully to the urgency of the situation and consequently accelerates their own necessary actions.

Since our nation is now undertaking to catch up with the mobilized military strength of the aggressors, every day is precious.

*The need for public support*

The necessary concentration, during a defense period, of more authority and responsibility in the Government than is customary in peacetime should not blind us to the fact that nationwide understanding and cooperation must be achieved. The very severity of the departure from customary methods, and from the level of peacetime enjoyment of goods and services, makes such public understanding even more essential.

The whole American people should consider the extent of this departure from normalcy, as it affects our economy and our economic problems.

The objective of maintaining maximum employment, production, and purchasing power, established by the Congress in the Employment Act of 1946, should be considered today in the light of circumstances very different from those of peacetime. In the months to come, there will be no general problem of unemployment, but instead one of encouraging the entry of more men and women into a labor force too small to meet all our national needs. There will be no problem of inducing the expansion of purchasing power, but instead one of restraining the growth and the use of purchasing power. Maximum production will be even more vital than in peacetime. But the major problem here will not be to devise national economic policies to furnish incentives, markets, or capital to private enterprise, in general, but instead to channel our limited resources of manpower and of materials into lines of production which are most essential.

In the first months after the outbreak in Korea, it was perhaps justifiable in the formulation of national programs to give considerable weight to maintaining our standards of living or even pushing them forward. It was also hoped that we might progress, although at a slower pace, with national policies of long-range social and economic value. It is still necessary to seek balance between these longer-range objectives and the requirements of national security, remembering that many of these objectives themselves are essential to defense. But in a national emergency, the weight to be given to the defense program grows vastly. The weight to be given to other objectives becomes correspondingly smaller.

The new effort will call for sacrifices not limited to those matters which the citizen himself directs, such as the buying of goods, the settlement of wages, and the making and saving of profits. During the past generation, our people have greatly expanded the role of their Government toward adding to the supply of services which in our civilization make up a substantial part of the requirements of comfortable living. The needs of the American family for education, for highways, for libraries, and for many health services, have been largely reflected in community action. We have steadily enlarged the responsibility of the State for the conservation and development of natural resources, as sources of future goods and services.

The demand for sacrifice now falls upon many of these operations of Government, each of which may compete with defense requirements. Each of these operations must justify itself thoroughly under present conditions, before money, manpower, or scarce materials may properly be allocated to it.

Next to the primary need to meet defense requirements, the policies and programs of greatest importance at this time are those which counteract or curb inflationary forces, and those which assist the expansion of productive capacity. The trend of the economy at the end of the year was highly inflationary, despite the progressive imposition of controls of an increasingly rigorous character. The accelerated defense program will now intensify these inflationary forces. The people must now choose between permitting serious inflation to proceed, and accepting sterner restrictions.

The American people are realistic enough to accept and help to implement these restraints. But by the same token, they are realistic enough to be slow in doing so, unless they know what greater purposes will be served by the surrender or suspension of the lesser but nonetheless important purposes toward which they were oriented before the defense emergency.

Moreover, the Government can only to a limited extent, even in an emergency, tell the people what to do; for the most part, it must ask for their action and their cooperation. And their cooperation will be given most enthusiastically if they feel that the burden is being shared equitably by all.

#### MAXIMIZING OUR PRODUCTIVE STRENGTH

This Review has constantly reiterated that production is at the heart of our economic strength. Only by more total production year by year can we generate the enormous power which we will need. This is not negated by the necessity to cut back sharply some lines of production, for the ultimate purpose even of these cutbacks is to get more vital production elsewhere and to enlarge the total. We have also indicated why accent on production may be even more vital, for the long hard pull which now seems to confront us, than in the event of total hostilities. And we have taken a resolute stand against the proposition that there is but little new productive potential within the economy, although we were near maximum production by peacetime standards in 1950. The American economy has not reached an absolute ceiling prohibiting further progress.

The following discussion of production problems is somewhat general. This is in part because a general economic staff like the Council can highlight problems, but must leave detailed decisions and execution to operating agencies. It is also in part because many precise decisions on the allocation of our resources for various productive purposes must await the further development of a comprehensive programming and priority operation.

## *Industrial expansion*

*Selective industrial expansion.* The need to devote a substantial portion of our resources to the primary military build-up limits our ability to expand productive facilities of all types. The expansion, for the time being, must be highly selective, but it is nonetheless urgent. While highly selective, it should be on a broader base than during World War II. This is true because we are not so short now as we were then of certain critical facilities; and also because, in the absence of total war, we can justifiably put more emphasis upon the development of general strength for the long pull.

Legislation enacted after the Korean outbreak authorizes the use of many of the same types of Government stimuli to selective private expansion which proved useful and essential in World War II.

Up to the end of 1950, 1,014 applications had been filed for the accelerated amortization privilege, covering 3.9 billion dollars of plant and equipment investment. Accelerated amortization had been approved by the National Security Resources Board in 149 cases on a total of 1.0 billion dollars of outlays, or about three-fourths of the total investment contemplated under these 149 applications.

Under the direct Government loan provision of the Defense Production Act, 136 applications had been filed by the end of the year for 822 million dollars of loans; two loans had been granted, for a total of about 1 million dollars.

At the end of 1950, after the initial three months of operations under the loan guarantee program authorized by the Defense Production Act, the Federal Reserve Banks had received a total of 157 applications for this type of assistance, totaling 82 million dollars. All of these requests were for working capital for firms supplying the Defense Departments directly. Fifty-eight applications had been approved, for a total of 30 million dollars, while the remainder were pending.

Private enterprise and funds can and should play a larger part in plant and equipment investment than was the case in World War II. The expansion program now needed places much less emphasis on temporary needs for war materiel facilities than the World War II program. During the next few years at least, the major part of facilities investment must go into expansion of basic industrial capacity, which will remain useful when peacetime conditions return. Private industry is currently in a much better financial position than it was at the outset of World War II to carry this load.

In most cases, the role of the Government should be limited to a programming of basic needs which will provide industry with a full consciousness of priorities of purpose, and to such controls over materials as will enable high-priority industrial expansion projects to get what they need to do the job. Government financial assistance and incentives should be centered upon projects required in the national interest which, because of

type, location, or other special cost factors, do not offer a prospect of reasonable long-term returns to private investment.

The incentives offered to private investors can be based on proper economic considerations only if the Government has possible recourse to the alternative of direct construction. This was demonstrated in World War II. The effectiveness of Government policies for encouraging crucial types of expansion should be improved by legislation empowering the Government to finance and construct facilities itself in special cases where reasonable available inducements to private investors are insufficient.

It is becoming increasingly important that we develop and apply standards of security dispersal regarding the location of new plants. In the present situation, very little can be done to alter the location of existing industrial plants and associated community facilities, or to affect plant expansion which is mainly a rounding-out of present facilities. New locations, certainly those aided by the Government, should be established with security in mind. Decentralization may be promoted locally within the commuting radius of metropolitan and industrial centers, or may involve the establishment of new plants in small or medium-sized cities beyond this radius. There is also the broad decentralization which stems from plans to develop regional economic strength.

The economic effects of the first type of decentralization are more localized, and involve mainly labor supply, transportation and communications, a variety of community and industrial facilities, and housing. Wherever possible, expenses of such decentralization should be borne privately; in some cases, governmental aid will be necessary.

The large regional type of decentralization affects the whole economic location pattern of the Nation. It is desirable that new industry important to security be located on the basis of careful consideration of the kind of defense and industrial expansion which each region can best support in view of cost and market as well as defense considerations.

*Electric power.* The electric power outlook, as discussed earlier in this Review, indicates a serious shortage of power—especially in some regions. The further development of power at Niagara Falls would bring in about a million and a quarter kilowatts of very low-cost generating capacity by 1955. The St. Lawrence seaway and power project would mean an additional 940,000 kilowatts of installed capacity, which will be needed in the area within a few years. A speeding-up of public power projects in the Pacific Northwest, plus the starting of several new ones, could add about 1,150,000 kilowatts in a region of critical shortage by 1954. The TVA program is being expanded greatly, so that some 3 million additional kilowatts should be available in that region by the end of 1953. These projects should be carried forward promptly, to meet the inevitable loads of defense production and other essential uses.

Increases in public power capacity will be much smaller than the increases in private power, which now are expected to total almost 20 million

kilowatts over the next three years, and probably will have to be stepped up. Necessary supplies of critical materials will have to be made available if these power expansions are to be realized.

*Atomic energy.* In terms of human resources, the atomic energy enterprise constitutes one of the largest bodies of scientific and technical personnel in the country today. In terms of plant and equipment, it represents one of our largest specialized productive assets, ranking with the plant investment of the nation's leading industrial enterprises. Recently industry has shown an increasing interest in participating on a profit and risk basis in developing nuclear power. The Atomic Energy Commission has received exploratory proposals from industry, looking toward the development of dual-purpose nuclear reactors designed to produce power for private use and fissionable material for sale to the Government. If such development should appear technically and economically feasible, a number of new questions would be raised relating to such matters as pricing, patents, and the coordination of the private and public roles. These questions would become the joint concern of the Congress, the President, and the Atomic Energy Commission, as provided by the Atomic Energy Act.

It is too early to calculate the contributions which this source of energy may add to our general productive strength. But certainly, in time, their contribution will be significant. This is another reason why, in the future as in the past, we may expect technological developments to add even more than increases in manpower utilization to the productive power of the United States.

#### *Basic resources*

The prospect of a rapid build-up in national defense during the next few years, followed by an indefinitely long period during which we must maintain and improve our defenses, emphasizes sharply the need for maximizing the productive capacity of our natural resources and the services our transportation system can yield, both for the short run and the long run. In a very real sense, the long-run strength of the economy, for peace or for war, will be measured by the availability of natural resources, their quality, and the care with which we handle them. At this time, when the more strictly civilian expenditures of Government must be held in check, it is essential that we be highly selective in our minerals, soil, forestry, transportation, and water programs. While they must be affected by our lack of resources to do all the things which are important, those which are most essential should be included in the program for industrial expansion.

This calls for intense planning to get the most efficient utilization of available facilities. It also warns us that, if we are not to be penny wise and pound foolish, we may need to make some highly selective additions to these facilities despite the additional strain upon resources, and to be even

more ruthless in slashing nonessentials. Roads, for example, range all the way from essential feeder lines for military and industrial mobilization to roads which add only to the pleasure or convenience of the peregrinating public.

*Minerals.* In contrast to our stronger position now than before World War II with respect to manpower and plant and equipment, we are less well off with respect to domestic supplies of the major strategic minerals. Net imports in metal equivalent, expressed as a percent of total U. S. consumption, increased from 1939 to 1949 by 4 percent for iron ore, 13 percent for bauxite, 23 percent for zinc, and 40 percent for lead. For copper, we moved from net exports equal to 36 percent of U. S. consumption in 1939 to a 1949 net import position of 38 percent. This points conclusively to the need for developing for these metals new sources which are as safe as possible from enemy attack.

Both private and public policies should be directed toward assuring additional supplies of iron ore as quickly as possible. Private companies are going ahead with the Labrador and Venezuela developments, so that by 1954 or 1955 the steel industry will be getting large tonnages of iron ore from these sources. The St. Lawrence seaway and power project should be started immediately, to make additional iron ore available in quantity in the great steel centers of Pittsburgh and the Great Lakes area. Demands on construction materials and manpower for this project would not be large during the next year and a half. If we move swiftly, the seaway could be in operation for the 1956 season, when Lake Superior ore production is expected to be falling off. Increased emphasis should also be given to research into technological methods for refining and using low-grade ores such as the taconites of the Lake Superior region.

Military and stockpile programs require large amounts of aluminum, copper, and many other metals, running in certain instances to a large percentage of total supply. Selective capacity expansion programs should be carefully related to the supplies of ores, electric power, and transport facilities which can be made available. Strenuous efforts should continue to be exerted to increase our imports of certain minerals and metals without harming friendly nations. Careful use of technical and capital assistance can lead to substantial increases in imports of some strategic minerals.

Discoveries of new petroleum reserves have been keeping pace with increased production during recent years, but we cannot expect this to continue indefinitely. Prudence requires that we encourage imports of petroleum and petroleum products, especially from nearby sources, while at the same time giving our full assistance to the development of foreign oil fields to supply friendly nations as well as ourselves. In addition, processes for the production of synthetic liquid fuels from oil shale and coal are rapidly approaching the point where they can be developed privately.

*Land and water conservation and development.* The pattern of expenditure in these areas which should be followed in the next few years is influ-

enced greatly by the time schedule of the defense program. The rapid build-up of defense expenditures, with the accompanying draft upon materials and other productive resources, will bring the defense part of the national effort to a peak within two years under present plans. Thereafter, if widespread warfare does not occur, and as general production increases, more of our productive resources would be available for civilian needs and for long-range programs of national development. This would give a hue of good fortune to a backlog of internal development projects, which are now well advanced in construction and, having been suspended or continued at minimum pace, will then be ready for immediate resumption on a speedy schedule.

In economizing on natural resources programs, we must be selective in what we curtail and what we allow to proceed. During the period of defense build-up, it will be necessary to curtail progress on certain development projects and programs for flood control, navigation, irrigation, and rural electrification. However, those uncompleted projects which will yield substantial amounts of hydroelectric power or municipal and industrial water supply needed for defense should be brought to completion as soon as feasible. Other developmental projects now well under way, and whose benefits can be made available within about the next year and a half, in general should be completed so that the substantial investments already made can be utilized. Other projects, whether started or only planned, which will make substantial additions to productive capacity, should receive careful consideration.

In this period of selective curtailment of resource development programs, it is important for defense that a variety of basic-data gathering, survey, investigation and experimental activities be continued in the various river basins and other regions. Increasing pressures on our forest, range, and agricultural land resources resulting from the defense program require adequate land management and conservation programs as basic supports for both military and industrial strength.

### *Manpower*

The objective of full employment takes on new and broader meaning as a result of the defense program. Our manpower resources are a vital factor limiting the ultimate expansion of our mobilization effort. It, therefore, becomes even more important to make full use of persons normally in the labor force. This means that unemployment and underemployment should be reduced to a minimum. To this point, our objectives remain the same as they were prior to the defense program.

In addition, however, defense requirements now make it essential for us to take steps to assure that the members of the civilian labor force are employed in ways in which they can individually contribute most to the total defense program. It means that every effort must be made to use the highest skills which each worker possesses, since the high quality of our labor force is a prime advantage.

The demands of the defense program mean not only that we must use our normal work force fully and efficiently, but also that we must expand the labor force by calling upon persons who do not normally seek employment. It is especially vital to secure complete public understanding of our manpower needs and active community cooperation.

*Expanding the labor force.* In expanding the labor force, the most important source is women, especially nonworking married women who do not have the responsibility of caring for young children. Women who work in defense jobs and who have children should be assisted, by means of nursery schools and other child care and community facilities, to care for their families and their homes.

Another important group is the aged; they should be encouraged to join the labor force by stepped-up recruiting efforts, and by a relaxation of those hiring standards which bar older workers from jobs which they are capable of performing. In the present state of partial but long-sustained mobilization, we do not believe that teenagers should be encouraged to leave school and join the civilian labor force. We should carry on our vocational rehabilitation work to enable a large number of disabled men and women to become employable; we should train older women, younger persons not in school, and others. Vigorous programs should assist members of minority groups to be utilized to the maximum of their capacities.

In addition to recruiting additional workers, we should utilize all of our present workers. It should be possible to gain about a million more workers by a reduction in the present level of unemployment. Moreover, there are about a million part-time workers who are willing and able to accept full-time jobs.

*Longer hours.* Some selective increases in the work week are needed immediately. In certain defense industries, where it is necessary to expand production without waiting for expanded capacity, additional shifts should be instituted. In other defense industries, shortages of critical skills indicate the need for longer hours for skilled workers. There is not yet a clear and urgent need for adopting a general increase in the work week for the economy as a whole. We should be ready to adopt such an increase as soon as it is needed, and in the meantime effort should be concentrated upon expanding the present labor force so that we will have more workers with experience and training.

*Improved utilization of the work force.* Attracting workers to the jobs where they are now most needed is at the heart of an effective manpower program. Basic responsibility for this problem must continue to be borne by informed workers in their individual employment decisions. But these decisions must be guided and supported by more positive governmental action.

First, there should be further development of the management-labor committees, now being established in many of the more acute labor market areas. These can help to provide essential local cooperation. Second, arrange-

ments will be necessary to remove the impediments to voluntary transfers of workers from less essential to essential activities, and protect workers affected by the curtailments in nonessential production. Such arrangements should safeguard seniority and pension rights, and offer better protection on a broader basis during conversion unemployment. Third, we must make certain that workers are most productively utilized while on the job. Here employers must assume basic responsibility for necessary training and upgrading, for taking all possible steps to improve the supervision, mechanization, and other factors contributory to maximum productivity, and restrict their hiring to the absolute minimum needed to meet production goals. The Government should encourage and facilitate these actions.

*Health, education, and security.* One of the thorniest questions confronting the whole defense effort is how to reappraise and redirect the public services whose necessary growth was resumed after World War II, and for which further growth had been appropriately planned before the defense emergency.

In education, for example, we cannot remedy the shortage of school buildings at the pace which seemed eminently desirable a year ago. On the other hand, there is a high priority for promoting education and training in the health professions. Also the vocational education program, which complements within-industry training, must be redirected toward greater emphasis on training for defense jobs. General education, which modern elementary and high school training affords, no less than specialized skills, is essential to the maintenance of a vital citizenry, whether in the civilian labor force or in the military. It would be wasteful beyond description, by any test, to deprive those not yet of military age of decent opportunities for such training, and to force them, by lack of equipment or staffing, into the streets instead of the schools. This would hardly make them more serviceable in the event that an even larger military establishment should become essential by the time they will have reached the age of service.

In the case of health, it is obvious that widespread deficiencies in health care do not make for maximum national strength at any time. Obviously we do not now have resources to build as many hospitals in as many places as we would like to do. On the other hand, certain features of health progress are now more vital than before and should be accelerated. Federal aid should be extended to local health units, with special emphasis on units in the more rapidly growing defense areas. As a part of a community facilities and housing program for rapidly growing defense areas, adequate health facilities and services, as well as schools, will be necessary.

In the case of social security, there are types of expansion which would constitute an immediate drain upon our resources, and which are less urgent by the test of national priorities than they seemed a year ago. But other types of social security expansion, such as old-age and survivor insurance, may be undertaken without an immediate drain upon our resources, and in fact over the next few years would be anti-inflationary by collecting more

funds than they disbursed. Moreover, since the fight against inflation will make it necessary to reduce the incentives which flow from wage increases available for spending, some incentives may be substituted by granting some wage increases where necessary but withholding them from the purchasing power stream by social security deductions which are a form of compulsory saving. In any event, even without increases in wage rates, there will be an enormous increase in total wages earned, through additions to the labor force and through longer working hours, at a time when it will be impossible to increase the supply of consumer goods. Increased social security deductions might provide one highly useful approach to this inflationary problem.

Because many of these services now under discussion are public rather than private in their nature, it may seem easier to curtail them than to curtail nonessential private activity and spending. But in a national emergency, the question of who spends the dollar, while not unimportant, should be subordinated to the larger question of what use of resources will do most to maximize our total strength. Nonessential Government outlays should by all means be cut; but essential public outlays should have priority over nonessential private demand. This whole problem calls for a kind of "budgeting" process more discriminating than that practiced in peacetime. In terms of the over-all programming of requirements and needs upon which the Council has placed so much stress, the amount of materials, manpower, and money which we can and should devote to education, to health services, and to other factors in human efficiency and morale, should be carefully and constantly weighed.

*Housing and community facilities.* The World War II experience brought into sharp focus the close relationship between industrial production and sufficient housing of adequate quality. Despite the nearly 5 million new nonfarm housing units which have been built since 1945, we have not yet caught up with the requirements of a nation of our population, incomes, and living standards. This was illustrated by the unprecedented and rising level of house construction in 1950. The defense emergency requires that we now set aside the praiseworthy targets for an even larger number and more varied types of housing which were projected last year and earlier. If the housing goals set forth in connection with the recent credit restrictions do not need to be reduced, they will permit a level of housing output at least sufficient to keep up with new family formations and even to allow some reduction of overcrowding.

In areas of defense expansion, on the other hand, the housing supply will need to be enlarged considerably. The emphasis should be upon rental housing serving the needs of middle- and lower-income families, along with necessary community facilities. While private industry should be encouraged to do as large a part of this job as it can, the experience in World War II makes it clear that publicly-financed housing must serve a larger portion of this type of need than in ordinary times. More easily than

privately-financed housing, such housing can be developed on a rental rather than a sale basis, and is more suited to migrating defense workers. Such housing is also more easily susceptible to occupancy standards. And such housing can save somewhat more by way of critical materials, because its utility after the defense period need not be taken so largely into consideration, and because it may even be built on a temporary or mobile basis if necessary—although previous experience casts some doubt upon large-scale resort to temporary housing in the current situation. Previous experience also demonstrates that, wherever possible, such housing should be built by local agencies, with Federal aid when needed, rather than by direct Federal construction. The latter method has always seemed superficially to promise greater speed; but actually, it has usually proved slower because of the high degree of interdependence among housing structures, the selection of sites, and municipal and other services which cannot be provided by the Federal Government.

The scheduling of housing for defense workers needs to be integrated more closely with other aspects of the defense program. In addition, the general determination of what volume of total housing can be permitted in the near future, throughout the country, will be made most wisely in the framework of the complete resource programming operation which the Council has identified as a first need of the whole defense effort. Housing is so essential to our general strength, that decisions affecting housing should rest upon the general strategy of the relative emphasis being placed upon immediate military needs and long-range economic strength.

#### *Adjustment of agricultural production*

The defense situation has significantly changed the farm outlook. Surpluses, which seemed difficult last June, present few problems today. While our agricultural policy continues to encourage abundance of farm products in general, it is now concentrated on specific items which are in short supply.

The demand for farm products has increased markedly in recent months. Military needs for cotton and wool have greatly enlarged the markets for these products. In addition, there is an exceptionally strong consumer demand for meats and many other foods. Coupled with these high demands, we have low supplies of cotton and wool—although fairly liberal stocks of foods. And we will need to maintain large stocks of food and feed as an insurance against unpredictable demands and against the hazards of weather.

In World War II, our food and fiber needs were met by a great increase in agricultural production. Total output of farm commodities increased by almost 20 percent from 1940 to 1944. This was made possible by good weather, by the rapid adoption of hybrid corn, and by using much more fertilizer and machinery. Since the war, output has remained at high levels, despite gradual reduction in the number of persons working on farms.

It will doubtless be more difficult to increase farm output in the future than it was after 1940. Yet substantial gains are feasible. Programs are being readjusted to help bring about the highest possible total output, and especially to encourage the production of the most needed commodities, such as cotton, wool, corn, and livestock products. In the case of cotton, there will be no 1951 acreage allotments or marketing quotas, and every effort is being made to produce a crop of 16 million bales, or 60 percent more than the 1950 crop. On January 5, it was announced that there will be no acreage allotments for wheat and corn in 1951. In the case of cotton and wheat, prices will be supported at 90 percent of parity. On the other hand, there are now no supports on potatoes or on eggs.

Farmers are using less manpower than before the war. But they are using three times as many tractors, twice the number of trucks, two and one-half times as much fertilizer, and two to three times as much electric power and power-driven machinery. The increased use of steel in the defense programs, and possibly the increased use of nitrogen in explosives, make it difficult to avoid some bottlenecks in food production. But our experience with this problem in World War II indicates that these bottlenecks can be kept at a minimum by the careful scheduling of requirements and by appropriate measures of allocation.

Although using less manpower, farmers are more dependent on skilled labor than in prewar times. This could rapidly become a difficult problem if the defense program continues to expand. For the present, it is less serious than the problem of assuring needed materials and facilities.

#### PROMOTION OF ECONOMIC STABILITY

The diversion of large amounts of resources to the defense effort tends powerfully to upset the economy by causing inflation, dislocating production and employment, and distorting the distribution of essential goods among the population. Such instabilities, if not brought under control, would undermine production and the whole defense effort by imposing hardships and inequities on the home front. The vigorous promotion of economic stability thus supports our basic production effort just as expansion of production buttresses economic stabilization.

Inflation is the principal threat to economic stability. Earlier in this review, we depicted the enormous inflationary forces which grow out of the expanding defense program, and which have already begun to march even before that program has gotten into high gear. The control of inflation is much more difficult than the expansion of production. The release of productive effort is gratifying in itself. The preponderant bulk of American production and production expansion will come through private initiative with no more than general guidance from government. But the imposition of harsh restraints goes against the grain and requires all of us to do things we would very much rather not do. The reasons for a mighty productive

effort are more or less self-explanatory; but to succeed with controls requires a constant effort toward the enlargement of public understanding.

There are three main ranges of controls available: (1) the indirect controls, such as tax and credit measures, which absorb or restrict the growth of excess purchasing power; (2) direct controls over production and distribution, such as allocations and limitation orders, which distribute resources among necessary purposes; and (3) direct price and wage controls, which are designed to suppress the price-wage spiral.

All three of these types of control are now clearly needed. In effective combination, they can provide a sound platform of economic stability upon which an abundant and balanced production program can build. Each is necessary to the other two and must be supported by the other two; in large measure, they are complements, not alternatives. This will be clearer if we examine their interrelations.

Allocations and limitation orders help to place goods where they are most needed. An inevitable result is to reduce the supply available for other uses. But allocations and limitation orders do not reduce consumer demand. If nothing else is done, prices will rise and some consumers may fail to receive essential supplies. Accordingly it is necessary to make use of taxes and other financial measures which reduce total purchasing power, and thereby reduce civilian demand for scarce supplies. These measures can be aided further by imposing selective credit restrictions and specific excise taxes, to curtail civilian demand for those products which are scarce because materials or plants are concentrated on defense production.

Even the most rigorous tax program designed to keep disposable incomes in line with available production requires the assistance of price and wage controls. If tax increases were followed by compensatory price and wage increases, the effects of the tax program in holding down spending would be largely nullified. Moreover, tax increases may be inadequate to check spending if there is a large volume of liquid savings which both business and consumers can use to buy goods. For the public to continue to hold these savings and for it to save at the needed higher rate in the future, requires confidence in the stability of prices. Only broad, direct price and wage stabilization can now convincingly provide this confidence.

Also, effective stabilization of prices is necessary to make our allocation and priority system work effectively. As long as prices are not controlled, the orderly flow of materials to the most needed places would be disrupted and our production schedules disorganized. This makes all the more urgent the need to stabilize prices if we are to achieve our production program.

It would be unwarranted, however, to embrace direct controls of prices and wages in the hope that they offer a less painful and more palatable remedy than do higher taxes. Price and wage controls prevent incomes from rising and thus help limit the growth of demand. But they do not in themselves reduce demand; on the contrary, the lower the prices, the

greater the demand; and this provides a breeding ground for black markets and evasion if purchasing power is not restrained. Disposable income must be reduced through taxation and other financial measures, or price and wage controls may be seriously undermined. Further, price controls must be supplemented by some direct controls over the kinds of civilian goods produced, if sellers are not to be able to sidestep price controls by varying their products and shifting to higher-priced and higher profits lines.

It should be recognized that controls, particularly direct controls, would place obstacles in the way of production unless the controls were carefully designed and competently administered. For example, delay in granting a priority may hold up a defense order; or, wages in less vital industries may be set relatively so high as to impede the recruitment of workers into the more vital ones; or, an error in price regulation may make it impossible to produce and sell certain goods except at a loss. The risk of these and similar mistakes are costs which we must expect in using direct controls. If the inflationary forces in the economy were minor, these costs of controls would be likely to far outweigh the benefits which they contribute to production. But when the inflationary forces are powerful, the losses to production resulting from direct controls are likely to be far smaller than the losses to production if instability develops. It is the latter kind of situation which we face in a major defense mobilization. We must do everything within our power to make the controls work smoothly, so as to interfere as little as possible with production.

While the interdependence and necessity of the different kinds of controls are clear, the emphasis in the last analysis must be placed upon the financial measures which drain off excessive purchasing power. These are basic for any long-run program, and without them, the others are bound to fail. This statement must be emphasized repeatedly because taxation seems to most people to be the most painful of stabilization measures, and, as a result, there is a tendency to seek in the direct controls an easy substitute. No economic mistake could be more serious. Indirect financial control measures, notably taxation, must be at the center of stabilization policy in the defense economy.

#### *Mobilizing our financial resources*

The distinguishing mark of indirect controls is that they operate through their effects on people's income and on their financial assets and liabilities. Their purpose is to mobilize the Nation's financial resources for the promotion of defense mobilization.

Defense mobilization requires the redirection of physical resources. To some extent this is done by direct order, as when men and women are drafted into the armed services. But to a major extent, financial measures are relied on to facilitate the redirection of resources. Financial mobilization is thus the rechanneling of the flows of incomes and expenditures, receipts and disbursements, in order to guide production in line with the require-

ments of defense and to distribute equitably that part of the product available for the civilian population.

The instruments of financial mobilization include, on the one hand, government expenditures whereby resources are commanded for the defense effort, and, on the other hand, a variety of measures for maintaining economic stability by reducing the competition of private demand for resources which are needed for defense.

Foremost among these measures of financial mobilization is taxation, which withdraws spending power by compulsion from private hands. The effect of taxation in reducing consumer and business spending is limited by the fact that it ordinarily does not impinge on past accumulations of funds.

A second measure is borrowing by government. To have an immediate effect on private demand, borrowing must be accompanied by an increase in net saving or a reduction in real investment, or both. Borrowing also helps to reduce demand by absorbing liquid funds which would otherwise be spent. Campaigns to sell government securities to the public promote this objective. A sort of "induced saving" also results when goods subject to price controls are in short supply, since people are thereby encouraged to save until the goods can be purchased at a later date. Saving as an instrument of financial mobilization is voluntary, and therefore more subject to unpredictable fluctuations.

A third measure of financial mobilization is credit control, whereby private borrowing is reduced or restrained from rising. The impact of credit control is limited, since it cannot prevent persons from spending their own assets.

It has previously been pointed out that financial measures and direct controls supplement each other in the maintenance of price stability. Thus, increased taxation is the basic financial measure on which government must place its greatest reliance if the gap between demand and supply is not to undermine price and wage controls. On the other hand, price and wage controls supplement taxation, since in their absence tax increases can be largely nullified through compensatory price and wage increases.

In one respect, the problem of financial mobilization, at least for the defense effort now contemplated, is not so serious as it was in World War II, since the present defense program does not require nearly so large a proportion of the national product as that war did. In several respects, however, the problem of financial mobilization is far more serious today than it was during World War II.

First, a longer period of mobilization is anticipated than was the case at the beginning of World War II. Accordingly, the measures to be adopted must be adequate not merely for a few years, but possibly for an indefinite period of years.

Second, World War II mobilization was undertaken when the country was still in a period of incomplete recovery, while the present defense mobilization is being added to a business boom which even before the Korean attack had carried industrial production to postwar record levels and

was being reflected in higher prices. In World War II, there was little credit expansion for business or consumption purposes, while thus far in the defense mobilization nearly the whole expansion of credit has been for private uses.

Third, the country is entering the present defense mobilization at a time when there is a tremendous volume of accumulated liquid assets. A substantial portion of the liquid assets is held in the form of Government debt. At the end of 1950 the debt outstanding not held by Federal Government agencies and trust accounts totaled 217.5 billion dollars, compared with 41.1 billion dollars at the beginning of 1940. This debt has a high degree of liquidity, so that for many persons and businesses it serves the function of cash. The large volume of liquid funds makes it more difficult than it would otherwise be to hold down demand through taxation. The large amounts of savings bonds held by the public, resulting from the successful savings campaign of World War II, add to the importance of present savings programs. This is accentuated by the fact that a large part of the Federal debt which was incurred during the war will mature over the next few years. Moreover, if and to the extent that the budget is not balanced through current tax collections, further borrowing will be necessary.

Fourth, the country is entering the defense program with far higher tax rates already on the books than was the case in 1940. For example, for 1939 there were less than 4 million taxable individual income tax returns; the exemption of a married couple was \$2,500, and the starting tax rate was 4 percent. Today there are approximately 43 million taxable returns; the exemption of a married couple is \$1,200, and the starting tax rate is 20 percent. In 1939, the top corporate income tax rate was 19 percent; today it is 47 percent, with an additional tax of 30 percent on excess profits. Clearly, it would be more difficult to obtain large additional revenues from increases in these taxes than was possible from the starting point of low rates and high exemptions at the beginning of World War II.

Fifth, effective stabilization measures need to be in operation more quickly and more completely than was necessary at the beginning of World War II. This results, in part, from the tightness of the economy since increased spending is reflected immediately in price increases. Moreover, the public is more conscious of the threat of rising prices than it was in 1940. Then, mobilization followed half a decade in which price increases had been accompanied by recovery and the increase in employment, and in which deflation and price decreases seemed more probable and more dangerous than price increases. Since then, the public has experienced substantial price rises which have affected not only their personal budgets, but also the financial assets upon which they rely for economic security in later life. People's willingness to save more and spend less is dependent largely on their being convinced that price stability will be achieved and maintained.

For this reassurance to be effective, it is imperative to stabilize prices as part of the mobilization effort. This presents the old problem of the hen and the egg. A high level of saving is important if prices are to be stabilized, but it is going to be difficult to achieve that saving unless prices are stabilized. Clearly, it will be necessary to move on this problem from every practical direction. In doing so, it should be with regard to both the immediate defense period and the more distant time when resources and funds can be shifted back again into their more customary uses. An important goal for mobilizing financial resources for defense is to reduce to a minimum the inflationary and other distorting effects on the economy in later years, as well as in the immediate period ahead.

The three segments of policy most important to financial mobilization—taxation, debt management, and credit policy—are discussed in the immediately following paragraphs. Other measures which directly reduce spending or prevent the enlargement of incomes are discussed in later sections dealing with priorities and allocations, and price and wage controls. While not in themselves financial measures, they are necessary for the success of financial policies, under present or prospective conditions.

### *Taxation*

The Council believes it to be of great importance to the future of the country that the firm and continuing policy of the Government be to pay through taxation for the entire cost of the defense program at present and contemplated levels. The reasons are clear and convincing. First, paying for the defense program out of current taxes largely offsets the inflationary pressures resulting from increased government expenditures. Taxation is superior to other methods of holding down spending by consumers and businesses. It does not rely on voluntary action. It does not interfere with the flexibility of market adjustments. It avoids the increase of debt, and obviates the danger that inflationary pressures of expenditures will not be offset at the time of borrowing or may arise at some later date.

Second, paying through current taxes distributes the burden immediately in a manner in which the Congress determines it should be distributed, not unpredictably and unfairly through inflation. When we pay as we go, those who serve in the armed forces will not have to pay taxes for increased debt service and debt retirement after they return to civilian life.

Third, there is no economic advantage in postponing taxes through borrowing, for the economic burden of the defense effort must be borne currently regardless of the manner in which the expenditures are financed. It is not the imposition of taxes to pay for defense that creates the economic burden of defense, and it is an illusion to think that through borrowing, the Nation can escape or postpone paying the bill.

Fourth, the tax load required to finance a defense program of the size now contemplated would not be unduly heavy at anticipated economic levels. Federal cash revenues collected during the fiscal year 1945

amounted to about 27 percent of the national income. To pay for Federal expenditures at the level projected for the end of the calendar year 1951 would not require a much higher percentage of national income. Such a tax load is heavy but not unbearable.

It is not to be concluded that a balanced budget could necessarily be maintained during a major war. But the magnitude of the present and planned defense effort is far from being as heavy a charge on the production of the country as was made during World War II. In general, a defense program that does not require a diversion of productive resources too large to be sustained over a long period of time is not too large to be financed through current taxation. We believe that from an economic point of view, a defense effort of present and contemplated size can and should be financed through taxation during the period of the effort.

This is not the same as saying that during the relatively short build-up period when expenditures are mounting rapidly month after month, tax collections can be kept equal to expenditures at all times. There are time lags in the passage of tax legislation, and time lags in the collection of taxes under new tax legislation. The shock of the tax bite on the economic system must also be considered. The adjustment to drastically higher taxes of the taxpayer's personal budget, as well as his attitude, outlook, and expectations, takes time. With due recognition of this, which means simply that taxes should be raised just as fast as possible, the point must be everlastingly stressed that there is to be no giving up the policy and goal of the balanced budget. There must be no let-up in tax increases until balance is achieved and maintained.

It must be recognized that to balance the defense budget will require taxes at rates substantially higher, perhaps even drastically higher, than have ever been imposed before in the United States. The regular corporation income tax is already substantially above the wartime level. Excise tax rates are at their wartime peak. Individual income rates are 3 percentage points below the wartime peak, although, due largely to income splitting, tax liabilities for married couples are substantially lower. The fact that the rates will have to exceed the wartime levels is regrettable, but should not be discouraging. It is generally recognized that taxes were much lower than they could and should have been during the last war.

The importance of reducing private spending influences the forms of taxes which should be used in a tax program, as well as its size. Other considerations are also important. A maximum productive effort should not be discouraged. The tax burden should be distributed in an equitable manner. The higher the tax burden becomes, the more important it is to avoid inequities which permit some taxpayers to escape paying their full share.

*The individual income tax.* We should continue to rely on the individual income tax for a large part of the additional revenue which will be required

for the defense effort. Drastic increases in rates will be necessary, which will make it more important than ever that the base be an equitable one.

There are numerous special provisions in the law which need to be changed, in order that the base of the tax may be a fair one on which heavy burdens can be appropriately levied. Thus, the rates on capital gains are too low in relation to the rates on other incomes, while the holding period is so short that the hiding of ordinary income under the capital gains cloak is encouraged. The depletion allowed under the percentage depletion treatment is so excessive for some industries as to constitute a major inequity, and percentage depletion has been extended to industries where it has no justification whatsoever. The split-income provisions of the Revenue Act of 1948 removed an inequity among certain married couples in different States, but introduced an extremely favorable concession for married couples generally. If this concession cannot be removed, it should be taken into account when considering the increase of income taxes. The exemption of interest on State and local securities provides the anomaly that States and localities can sell securities at lower interest rates than the Federal Government. More important, a large part of the tax benefit accrues to the security holder rather than to the State and local government. The defense period would be an excellent time to remove this old-time anomaly from the tax law.

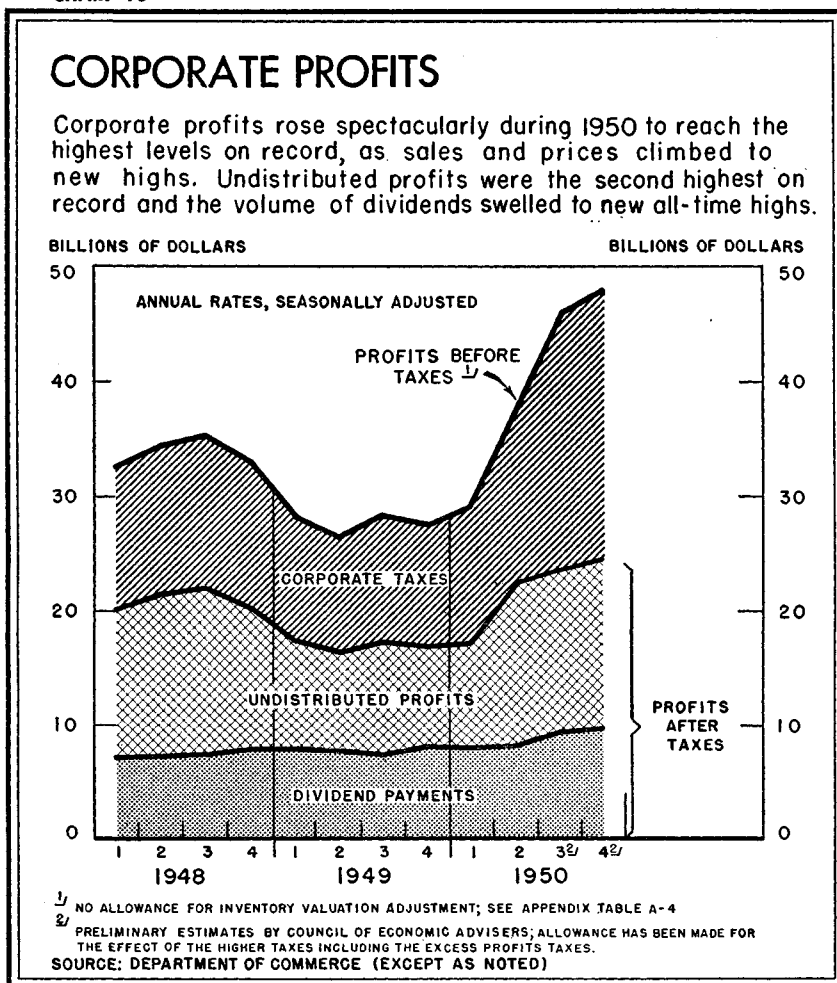
Income tax increases should be imposed at all levels, emphasizing the progressive character of the tax structure; but by far the largest part of the additional revenue must come from the middle and lower tax brackets. These are the brackets in which the great bulk of the income is located. Of the total net income shown on all taxable returns, 86 percent of the amount remaining after Federal income taxes is estimated to be received by taxpayers with net incomes of less than \$10,000. To hold down consumption, which is vital to the control of inflation, the bulk of consumers must be affected directly by the tax increases.

*Estate and Gift Taxes.* The estate and gift taxes have less direct anti-inflationary effects than most other taxes, but in the interests of distributing the defense burden fairly, these taxes need to be overhauled and strengthened. The structure of the estate and gift taxes permits large amounts of transfers to be made with no tax or at a very low tax rate. These defects were accentuated by the Revenue Act of 1948. The defective structure of the taxes should be corrected to make them fairer and more productive, and the rates and exemptions should be set at such levels as to give their proper and more adequate place in the tax structure.

*Corporate taxes.* Taxes on corporate profits were raised substantially in 1950, but there is room for further increase. Corporate profits before taxes in the second half of 1950 have been approximating a rate of about 47 billion dollars. Federal, State, and local corporate taxes, including the excess profits tax, will absorb at this rate of profits on a full year basis approximately 24 billion dollars, leaving 23 billion dollars after taxes. Several

billion dollars of this can be taken through further taxation and still permit corporations to maintain reasonable dividend payments, and to continue necessary programs of expansion without impairment of their financial position (see chart 18). Heavy corporate taxes contribute to the anti-inflation program, because they limit the amounts corporations have available for dividends and for investment. Moreover, without a further substantial in-

CHART 18



crease in corporate tax rates, there may be an accelerated rise in security prices, which feeds inflationary consumer spending and could easily spread to other markets and run directly counter to the goals of the stabilization program. Increasing the tax burden on corporations is essential also from the point of view of equity. It is not convincing to tell the public that consumption must be reduced and personal taxes greatly increased, while corporations maintain profits at very high levels. Wage earners can hardly

be expected not to demand higher wages, if they see that corporations have profits that would permit substantial wage concessions without making necessary an increase in prices.

The excess profits tax, which was passed by the recent Congress, makes a major contribution to the corporate tax structure. It appears probable, however, that some of the allowances made are unnecessarily generous and remove from the excess profits tax some profits which should be taxed at the higher rate.

*Excise taxes.* There is a particularly good reason for heavy increases of excise taxes on civilian goods which compete for materials and facilities with the defense effort, and the supply of which will very likely have to be drastically reduced. In the absence of the most rigorously enforced price control, the price of such goods is almost certain to rise. There is no justification for such price increases going to producers or dealers, and the effect would be to inflate business incomes and to stimulate workers to demand increased wages. By means of heavy excise taxes on such goods, the price increase would be diverted into the Federal Treasury in the form of tax revenue to the extent that the goods were available. Such taxes would be particularly appropriate on durable goods which are not essentials of life.

The rates of many of the other excise taxes might be increased somewhat. New items might be taxed, but to add substantially to the excise tax base would involve the taxation of commodities of mass consumption. These are, in general, necessities of life, and to tax them would place an inordinate burden on low-income families. Circumspection will be required also in increasing taxes on business-cost items, since these would most likely be passed on in the form of higher prices and affect the cost of living and of the defense program.

Increases in some excise taxes, which are reflected in the price structure, are a necessary device under current conditions. Yet it cannot be overlooked that such measures, in their very nature, bear more heavily on families with limited means than upon families in higher income groups. To a degree, this may be unavoidable, because an economic mobilization program cannot attempt to remove all of the differentials in real incomes and in consumption which are inherent in our economic system. Nonetheless, a defense program calls for sacrifices so great that there must be even more emphasis upon considerations of equity than in normal times. Towards this end, should the situation become more critical and some shortages become acute, there would need to be relatively more emphasis than thus far upon rationing and other devices, outside the price and tax structure, to promote equitable distribution of certain types of goods.

*State and local taxes.* Since tax policies are not solely a matter of Federal legislation, it may be added that the State and local governments also can help to reduce inflationary pressures. With the existing State and local tax structure, advancing prices and personal incomes tend to produce surplus revenues, particularly for the States. To the extent that these surpluses

occur, the State and local governments should build up reserves for later use rather than reduce the level of tax rates. In their expenditure policies, likewise, these governments should take all possible steps to conserve manpower and materials. By adhering to such policies during the last war, the State and local governments made a noteworthy contribution to economic stabilization. They can help again during the present emergency.

### *Debt management*

Policies of debt management can make an important contribution to the success or failure of our stabilization objective for the defense period and afterwards. The public debt today is more than five times as large as it was at the beginning of the defense financing period prior to World War II. It comprises approximately one-half of the total debt of the country, and constitutes a large portion of the assets of all the major investor classes of the country. Operations affecting the public debt have repercussions which are felt throughout every sector of the economy.

It is of major importance for the maintenance of economic stability that the public debt be bought and held by nonbank investors. Bank purchases of government securities are accompanied by an expansion of bank credit. Under present conditions, it is even more important than during World War II that the maximum amount of debt, including both new and re-funding issues, be sold to and held by the nonbank public. We believe that the Treasury should continue to use every effort to expand Government security holdings of nonbank investors, particularly individuals.

An important objective of debt management policy has been the maintenance of an orderly public market for United States securities. A stable and confident situation in the market for Federal securities is particularly important during a period of large military expenditures when new and heavy demands will have to be made on the Nation's financial system.

The accumulated savings of the wartime period eased to a large extent the reconversion of business in the postwar years and supported postwar prosperity. The highly liquid condition of the Nation's financial assets, however, also made for excessive demand and contributed to the postwar inflation. The achievement of monetary stability in the future will be made easier if the proportion of debt held in readily monetizable forms can be reduced.

### *General credit policy*

Three purposes of credit policy which are particularly important in the period ahead are, first, to facilitate the smooth transition of business and industry to meet the requirements of defense mobilization; second, to assist Government debt management; and third, to minimize inflationary pressures. To achieve all three purposes at the same time presents something of a dilemma, since smooth economic transition may require easily available credit, while minimizing the pressure on prices calls for restrict-

ing the volume of credit at many points. The problem is pointed up by the fact that, during the second half of 1950, the rapid expansion of bank loans contributed to the inflationary pressures built up during that period. There is a real danger that, for a time at least, consumer and business buying, based on credit, will continue to be of a magnitude which will aggravate inflationary pressures. Because of the needs of debt management, however, general credit policy cannot be expected to be a major anti-inflationary instrument during the coming period of intensive mobilization.

Finding the solution to this problem of credit policy will call for a careful appraisal of the applicability under present and prospective conditions of such traditional central banking techniques as changes in rediscount rates, reserve requirements, and open-market operations. It will undoubtedly be necessary, at least in the immediate period ahead, to rely more on selective than on general credit controls. It may be found feasible to extend selective controls to other kinds of loans than those to finance the purchase of consumers' goods, real estate, and securities, and to secure voluntary cooperative action on the part of banks to attain this objective. It is possible, and it may be found desirable, to regulate and limit the issue of new private securities.

One hopeful element in the picture is suggested by the experience of World War II, which supports the view that, if price controls and controls over inventories and facilities expansion are vigorously used, the problem of inflationary growth of bank credit will be mitigated. Price control, combined with the diversion of materials from civilian production, may be expected to restrict new credit to that used for the promotion of productive capacity in the defense program.

#### *Selective credit controls*

At the present time, two major selective credit controls are in operation: Regulation W, which requires minimum down payments on purchases of the principal types of consumer durables; and Regulation X, which regulates terms on residential mortgages. Regulation W was in effect during the war and during most of the postwar period until June 30, 1949, at which time legislative authority expired. It was reinstated on September 18, 1950. Less than a month after the Korean outbreak, the President asked the Government housing agencies substantially to tighten terms on all mortgage loans insured or guaranteed by them—roughly half of all mortgage loans. In October, a more comprehensive regulation covering conventional loans on new one- and two-family dwellings, as well as Government-insured or guaranteed loans, was put into effect. At the present time, the regulation is being extended to multi-family structures, principally by the requirement of maximum loan values. During World War II, the substantial reduction of private residential construction by direct controls minimized the need for credit controls, although it would have been desirable to curb demand and

limit the price rise on existing dwellings. In the postwar period, previous to the Korean outbreak, overcoming the acute housing shortage was regarded as a primary aim of public policy, and accordingly, credit measures were designed to provide positive encouragement to residential construction.

Regulation W has had some immediate effect in curtailing demand, but to date the effect has been small, in comparison to the reduction in sales which will be necessary in the future. In the case of Regulation X, the effects of the regulation cannot yet be appraised, to determine whether further tightening of terms will be warranted. The large volume of work under way, and commitments made prior to the date of the regulation, will assure the continuance of a relatively large volume of residential construction well into the spring months. This has delayed the full impact of the regulation.

The restriction of consumer credit and of housing credit inevitably bears harder on the lower income groups which have used these forms of credit most extensively. The restraint upon their buying imposed through the present regulation should not be considered a serious and unreasonable hardship. If, however, much more severe restrictions on the supply of consumer durable goods and the construction of housing should become necessary, it would no longer be feasible nor equitable to achieve the needed restraint exclusively through the device of making credit unavailable. This would mean that the drastically reduced supply would go exclusively to those who have the ready cash to pay for appliances or houses. In the case of such drastic restrictions, other forms of allocating the remaining supply would have to be considered. Such drastic curtailments are, however, not contemplated at the present time. The sacrifices imposed on consumers under present regulations are not great in comparison with the benefit they derive from a successful policy of price stabilization.

In the case of housing, the adaptation of the program to a defense economy will require modification of the over-all approach taken in Regulation X. Terms applicable to some housing construction may have to be further tightened. In general, a more selective approach will be required. Measures will be needed to focus housing construction upon defense areas. Other measures will be needed to adjust the character of this housing—as to prices, rents, and size—to the needs of defense workers. Still other measures may be needed with respect to the general housing program, so that throughout the country the limited supply of new houses may be made to serve first needs first. To encourage a larger volume of rental housing, legislation should provide the FHA with a special type of insurance authority, differing in terms from the current legislation and concentrating mainly upon defense needs. A substantial volume of public housing will also be needed, with reshaping to meet defense requirements.

One serious defect of the Defense Production Act of 1950 is that it does not contain authority to prescribe credit terms on the sales of existing homes,

except on mortgages insured or guaranteed by the Federal Government. Exemption of these homes from credit regulation may result in a large rise in the price of existing homes, thus adding credit-created capital gains to the spending stream. A rise in the price of existing homes would intensify inflation also, by affecting prices on new homes.

### *Materials controls*

*Priorities and allocations.* Under the Defense Production Act enacted last September, the National Production Authority quickly put into force a basic regulation under which the materials and components needed to fill defense orders were given priority over other business. Subsequently, recognition of the urgency of protecting certain other essential programs led to special assistance in providing steel for the accelerated building of freight cars and of Great Lakes vessels, primarily iron ore carriers. Steps have also been taken to insure more equitable and orderly distribution of priority-rated orders, in a number of industries, by establishing maximum percentages of output beyond which individual producers need not accept further rated orders.

Orders have been issued cutting back nonpriority uses of aluminum, copper, zinc, rubber, tin, nickel, cadmium, columbium-bearing steel, and cobalt. The first purpose of these orders was to distribute the necessary curtailment fairly evenly over the various nonpriority users, to avoid drastic dislocations of production and employment. These restraints also afford incentive to the directly-affected users to conserve scarce material, by redesign or substitutions, while maintaining their output.

By the end of the year, a number of orders had been issued which selectively curtail or prohibit certain less essential uses of the material in question, rather than curtailing all non-rated uses uniformly. For one material, cobalt, complete allocation was ordered.

The development of priorities and allocation controls since the Korean outbreak, as outlined above, has been patterned on methods employed immediately before and during the early stages of U. S. participation in World War II. Some shortcomings in these types of controls are already becoming evident. For one thing, it has been impossible as yet to build effective machinery for insuring compliance with the increasingly complex pattern of rules—a defect which should be remedied as rapidly as possible. Also, the system of curtailing non-priority uses of scarce materials by uniform percentages at the level of primary shapes and semifinished products often fails to give the producer of finished products an adequate incentive to substitute, where feasible, components containing less of the scarce material. The basic shortcoming of the uniform horizontal-cut approach is that it makes no distinction between more and less essential civilian uses. Thus it does not really maximize the production of the most necessary goods, and quite possibly does not even maximize total production.

The use of direct controls has thus far been limited almost entirely to

aiding the direct defense programs, and the proportions of supply eligible for rated orders are still low. But these proportions are rising rapidly as the pace of mobilization is stepped up. It should now be possible to progress to the necessary next stage of more comprehensive and effective control, with far less lost motion than a decade ago. The exigencies of current mobilization call for all speed in staffing and other preparations for instituting complete allocations of a few key materials, along the lines of the Controlled Materials Plan, at the earliest possible date. In the interim, there will be increased pressure for development and authorization of essential civilian programs eligible for priorities assistance, on the footing now represented by the freight car and Great Lakes vessels programs. It has been realized from the start that a proliferation of such priority programs leads rapidly to a breakdown of the priority system. Advancing the date for instituting allocations would shorten the interval to be bridged by a priorities system, and thus remove the danger of such a breakdown.

Even before complete allocations are in operation, it will be necessary to impose further and more drastic cutbacks and prohibitions of selected least essential end uses. The control agencies are moving in this direction. In the initial phase of the mobilization effort, the preference for uniform percentage rather than selective cutbacks on civilian uses could be justified to some extent, on grounds of maintaining production and employment in general. But in the phase of mobilization which we have now entered, this justification loses weight progressively.

An improved system of direct control of materials should entail a careful program for conserving scarce materials by all those who process, use, or handle them in any way. Many of the practices evolved during World War II to stretch supplies of scarce materials are being put to use again. Various sales-appeal features, such as chromium trim and nonessential parts, can be removed from equipment. In the production of metal parts and alloys, use of substitutes for the more essential materials will bring great savings of scarce materials. The useful life of clothing, tools, and other commodities can be lengthened by the use of protective coatings and treatments. Holding styles of articles to a limited number would reduce the need for maintaining large and varied inventories, and permit greater economies of production.

The search for substitutes, already under way, should be intensified. The military research program is seeking substitutes for the copper used in cartridge cases, for scarce alloy metals used in jet engines, and for many other commodities. Federal agencies are conducting research in such fields as new and substitute agricultural materials, new techniques of minerals exploration, and new sources of minerals and substitutes. Programs are presently being conducted to standardize descriptions and unify terminology and classification systems for supply items.

*Procurement.* With the prospect that, during this year, the Federal Government will be buying an increasingly substantial share of the total na-

tional product for defense purposes, procurement policies become a major factor in the mobilization of productive resources. Without effective policies, there would inevitably be loss of output through disruption of production schedules, and inefficient and unbalanced utilization of the Nation's resources of manpower and facilities. The policies followed in large-scale military procurement have lasting effects on the competitive and geographical structure of our industries, and on their ability to expand and adapt themselves to the demands which will be made on them.

The most important general principle of sound procurement policy, at this stage in the program, is that the supply base should be broadened as far as practicable. Contracts should not be piled on a few large and familiar suppliers, but spread widely; and subcontracting should be actively encouraged. Broad distribution of defense business will give many firms the basic experience needed for subsequent rapid step-ups in war goods production. There are, of course, special cases in which a large procurement contract could not be split up without excessive loss of time or efficiency; and as the mobilization proceeds, many plants should for technical reasons devote themselves exclusively either to military or nonmilitary output. But the basic objective of broadening the base of supply will remain valid.

Such a policy requires a major continuing effort to hunt out and develop hitherto unused suppliers, particularly among the smaller firms. These firms in the aggregate have much to contribute, but they are normally at a disadvantage in securing business where large quantities of goods are being procured in great urgency. The extra time and effort required for their utilization will pay off increasingly as the pressure grows. Maximum practicable latitude in specifications will be helpful.

To promote better utilization of facilities and manpower, to ease the burden on transportation, and to make essential supply systems less vulnerable to disruption by attack or sabotage, it is vital that procurement policy take account of the relative availability of resources in different communities and plants. For the most part, there should be reliance upon cooperation by business, supplemented in exceptional cases by the use of Government powers to requisition facilities or to place mandatory contracts.

The pricing policies followed in procurement importantly affect efficiency. Although excess profit taxation and contract renegotiation are both useful in recapturing some of the windfall gains of the emergency, neither takes the place of a careful drawing of the original contracts in such a way as to encourage the cutting of production costs. Both in the initial letting of contracts and in subsequent renegotiation, the principle should be that the supplier has an opportunity to secure extra profits by finding additional economies, but not to retain extra profits which he may receive without constructive effort on his part.

It is clear that, in order to implement a procurement policy which meets the needs sketched above, central formulation of standards and coordination

of procurement activities are essential. Procurement policy must be closely tied to the other phases of the effort to expand production, and to avoid disruptive price rises.

*Policy for profits, prices, and wages*

In a defense emergency, more widespread use of controls than in peacetime is essential. But controls obviously do not remove the need to formulate policy. On the contrary, controls make this even more essential, because the very purpose of controls is to achieve policy objectives with more rapidity and certainty than they could be accomplished without controls. Although taxation is an authoritative indirect control action on the part of Government, one seldom hears the proposition advanced that there is no need for tax policy to guide tax action. But there is more frequent expression of the fallacy that the imposition of extraordinary or emergency controls upon profits, prices, and wages does not equally depend upon sound policy for their success. In these areas, consequently, the Council feels that it can be most helpful by outlining policy guides, rather than by treating those detailed questions of formulae, timing, and application which must necessarily rest with specialized agencies charged with segments of the stabilization effort.

In peacetime, the function of profits, prices, and wages is to contribute to the most efficient use of our total resources for the purposes which the Nation deems desirable. Prices serve to allocate products among buyers and to guide producers toward the most desirable products and the most economical methods of production. Profits provide incentives and direction to enterprise in making business investments and help supply funds for that purpose. Wages serve to provide purchasing power and work incentives to a large part of the consuming public and lead to the most effective use of labor.

In early 1950 the Council sought to outline profit, price, and wage policies for peacetime stability and growth. We found the key to stability and growth in a continuing "balance" between investment and consumption. This balance on the one hand would enable business to make full utilization of the labor force and of new technology toward the end of maximum production; and on the other hand would provide wage earners and other consumers with enough purchasing power to consume the goods produced, without excess demand leading to inflation or inadequate demand leading to recession or depression.

The economy seemed to be in fairly good balance in early 1950, although some further adjustments were needed. This led to the question of how this balance might be maintained in future years, as the total output of the economy increased three percent a year on the average. It seemed clear that the ratio of profits to the volume of business activity was in general rewarding, and that the further growth of the economy would keep these profits rewarding (and even increase them in absolute terms) without the

aid of further price increases. This disposed of the only argument that could legitimately be advanced for a rise in the general price level, namely, that business was not receiving sufficient funds to exercise its function in a vigorous and growing economy.

The next question was whether the large share of increasing production, which over the years must find its way into ultimate consumption and higher living standards, should be passed on in the form of a general declining price level or a generally rising wage level. We observed that, while either approach was theoretically obtainable, the dynamics of the American economy argued strongly for a fairly stable price level and a rising level of incomes measured by increases in production and productivity. Thus, in early 1950, we looked with general favor upon the new wage formulae which gave reflection to this economic philosophy. In all matters of profits, prices, and wages, however, we recognize the need for individual variations to promote efficient operations in a complex and variegated economy.

The time has now come to reconsider this entire formulation of profit-price-wage policy, in the light of new facts which drastically change the use to which we must put our resources. The central character of this change has been discussed fully in other sections of this Review. We must strive even harder to lift total production, although we must drastically alter its composition. But since so large a part of this total production will be absorbed in the primary defense effort, the level of consumption, during the next few years at least, cannot rise as in normal peacetime and may have to move downward. Cutbacks in some types of investment must be sufficiently drastic to permit expansion essential to the defense effort to move forward even faster.

What do these new facts mean for profit policy? They indicate that the current general level of profits, which is much higher than the rewarding level in early 1950, can be reduced further through taxation without impairing the initiative or types of investment which are now urgently needed. This is demonstrated more comprehensively in other parts of this Review, including the discussion of tax policy. A further reason for compressing profits after taxes below the unprecedented high levels which they have now attained is that, unless this is done, it will be futile to attempt to achieve wage stabilization. We cannot afford a soft tax policy, in order to take care of the exceptional instances where further incentives may be needed to stimulate some types of business investment. These isolated instances should be taken care of by selective policies, such as tax amortization, selective price allowances, or financial aid.

These conclusions about profits have an important bearing upon price policy under current and foreseeable circumstances. Every argument which was advanced a year ago against increases in the general price level applies with multiple force now. The price level is already much higher than a year ago, and inflationary forces are mounting. Further price in-

creases in general can serve no economic function, and if these increases go much further they will do irreparable damage. There is no proposition of economics on which there is more general agreement than this. Consequently, the imposition of price controls having been initiated, this activity should move forward with speed and decisiveness. It should seek, as rapidly as possible, along with other controls both indirect and direct, to achieve and maintain general price stability. Clearly, the determination of the items on which price controls should next be imposed, or in what order, or to what exact scope, is an operational function for the Economic Stabilization Agency, subject to the general direction of the Office of Defense Mobilization.

Drastic action on the price front—and it should be drastic—does not mean the use of only one technique of price control as has been urged in some quarters. We must be flexible in the use of pricing methods. The pricing techniques, whether of the freeze, “dollars-and-cents”, or margin control variety, must be skillfully and closely attuned to the peculiarities of individual industries, labor markets, and distributive levels. It is necessary to deal with wide differences among profit and cost conditions. It is necessary to encompass a vast variety of commodities, some standardized and others highly differentiated.

Any nation-wide program must sacrifice some desirable refinements in the interest of speed, uniformity, administrative feasibility, and public acceptance. In fact, more stress should be placed upon these latter considerations than upon the minutiae of differential treatment, because it is more important to put brakes upon inflation than to get a perfect system of controls. Nonetheless, discretion and discriminating judgment must be exercised, lest the objective of effective price control cut across other equally important objectives. The most important of these other objectives is to maintain maximum production, and this requires, among other things, some flexibility in dealing with specific prices.

The prices of speculative farm products, such as cotton, wheat, and soybeans are affected substantially by trading in futures contracts on the commodity exchanges. In an inflationary period, excessive speculation in farm commodities would make price stabilization difficult, if not impossible. One of the most effective ways of limiting speculative trading, without hindering legitimate hedging operations, is by regulating the minimum margins required for speculative deals. No Government agency now has authority to require adequate margins for this purpose. Such authority should be granted by the Congress without delay.

The experience of World War II revealed clearly that price controls, particularly in the case of low-priced lines and commodities subject to frequent changes in style and model, must be reinforced by and meshed with production and distribution controls. Since we will be diverting nearly one-fifth of our production to the defense effort, it becomes all the more necessary to ensure that resources available for civilian output are devoted

to the most urgent civilian needs at least cost. With the imposition of controls to prevent an inflationary price spiral, we must recognize that a price structure geared to peacetime patterns of demand cannot be expected to bring about the pattern of output necessary to an advanced defense economy. While price and wage controls must be operated in such a manner as to provide adequate incentives to maintain maximum output, they cannot, except in rare cases, be used to determine the composition of output. Such a task is not administratively feasible. It is more simply and properly the task of the appropriate production controls.

In view of the particularly inflationary price performance of many of the scarce raw materials in international trade, and because of the inability of the United States to cope with this problem unilaterally by means of simple domestic price controls, every effort should be made to hasten the development of international agreements to allocate such materials and restrain their price movements. Meanwhile, the United States purchases of some commodities should be centralized in the hands of the Government, which, in turn, would resell them to domestic users. This has already been done in the case of rubber, and the immediate impact of this action has been a drop in its price.

The stabilization of wages, since it affects the very livelihood of millions of families, depends for its success upon three pivotal points. First, holding the line on wages depends basically upon holding the line on the cost of living. When a ceiling is placed upon prices in a particular industry, it follows that wages in that industry must take account of this price ceiling from the viewpoint of business costs and adequate profit margins. But the establishment of price ceilings in a particular industry is not a sufficient foundation for holding the line on wages in that industry, if the prices of things which workers must buy continue to rise. Efforts to achieve wage stabilization cannot await a complete or perfect stabilization of the cost of living, because no practical aspect of economic stabilization can be delayed until some other aspect of the problem is completely solved. Nonetheless, success in holding the line on wages cannot be expected without practical success in holding the line on the cost of living. This requires vigorous action on the price front, on the tax front, and on all fronts designed to achieve price stability both by indirect and direct controls. It requires much tighter rent control, reinforced by adequate legislation for that purpose, because rent is so large an item in the cost of living of middle income and low income families.

The second requisite for successful wage stabilization is a rounded program of economic stabilization which recognizes that excessive purchasing power must be restrained in all major sectors in the economy, and that the imposition of sacrifices must be equitable. The Council feels that its recommendations with respect to corporate and other taxes, with respect to price controls, and with respect to other types of restraints, provide a fair guide to the achievement of this balanced stabilization program through legislative

and administrative action. Wage earners are an important segment of the income-earning population; but there are other important segments—office workers, professional people, farmers, and business groups. Each will be willing to do more in support of the defense program, if all are doing their share. Much toward this end has already been accomplished.

A third consideration in effective wage stabilization is that there be consultation between Government and representatives of workers both in the formulation of policy and with regard to its execution. The Council has frequently expressed the high value which it places upon such conferences.

With these three pivotal points as a foundation, the economic objective of wage stabilization should be to prevent the total of all wages available for spending from rising greatly, during a period when the availability of goods for consumption cannot rise and, on a per capita basis, is likely to fall.

There are factors which will make it extremely difficult to achieve the objective of holding total wages available for spending in line with the availability of consumer goods. The obstacles are fairly obvious. In the first place, the great numbers of new workers called for by the defense effort, and the longer hours, will result in more total wage earnings even without any increase in wage rates. In the second place, there will be a few instances where some wages must be raised to facilitate the recruitment of workers for defense production, by modifying some of the wage differentials which now exist. In the third place, there is the problem of ensuring that some incentives exist, particularly to effectuate shifts toward defense production. It may not be possible to achieve completely the objective of holding wages available for spending in line with the availability of consumer goods, but every effort should be made to get as close to it as feasible. Doubtful questions should be resolved in favor of stabilization.

In seeking to achieve this objective of wage stabilization as rapidly as possible, two of the most difficult problems involve "cost of living" adjustments and "productivity" or other adjustments designed to provide incentive for increased effort. The principal adjustments to cover increases in the cost of living can not be entirely set aside, for to do so would make a particular sector of the population liable for any inability of the Government to hold the line on the most important front of all. The gaps have not yet been closed in the defense line against increases in the cost of living; and if these increases continued at a fast pace, the buying power of workers would decline relative to the available supply of the consumer goods, instead of tending to maintain a constant relationship to it. On the other hand, only a small percentage of middle income and low income families in United States are now protected by "cost of living" adjustments; and to afford full protection to one group alone would be at the expense of others and would not represent equality of sacrifice. There is no hard and fast rule which can be applied to this problem. Insofar as the Government is successful in holding the line on the cost of living, the problem reduces itself to nominal proportions. So long as this effort is not successful,

it is practical to expect that adjustments will have to be made in many cases, but that the relation and speed of these adjustments should be restrained to avoid the spiral which results when prices and wages and costs start chasing each other.

The problem of wage increases to reflect increased effort, whether by "productivity" allowances or other methods arrived at by collective bargaining, is different from the "cost of living" adjustment problems. In ordinary times, as the foregoing discussion has indicated, such adjustments are a desirable way of passing along part of the benefits of increasing output. But during the defense emergency, over the next year or two at least, the defense program will be absorbing the increased output and it will not be available for civilian use. Under these circumstances, one approach to help to keep total wages available for spending as nearly as possible in line with the available supply of consumer goods, would be to restrain increases in wage rates. A second approach to this same objective would be to permit some increases in these wage rates, in return for increased productive results, but to prevent these increases from finding their way into the spending stream, by means of higher taxes, or larger social security deductions. Each of these two approaches has points of desirability. The first makes for more uniformity, the second for more flexibility. From the viewpoint of a smooth wage controls operation, and the promotion of harmonious industrial relations, one approach will work better in some instances and the other approach will work better in other instances. The second approach, to a degree, furnishes an incentive factor which might prove valuable for the long-sustained effort which we must now make to increase production and to work harder and longer. This incentive factor, as applied to the individual, may prove very important. In view of all these considerations, perhaps some combination of the two approaches discussed in this paragraph may prove necessary. In addition, labor can help in the stabilization effort by encouraging the purchase of bonds, as one of the means by which excess purchasing power can be kept away from the markets for goods.

In the case of wages even more than prices, some flexibility must be maintained. Some wage adjustments may become necessary to correct clear inequities among rates for comparable work; to allow for legitimate job reclassifications within given firms; to correct "substandards" of living; and, in certain instances, to assist in the recruitment of scarce labor skills urgently needed by defense industries. But these adjustments should be carefully screened and held to a minimum. Otherwise, they will cumulate the pressures which at best will make it very hard to hold average wage receipts in line with the availability of goods or to prevent the total volume of wages (including those paid to new workers and for longer hours) from rising dangerously above the availability of goods.

From the time the OPA issued its first formal price schedule until the institution of general price controls in April 1942, fourteen months elapsed

and the agency had developed an organization of 20,000 employees. Authority to stabilize wages was not granted for still another six months. This time, whatever the ultimate goal, the pace of action should be much more rapid. The Economic Stabilization Agency has power to put ceilings on wages as well as prices. It is already moving to hold basic industrial prices, to control selectively the prices and wages of some products; and to develop general price and wage standards to serve as a framework for price and wage policy and to identify the areas where controls become urgent because these standards are violated. The Agency should strive to accelerate action, in view of the inflationary potential now so clearly apparent, and in view of the fact that control action anticipated but not made effective in itself stimulates speculative inflation.

#### INTERNATIONAL ECONOMIC POLICY

In framing the economic programs to build up our national strength, we must bear in mind that this strength is bound up with that of other free nations, immediately as well as in the long run. The requirements of defense call for the adoption of some new economic programs in the international field, for changes of emphasis in some of our present ones, and for close coordination of our international and our domestic economic programs. Certain broad principles imposed by these requirements can be stated at the present time.

##### *Economic aid to foreign countries*

With our economic resources strained by the burden of defense, every use of these resources implies the sacrifice of some alternative use. Under these conditions, our foreign as well as our domestic programs must be designed so that they are effective and efficient in furthering the purposes which now have highest priority. In determining what we can afford by way of aid to other countries, we must take into account that such aid limits the expansion of goods available for domestic use. Against this consideration, we must balance the contribution that aid to friendly countries will make in sustaining or increasing our joint strength, taking into account the combined military, political, and economic aspects of our security interests.

The fact that our economy is operating under forced draft means not only that foreign aid programs must be screened to serve high priority purposes; they must all be under continuous survey to see that such purposes are carried out, and that the programs are adjusted to changing conditions.

Aid to Western Europe should be related to the high priority requirement for a rapid rebuilding of common defensive strength. This calls for the fullest possible use of resources outside as well as inside the United States. In Western Europe is to be found the largest industrial potential in the world outside the United States, and a skilled labor force exceeding in number either our own or that of the Soviet Union. It would be a formidable asset in the hands of a potential enemy. Western Europe

can and should provide the major part of the resources for its own rearmament. In some countries, notably Germany and Italy, the labor force and plant capacity are not being fully utilized; production can be expanded by placement of orders, if adequate raw materials and certain needed ancillary facilities are made available. Hours of work and participation in the labor force will have to be increased in Western Europe, as they will in the United States. But resources needed for defense production will also have to be provided in Western European countries, as in the United States, by restricting both consumption and normal improvement of the capital stock.

Even this will not provide enough labor, material, and plant capacity. In order to obtain the most rapid possible build-up of defensive strength, we, with a much larger industrial potential in relation to population, shall have to provide large amounts of military equipment and supplies to our North Atlantic Treaty partners.

Achievement of the necessary defensive strength in Western Europe will also require provision of economic aid. Although most of these countries had been making substantial progress toward self-support, indicating that their resources were becoming more nearly adequate to the demands being made upon them at that time, these demands are now being much increased. Their own rearmament will greatly intensify the pressure on their economic resources. The rise in the prices of their raw material imports, more rapid than that of their export prices, has already increased the volume of exports required to pay for a given quantity of imports. This has put some additional pressure on their resources. The full impact of this rise has probably not yet been felt. More important, the increase in their armed forces and in their own armament production will reduce the resources available to produce goods for export, and for their own consumption and investment. Economic aid for recovery purposes, the need for which has been declining rapidly, must give way to aid needed to support a strengthening of the common defenses.

The degree to which our aid takes a military or nonmilitary form does not indicate its essentiality to the defense effort. If one country can produce military goods most efficiently, the most economic use of common resources may make it desirable for that country to produce more of these goods than its own military establishment requires. If this forces it to cut its production of civilian goods below its requirements, a larger proportion of the aid it requires may take a nonmilitary form. Similarly, one country may make its greatest contribution in the form of manpower for the common armed forces, and, as a result, have to cut its civilian production. Provided that a country is making its maximum contribution to production and to curtailing nonessential use of civilian goods, such aid as it may require in making this contribution is essential to the common defense effort, whether it takes a military or economic form.

In reappraising foreign aid programs and shifting their emphasis, we must continue to recognize that Soviet-dominated aggression is neither solely military nor of short-run character. Some parts of the world are threatened by Communist penetration but are not subject to direct military threat. In many areas where there is a direct military threat, this threat exists or is particularly dangerous because political, social, and economic conditions provide a fertile soil for penetration of Soviet-Communist ideology. In some of these cases, well-designed assistance in expanding production, even of goods unrelated to military strength, can contribute to the essential aspects of common security.

The productivity of some of the underdeveloped countries is also an important element in the defense of the free world. Not only do these areas produce the raw materials upon which essential production in the United States and other industrial countries depends; in addition, they must be able to provide for the essential needs of their peoples if they are to be kept free from Communist domination. While there is a great production potential in these countries, the difficulties are primarily inefficient techniques of production, inadequate capital to develop the resources, and in many cases institutional obstacles. The large contribution which many of these countries can nevertheless make to the common strength must be fully taken into account. Increased demand for their products has already substantially improved their financial position and their ability to contribute. Present plans to help them increase their productive capacity are based on a recognition that such increases contribute to our national security, both directly and indirectly, by improving the economic strength of these countries and reducing their vulnerability to subversion.

But the common danger and the greatly increased strain on our own resources call for reappraising and, if necessary, altering the character and time focus of such programs. Greater emphasis must be put on production of raw materials which will be scarce in relation to important demands. Increased production of food in these countries would reduce the drain on the United States. It will also be necessary to shift emphasis to programs which produce results quickly.

Expansion of productive capacity calls for private capital investment, and public investment by the Export-Import Bank and the International Bank for Reconstruction and Development. Grants for technical assistance and, in some critical areas, capital development will be necessary. Despite present international tensions, measures to facilitate private investment can still be effective in certain areas and are particularly needed to expand raw material production. It is desirable to enact legislation authorizing guarantees to private capital against certain risks peculiar to foreign investment, and to continue efforts to negotiate investment treaties.

A carefully selective expansion of public investment is also required to support the security effort. The burden of lending to develop production, especially where security interests primarily of the United States are in-

volved, requires the Export-Import Bank to play an active role. The Bank's uncommitted lending authority is now only about 500 million dollars. This seriously restricts it. Its lending authority should be raised by 1 billion dollars, from the present 3.5 billion dollars to 4.5 billion.

### *Control of commodities in world trade*

Even vigorous efforts to expand foreign and domestic production of the major raw materials cannot achieve results in time to prevent some important cases of severe shortages, sharp price rises, and maldistribution of supplies. For some commodities, these effects have already occurred. In a few cases, greatly increased United States demand or, as in cotton, reduced supply, has in fact threatened to cut essential production abroad. International collaboration is needed to improve the distribution of important products in acutely short supply, so that nonessential uses in some countries do not deprive essential uses in others. The major concrete problems are to identify the commodities requiring such collaboration, to work out the policies which should govern their distribution, and to work out and put into effect the mechanisms best suited for the purpose, both internationally and within the countries affected.

It will become increasingly necessary to control the export of materials in short supply in the United States which are necessary to our defense program, and to direct exports of some commodities to countries where they are most urgently needed. For these reasons, as well as for obvious security reasons, the power to control exports, which is scheduled to expire on June 30, 1951, should be extended.

In view of emergency shortages of raw materials, and to implement international arrangements for their distribution, the power to control imports, which also expires on June 30, 1951, needs to be extended.

It will also become increasingly urgent to secure close coordination between the day-to-day operation of domestic and of international commodity control programs. Where there is excess demand for commodities which we import or export, we must limit domestic use, not only to avoid taking more than our agreed-upon share of world imports, but also to assure that goods are available for necessary exports. Fiscal and credit policies can help by restraining demand for the final products which use the particular raw materials. For example, controls which cut the demand for automobiles also indirectly cut the demand for rubber. But such measures probably cannot suffice; international allocation of a commodity implies domestic priority or allocation as well. The administration of these domestic controls must take into account the needs of other countries, not only for goods used in defense production, but also for essential civilian goods and services.

Fiscal, credit, and allocation measures will exert some restraining influence upon prices of the major commodities in world trade. But this influence is likely to be limited. Violent price rises in these commodities create balance of payments difficulties in the importing countries and, through

their effects upon costs, reinforce existing inflationary pressures. For the exporting countries, they raise real incomes but may also introduce a considerable element of inflation and lay the basis for future dislocations. The advisability of attempting to control them by international action depends on the extent to which the higher prices elicit increased production, which depends largely on the technical conditions of production for the particular commodity and on how long the price increase is expected to last. In general, it seems desirable to place primary emphasis on vigorous measures to reduce or eliminate nonessential uses.

### *Commercial and financial policies*

With the virtual certainty of widespread labor and material shortages for an indefinite period, we must use all methods of increasing our available supplies which do not prevent friendly countries from satisfying their own needs. Commercial and financial practices which divert demand from foreign to United States production put pressure on our resources; their relaxation can help to counter inflationary pressures.

First, various statutes require, with certain exceptions, that the Federal Government, and State and local government authorities receiving Federal funds, buy only goods manufactured or mined in the United States or produced from domestic materials. The defense effort generally, and especially the stockpile program, will require increasing Government purchases of imported materials. Such purchases will, in addition, relieve shortages and inflationary pressures in this country. The Congress has just given the President emergency and temporary power to authorize Federal procurement in connection with national defense without regard to these and other restrictive provisions of existing law, when such procurement is in the interest of national defense. Under these new powers, the fullest possible use should be made of foreign as well as domestic sources of commodities needed for defense purposes, including stockpiling.

Second, the diminishing availability of goods in this country makes more desirable a reduction of tariff barriers. Despite duty reductions under reciprocal trade agreements, many United States imports are still subject to high duties. For reasons which have often been explained, our long- as well as short-run policies require that we extend the Trade Agreements Act, which expires on June 12, 1951, and that customs procedures, which now also impede the entry of foreign supplies, be simplified by enacting the proposed Customs Simplification Act. But further action is desirable in the present inflationary situation. It would be desirable to enact temporary legislation, authorizing the President to make unilateral reductions or suspensions of tariff duties and import restrictions on commodities in short supply, as long as emergency conditions exist. This is desirable, not only in connection with materials for further processing, such as copper, but may also be desirable in connection with finished commodities.

Third, we place an additional strain upon our resources, and add to domestic inflationary pressures, when we require that Government loans or grants to foreign countries be spent on goods produced in the United States. Such aid is generally intended to supplement the recipient country's total economic resources, not to promote United States exports. If the recipient can obtain the particular commodities it needs more cheaply from another source, it should in general be left free to do so. Until recently, it was probable that the "tying" of loans or grants affected primarily the composition rather than the total amount of United States exports; if the recipient of dollar assistance did not spend the proceeds in the United States, the country in which it did spend the dollars would probably do so. Even under these conditions, there would be good reasons why it should be our general policy not to tie our aid to our exports. Now, however, it is probable that a smaller portion of aid spent in foreign countries would be re-spent here. A general policy of not tying dollar aid to United States goods would, therefore, help ease the inflationary strain of exports on our economy. At the same time, it would give other countries a greater chance to earn dollars by exporting to the recipients of our aid. Since some of these countries may themselves be receiving aid from us, this policy may reduce their need for such aid. These principles were recognized in the Mutual Defense Assistance Act, which provided that United States military assistance for foreign countries may be used to obtain equipment, materials, and services from any source.

In general, all measures to reduce artificial barriers to imports and artificial stimuli to exports tend to ease inflationary pressures in this country. Present circumstances offer the opportunity for taking these measures with little, if any, disturbance to related domestic industries, and with maximum benefit to the American public as a whole.

## Part V. Details of Economic Trends in 1950

### EMPLOYMENT AND PRODUCTION

#### *Employment*

**D**URING the past year, there have been significant labor market changes. The civilian labor force averaged 63.1 million in 1950, compared with 62.1 in 1949. For the year as a whole, almost 60.0 million persons were employed in civilian occupations, or about 1.3 million more than in 1949 and 0.6 million above the average of 59.4 in 1948. Non-farm employment increased by 1.8 million. Farm employment decreased by about 500,000; part of this decline may be attributable to the availability of better paying jobs in industry, which tended to attract workers away from the farm. Unemployment averaged 250,000 less than in 1949. (See chart 19.)

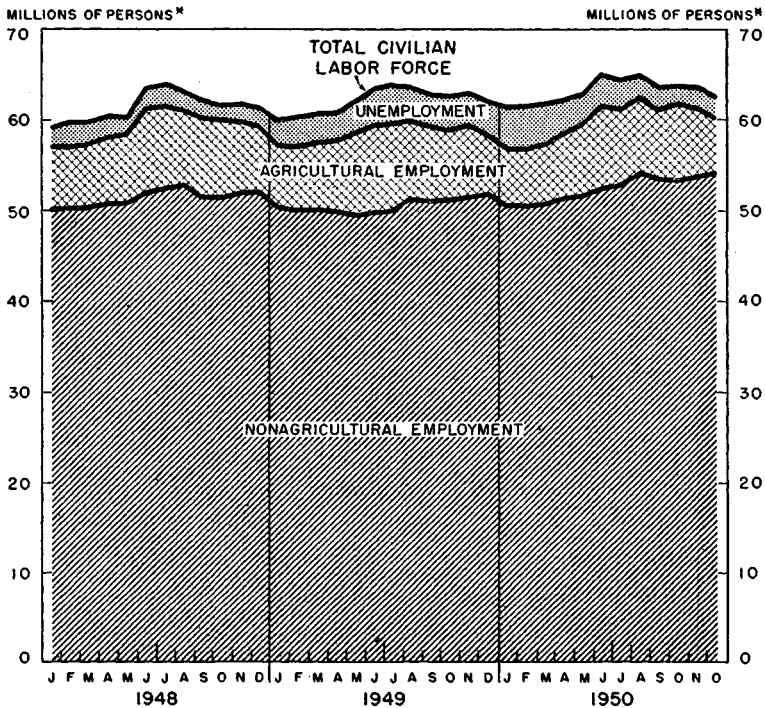
From 56.9 million in January 1950, with seasonal activity at a low point, civilian employment increased rapidly to an all-time high of 62.4 million in the summer. It then declined seasonally to 61.1 million in the fourth quarter, or about 2.1 million above the average in the fourth quarter of 1949. During the first half of 1950, this steady increase in the number of people at work reflected the growing momentum of economic recovery. Employment was given an additional push in the third quarter, when the outbreak in Korea led to anticipatory buying of consumer durables, when expenditures for expansion of plant and equipment increased, and when manufacturers began to build up their work forces.

Average manufacturing employment in 1950 exceeded that in 1949 by about 700,000, with the largest gains in establishments manufacturing durable goods. In November 1950, 15.7 million persons were engaged in manufacturing, compared with 13.8 million in November 1949. Between June and November, 683,000 employees were added to the payrolls of durable goods establishments. The most important rises came in electrical and nonelectrical machinery, primary and fabricated metals, instruments, and aircraft. As a result, employment in durable goods manufacturing reached 8.6 million, climbing above the high level of 8.4 million in November 1948. There was also a significant increase in employment in nondurable industries, with the November 1950 figure at 7.1 million, compared with 6.8 a year earlier. Employment in nondurable manufacturing increased by 358,000 between June and November. Employment in the production of textiles, apparel, and foods

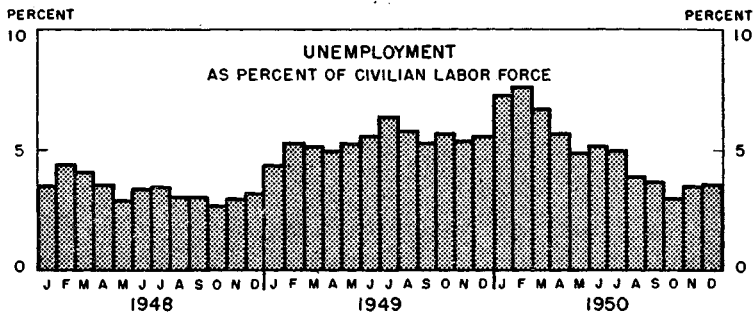
CHART 19

## CIVILIAN LABOR FORCE

Civilian employment averaged 60.0 million persons in 1950, 1.3 million higher than in 1949. The increase was entirely in the nonagricultural segment of the economy, agricultural employment dropping about a half million.



During 1950, unemployment averaged about 250,000 less than in 1949. There was a striking improvement during the year. The December level of 2.2 million, or 3.6 percent of the civilian labor force, was more than a million below December a year ago, when 5.6 percent of the labor force was unemployed.



\*14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF COMMERCE.

expanded seasonally; chemicals, paper, and rubber products made significant gains. Compared with November 1949, important gains in employment also appeared in contract construction, where there was a rise of about 290,000; in trade, where there was a gain of about 270,000; and in the Federal Government, where a pronounced upturn in employment toward the end of the year reflected the impact of the defense program.

The general tightening which took place in the labor market is shown by the change in labor market classifications between late 1949 and 1950. In November 1949, out of 139 major labor market areas surveyed, only five were classified as having a tight or balanced labor supply (under 3 percent unemployed). By November 1950, out of 152 areas, 56 had been given this classification. In addition to this general tightening in the labor market areas, serious shortages of certain skills had developed by the end of the year in some parts of the country. In addition, nationwide shortages have emerged of certain professional workers who are of prime importance to the defense effort. This is particularly noticeable in the science and engineering professions.

### *Unemployment*

The general economic recovery during the first half of 1950, and inflationary pressures in the second half, were mirrored in a marked improvement in the unemployment situation. Beginning with March, the number of unemployed persons decreased almost steadily and more than seasonally, until in October unemployment was down to 1.9 million. The December figure of 2.2 million unemployed is more than a million below a year ago. The average number of persons unemployed for the year 1950 as a whole was only about 250,000 less than for 1949. (See chart 19.)

At the end of the year 1950, 3.6 percent of the civilian labor force was unemployed. Such a small percentage of unemployment indicates that we are nearing what is ordinarily considered to be the minimum for a peacetime economy. It is not irreducible, however, and the employment of more persons now unemployed can help to meet pressing needs for a larger number of workers and greater production. Production may also be increased by a fuller utilization of the 1.1 million persons who at the end of the year were working part-time, but who were able and willing to accept full-time jobs. (See appendix tables A-11 and A-12 for further statistics of employment and unemployment.)

### *Production*

Last January, the Council stated that to achieve maximum employment it would be necessary to increase total production of goods and services by about 7 percent over 1949. As a result of the strong demand following the Korean outbreak, the economy actually produced 7 percent more goods and services in the year 1950 than during 1949, and by the fourth quarter had reached an annual rate 10 percent higher than for the year 1949.

These measurements of production of goods and services are based on gross national product adjusted for price changes. (See appendix tables A-1, A-9, and A-10.)

*Production of goods.* Total physical production of goods during 1950 was 11 percent above 1949, and reached a record high for any peacetime year, according to the physical production index which includes agricultural and nonagricultural production. Comparison with war years is difficult, but apparently the 1950 output was close to the record reached in World War II. (See appendix table A-16.)

Total agricultural output in 1950 was 2 percent below 1949, and 3 percent below 1948. Although the production of farm crops in 1950 was the fourth largest on record, it was  $4\frac{1}{2}$  percent below 1949, due mainly to a large drop in the output of cotton. The drop in crop production was partly offset by an increase of 2 percent in the output of livestock products. Per capita food consumption in 1951 is likely to be about 3 percent higher than last year.

Industrial production recovered early in 1950 from the 1949 drop and continued to increase throughout most of the year. For the year as a whole, the industrial production index was about 200 percent of the 1935-39 average. This represented an increase of 14 percent above 1949, and more than 4 percent above 1948. (See chart 20 and appendix table A-17.)

Gains in output occurred during 1950 in most industries. The output of durables at the end of the year was 31 percent above that of a year earlier. Steel production was about 96.5 million tons, almost 25 percent more than in 1949, and an all-time record. The automobile industry produced at a record rate during most of the year, turning out 8 million cars and trucks for the year as a whole. Production was hampered by work stoppages early in the year, but reached a peak in June.

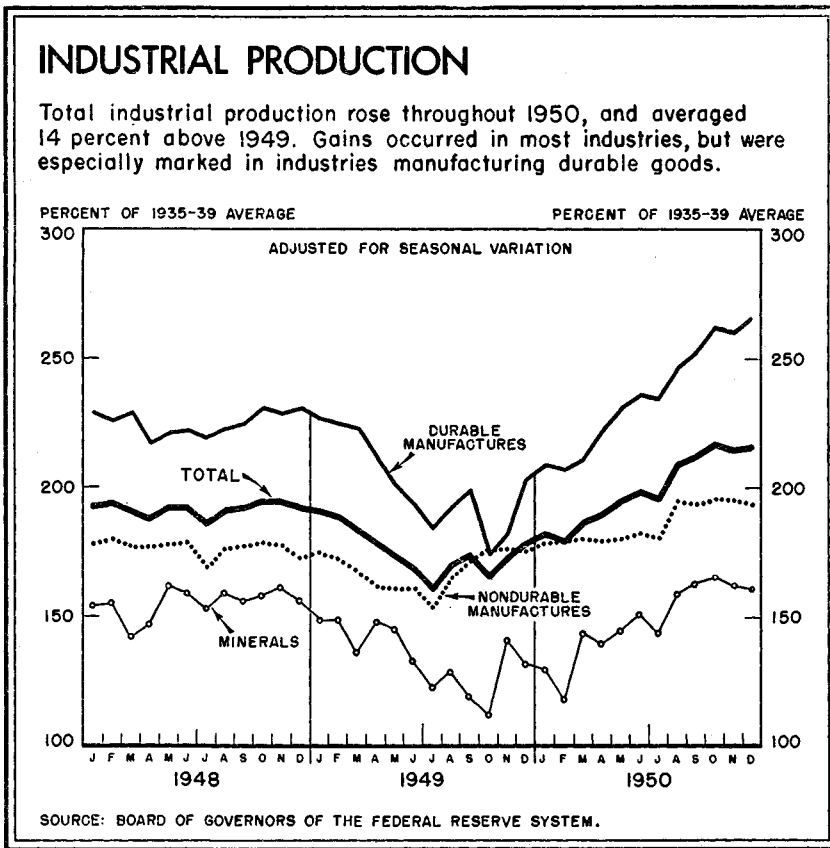
Production of such consumer durable goods as household appliances, radios, and television sets leveled off toward the end of the year, after increasing sharply in earlier months.

As the defense program got under way in the second half, industries related to the defense program, such as machinery, aircraft, shipbuilding, and railroad equipment, increased their output.

Total production of nondurable goods for the year was about 11 percent above the 1949 level. The output of nondurable goods increased throughout the first three quarters of the year, reached a peak in the early part of the fourth quarter, and declined very slightly during the rest of the year.

Mineral production was hampered in the early part of 1950 by the work stoppage in the coal mining industry, but then moved up to a level above the highest prevailing rate during 1949. Bituminous coal stocks held by industrial consumers and retail dealers at the end of 1950 were estimated to be only 700,000 tons below the postwar peak reached a year and a half ago.

CHART 20



Higher output was also registered by several important industries which are not included in the industrial production index. Electric power output showed a steady expansion in the last half of the year, averaging about 13 percent above 1949 for the year as a whole.

In physical terms, construction reached an all-time peak during the third quarter of the year; for the year as a whole it was 17 percent over 1949.

*Production of services.* Detailed figures are not available to show changes in the output of most services. There was an increase of 4 percent in real (constant prices) personal expenditures for services from 1949 to 1950, suggesting a roughly similar change in the total output of services. (See appendix table A-10.)

### PRICES, WAGES, AND PROFITS

#### *Prices*

Commodity prices as a whole moved upward throughout 1950, but the pace of the advance, particularly in wholesale markets, picked up sharply after the outbreak of the Korean hostilities at midyear. The prices of

most commodities followed a rough pattern of moderate strength in the first half of 1950, followed by rapid increases in the second half, which brought most indexes to all-time highs.

The general upsurge of prices in the second half of the year was not regular. It developed in a series of partially overlapping waves, the first of which reached a crest and flattened out with the temporarily good news from Korea in September. Following the intervention of the Chinese in late November, price increases accelerated again.

The speed and force with which industrial prices responded to the new international dangers were exceptional when compared with most previous inflations. There was a good deal of price-raising by industries in anticipation of the announced expansion of the defense program and of price control.

*Wholesale prices.* In December 1950 wholesale prices were 10.9 percent above their level last June, and 15.4 percent higher than in December 1949. The all-commodity index exceeded the previous postwar 1948 peak for the first time in November 1950. Of the three major categories, farm products scored the greatest over-all gain during the year, but foods and industrial products did not lag very far behind, and all three groups recorded price increases of over 10 percent during the second half of the year. The timing of their movements differed. (See chart 3 on page 41, and table 2.)

The 4 percent rise in wholesale prices during the first six months of the year was mainly the result of increases in farm and food prices. Industrial prices rose 2.3 percent during the period in a slow but steady gain which reflected the major recovery of the domestic economy.

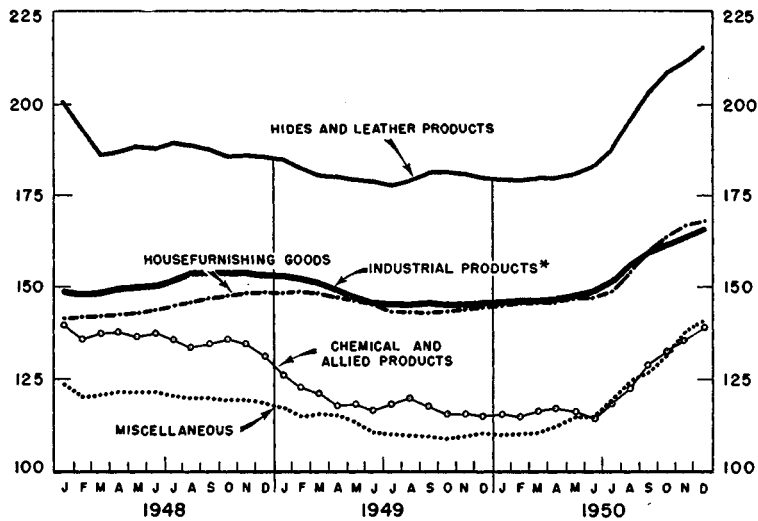
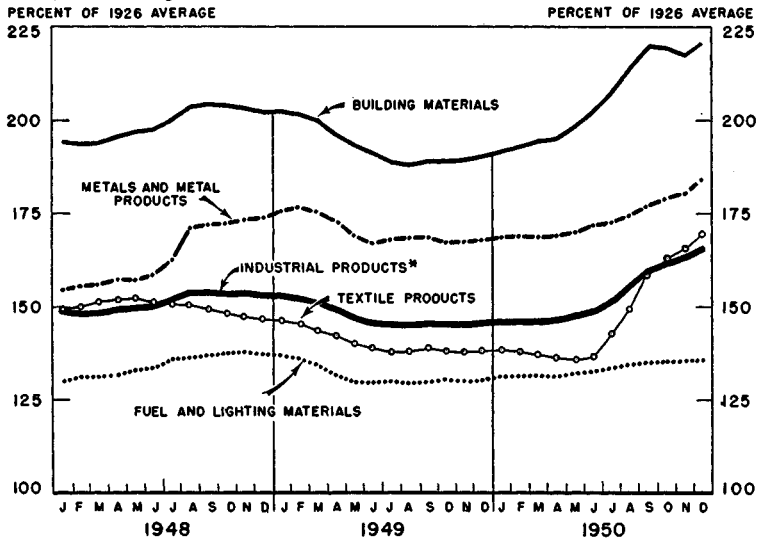
Immediately after the Korean outbreak, the monthly rate of increase in wholesale industrial prices, which had averaged less than one-half percent during the first half-year, increased almost five-fold. The rate of increase averaged more than 2 percent per month during the third quarter, and much less during October and November. Following the China attack, the rate of increase immediately accelerated.

The swiftness of the response of manufacturers' and other industrial pricing to the Korean situation exceeded what might have been expected from past experience. It was not confined to a few industries. By mid-October, at the end of the "first wave," the prices of over 75 percent of the industrial commodities in the BLS weekly wholesale price index had increased; 44 percent had risen 10 percent or more, and 26 percent were up 20 percent or more over their pre-Korean levels. These increases, in a great many cases, were not forced by cost increases already incurred. In part, they were a reflection of the enormous wave of consumer buying and of business orders in the third quarter. And in considerable measure, no doubt, they represented efforts to jockey into a favorable position in the event a price freeze were ordered.

The rise in industrial prices during the second half of 1950, while notable for its generality, was by no means uniform among industrial groups. Textiles, recording the largest increase, rose 24 percent; chemicals and

# WHOLESALE PRICES OF INDUSTRIAL PRODUCTS

Industrial prices, which were comparatively stable in the 1st half of 1950, rose with exceptional vigor in response to the Korean outbreak. All major groups advanced substantially, and most groups reached new postwar highs.



\* ALL COMMODITIES OTHER THAN FARM PRODUCTS AND FOODS.

SOURCE: DEPARTMENT OF LABDR.

allied products 21.5 percent; and metal and metal products 7.1 percent. Prices of building materials reached a peak in September, receded in October and November because of a sharp drop in some lumber prices, and then moved to an all-time high in December. (See chart 21.)

The inflation was marked, moreover, by the violent gyrations in the generally upward course of prices of imported raw materials directly demanded for defense production. Tin, natural rubber, and wool were the notable instances. Such prices were particularly sensitive to the military news from Korea. In the case of rubber, the institution of centralized purchasing late in December resulted in a substantial drop in prices.

For a few weeks immediately after the Korean outbreak, there was a precipitous upshoot in wholesale farm and food prices. Thereafter, farm prices moved unevenly before beginning to rise again in late October, and wholesale foods roughly paralleled their course. Livestock and meats were the principal moderating factors in the agricultural sector, reaching their post-Korean highs in the last week of August and thereafter entering a seasonal decline as hog prices dropped sharply. By late November, prices of these products began to rise again. Other farm prices were much more buoyant during the last four months of the year, with cotton, as a result of a short supply and the sudden expansion in domestic and export demand, reaching all-time highs. Currently, beef cattle, veal calves, lambs, rice, wool, cotton, and cottonseed are the major farm commodities selling at prices above the minimum permissible ceilings provided for in the Defense Production Act. (Further details on wholesale prices may be found in appendix table A-24. Prices received and paid by farmers are shown in appendix table A-25.)

TABLE 2.—Changes in wholesale prices

Commodity group	Percentage change			
	December 1949 to June 1950	June 1950 to December 1950	December 1949 to December 1950	Pre-Korean peak to December 1950
All commodities.....	+4.0	+10.9	+15.4	+2.8
Farm products.....	+7.1	+12.9	+20.9	-6.0
Foods.....	+4.1	+10.4	+14.9	-5.8
Other than farm products and foods.....	+2.3	+11.5	+14.1	+8.0
Hides and leather products.....	+1.5	+18.2	+20.0	+6.1
Textile products.....	-1.2	+24.0	+22.6	+12.5
Fuel and lighting materials.....	+1.8	+2.2	+4.0	-1.5
Metals and metal products.....	+2.4	+7.1	+9.7	+4.8
Building materials.....	+6.1	+8.9	+15.5	+7.8
Chemicals and allied products.....	-7.7	+21.5	+20.7	+2
Housefurnishing goods.....	+1.9	+14.3	+16.4	+13.1
Miscellaneous.....	+3.6	+22.5	+26.9	+13.7
Special groups:				
Raw materials.....	+5.1	+10.0	+15.6	+1
Semimanufactured articles.....	+2.6	+16.6	+19.6	+7.3
Manufactured products.....	+3.7	+7.4	+11.4	+2

<sup>1</sup> November 1950 used.

Source: Department of Labor. (See appendix table A-24.)

*Consumers' prices.* The consumers' price index by November 1950 was 4.8 percent over December 1949, and 3.2 percent above the June 1950 level. It reached a record high in October, and continued to climb in the last two months of the year. Preliminary indications are that the index rose sharply in December. (See appendix table A-23.)

A sharp rise in retail food prices after April accounted for much of the over-all increase in consumers' prices in the first half-year, and continued to lead the index upward in July. Thereafter, however, because of a seasonal decline in fresh vegetable prices and, more importantly, because of some weakening of meat prices, the food component of the index leveled off for several months. The other components, particularly apparel and housefurnishings, supplied the principal upward force. Fuel and utility costs also rose substantially, and rents continued to edge higher. (See chart 22 and table 3.)

However, in the second half of November, food prices began to move up again sharply and by December 15 were 3.2 percent above the November level and 5.7 percent above the pre-Korean level. Particularly spectacular was the rise in egg prices which advanced 66 percent over the June level, accounting for more than half of the rise in retail food prices. Fats and oils, beverages, and dairy products also scored substantial gains. While complete data for December are not yet available, it should be noted that the estimated increase in retail food prices of 3.2 percent between November and December will alone raise the consumers' price index for December by about 1.4 percent above November. Since other retail prices have undoubtedly also advanced, the total increase in consumers' prices in December will be substantially above 1.4 percent. This indicates a rise of over 6 percent in consumers' prices during 1950, and of over 4½ percent during the second half of 1950.

TABLE 3.—Changes in consumers' prices

Item	Percentage change			
	December 1949 to * June 1950	June 1950 to November 1950	December 1949 to November 1950	Pre-Korean peak to November 1950
All items.....	+1.6	<sup>1</sup> +3.2	<sup>1</sup> +4.8	<sup>1</sup> +0.6
Food.....	+3.7	<sup>2</sup> +5.7	<sup>3</sup> +9.6	<sup>3</sup> -2
Apparel.....	-.4	+5.4	+5.0	-3.3
Rent.....	+1.4	+1.2	+2.6	+1.2
Fuel, electricity, and refrigeration.....	-.6	+3.5	+2.9	+1.6
Housefurnishings.....	-.1	+9.2	+9.1	+1.8
Miscellaneous.....	-.1	+3.3	+3.2	+3.2

<sup>1</sup> Incomplete data for December indicate a substantial further rise in that month.

<sup>2</sup> December 1950 used.

Source: Department of Labor. (See appendix table A-23.)

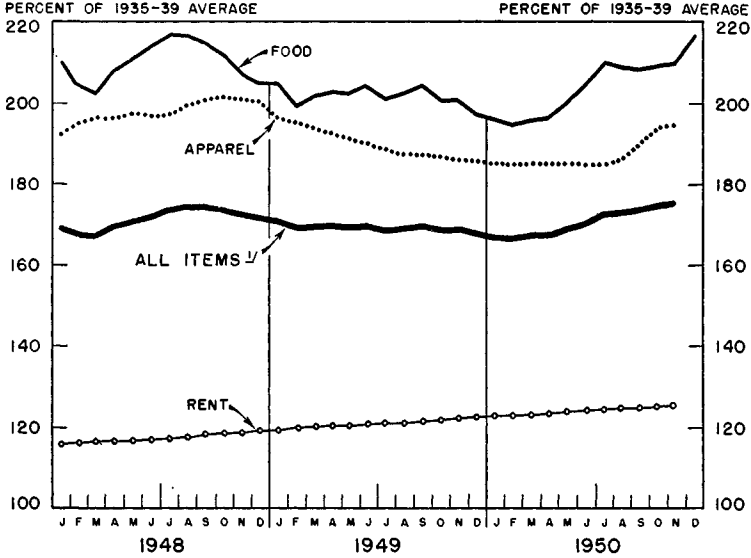
### Wages

Wages and salaries, which had remained relatively steady throughout 1949, rose continuously in 1950, as wage rate increases, longer weekly hours,

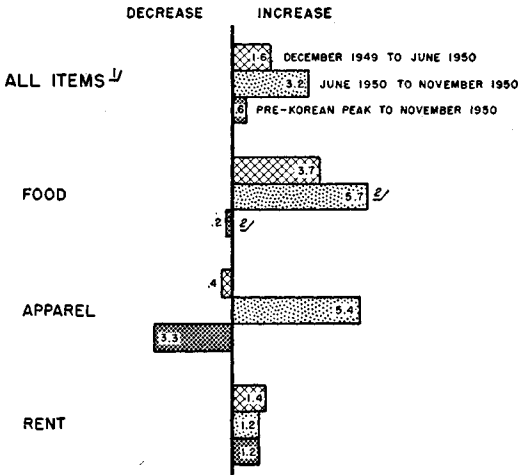
CHART 22

## CONSUMERS' PRICES

Consumers' prices reached new high levels in 1950. A sharp increase in food prices began in the 2nd quarter of the year, but the rise was not steady. Most other components were stable in the 1st half of the year but advanced steadily and rapidly in the 2nd half.



## PERCENTAGE CHANGES



<sup>1</sup>ALSO INCLUDES HOUSEFURNISHINGS, FUEL, ELECTRICITY, REFRIGERATION, AND MISCELLANEOUS GOODS AND SERVICES NOT SHOWN ON THIS CHART.

<sup>2</sup>PERCENTAGE CHANGE TO DECEMBER 1950.

SOURCE: DEPARTMENT OF LABOR.

and increased employment were reflected in workers' incomes. In the fourth quarter of 1949, aggregate wages and salaries and other labor income (see appendix table A-5) were at a seasonally adjusted annual rate of 134.6 billion dollars. By the fourth quarter of 1950, they had risen by over 21 billion, to a new high of 155.9 billion. About half of the increase during the year may be attributed to increased employment. The other half may be attributed to increased hours, higher wage rates, and increases in other labor income.

In November 1949, average hourly earnings in all manufacturing industries were \$1.392. By November 1950, they had risen about 12 cents, to a new high of \$1.510. The increase has been especially pronounced since August. In the durable goods manufacturing segment, there was an increase of about 13 cents between November 1949 and November 1950, compared with an increase of about 9 cents in nondurable goods manufacturing.

Average weekly earnings showed an even sharper increase, due largely to the increase in the length of the work week in many industries, with consequent overtime pay. Such earnings in all manufacturing were \$54.43 in November 1949, and by November 1950 they had risen to \$62.06. The increase in durable goods manufacturing was sharper than in nondurable goods; average weekly earnings in durable manufacturing increased by about \$9.50 during the period, while those in nondurable manufacturing increased by half this amount. Real weekly earnings in all manufacturing, measured by changes in the consumers' price index, rose by almost 10 percent between November 1949 and November 1950.

Average weekly hours in all manufacturing increased from 39.1 hours in November 1949 to 41.1 hours in November 1950, a gain of 2.0 hours. The upward trend was markedly greater in durable goods manufacturing, where the rise was 2.8 hours to 41.8 hours a week, than in nondurable goods manufacturing, where the rise was 0.9 hour to 40.2 hours a week. (Statistics on wages, hours of work, and earnings are shown in appendix tables A-13, A-14, and A-15.)

*Wage negotiations.* The pattern of wage negotiations and contract settlements during 1950 divided into two distinct parts. During the first half of the year, contract settlements were generally moderate by postwar standards, with emphasis on supplementary benefits. After September, a landslide movement developed for sizable wage increases, accompanied in some instances by fringe benefits.

During the first half of the year, contract settlements with general wage advances were made most frequently in nonmanufacturing industries, particularly in construction. The most important settlement was the renewal of the General Motors contract, with a provision for a five-year term with cost-of-living adjustments, "productivity" increases of 4 cents each year throughout the life of the contract, and a pension plan and increased social insurance benefits.

After the Korean development, pressures built up for wage increases as the labor market tightened, the cost of living began to increase, and profits reached new highs. Late in August and in September, a movement for rapid and sizable wage increases developed in the mass production industries, led by a round of wage increases in the automobile industry. Some of the wage increases were based in part on cost-of-living adjustments, within the terms of existing contracts. General Motors production workers, for example, received a 5 cents cost-of-living adjustment at the beginning of September, in consequence of the rise in the consumers' price index between April and July and another increase of 3 cents in December. In August, Chrysler employees were granted an increase of 10 cents an hour, without the formality of a wage reopening, and without a change in the terms of the three and a half month old contract. However, the contract was changed in December to include the General Motors wage arrangement, bringing an additional increase of one cent. On September 4, Ford and the UAW-CIO set aside a contract four months before a permissive reopening date to negotiate a new agreement with wage provisions similar to the General Motors arrangement, and with an immediate cost-of-living increase of eight cents an hour which was later raised to 11 cents. Other automobile companies quickly fell into line.

The wage-increase movement spread rapidly during the last four months of 1950, accelerated by the continued rise in the consumers' price index, and by expectations of wage and price controls. Most increases were granted in manufacturing industries. Through formal or voluntary wage reopenings, adjustments became widespread in meat packing, textiles, apparel, petroleum, rubber, glass, and the major metalworking industries (including basic steel, aluminum, aircraft, electrical machinery, and agricultural implements). A substantial number of workers in non-manufacturing industries (particularly maritime, telephone, and the railroad industries) also received wage increases. In addition, a large number of unorganized clerical and production workers have received wage increases since midyear 1950. Even when all of these groups are included, it is probable that somewhat less than half of the workers in private nonagricultural employment have participated in the wage adjustments which have been made since the Korean outbreak.

During the past few months, second adjustments were common which supplemented increases negotiated earlier in the year. Many of these second adjustments were prompted by a desire to revise agreements which were concluded before the Korean outbreak. In many cases, wage increases were granted by voluntary action on the part of employers, either by consenting to discuss wage matters with union representatives prior to formal wage reopening dates, or by offering increases prior to formal negotiations. This willingness of many employers to consider wage increases made it possible for so many organized workers to receive increases within such a short period of time.

During 1950, two devices to cover future adjustments under long-term contracts came into prominence: the first, cost-of-living escalator clauses which tie wage rates or cost-of-living allowances to changes in the BLS Consumers' Price Index; the second, stipulations regarding adjustments to be made in 1951 or later without reference to price developments. A large number of workers are covered by contracts which provide one or both arrangements. According to BLS estimates, about 1½ million organized workers are now covered by cost-of-living escalator clauses. Close to the same number, but not always the same workers, have been promised a specified increase or increases in 1951 or later. The combination of the two devices, commonly identified as the General Motors formula, appears in many contracts.

As a result of these developments, wage increases in the second half of 1950 have contributed materially to the underlying inflationary situation. In many instances, increases in wage rates have been followed by price increases. In other instances, price increases have encouraged demands for wage increases. Between the second and fourth quarters of 1950, the total increase in aggregate wages and salaries, which resulted from more employment, longer hours, higher wage rates, and other increases in labor income, amounted to almost 15 billion dollars.

### *Profits*

The year 1950 witnessed the largest total profits in American business history, reflecting record levels of sales and prices. (See chart 18 on page 105.) For 1950 as a whole, corporate book profits before taxes (not adjusted for inventory valuation) were 40.2 billion dollars, compared with 27.6 billion dollars in 1949, and 33.9 billion in 1948, the previous record year. (See appendix tables A-32 through A-36 for statistics on profits.)

The recovery movement in the first half of 1950 had, by the second quarter, already brought profits to new record levels and with the tremendous expansion in business during the second half of the year, profits rose to even higher levels. By the fourth quarter, corporate book profits were at an estimated annual rate of 48 billion dollars before taxes, compared with an annual rate of 27.6 billion in the fourth quarter of 1949, a rise of almost 75 percent. Prior to 1950, the previous peak was reached in the third quarter of 1948, with corporate book profits at an annual rate of 35.3 billion dollars.

Corporate book profits after taxes also reached new highs. (The tax liabilities reflect the higher income taxes already passed, including the effects of excess profits taxes.) In the fourth quarter of 1950, corporate book profits after taxes (not adjusted for inventory valuation) were running at an estimated annual rate of 24.5 billion dollars, compared with 16.9 billion dollars in the fourth quarter of 1949, and with the previous peak of 21.9 billion in the third quarter of 1948. Corporate book profits after

taxes in 1950 were 21.9 billion dollars, compared with 17.0 billion in 1949, and 20.9 billion in 1948. The 1950 profits after taxes represented about 5 percent on sales, and over 9½ percent on net worth, compared with under 4½ percent and 8 percent, respectively, in 1949.

Net income of nonagricultural unincorporated businesses and the professions (not adjusted for inventory valuation) also made new records. In the fourth quarter of 1950, it was running at an annual rate of 25.9 billion dollars before taxes, compared with 20.3 billion in the fourth quarter of 1949, a rise of 28 percent. For 1950 as a whole, net income of unincorporated business amounted to 24.7 billion dollars, compared with 20.3 billion in 1949. (See appendix table A-4.)

Net income of farm proprietors in the second half of 1950 increased in response to higher farm prices. By the fourth quarter of 1950, net income of farm proprietors before taxes was at an annual rate of 14.0 billion dollars, compared with 12.8 billion dollars in the fourth quarter of 1949. However, the fourth quarter level was about 25 percent below the postwar peak annual rate of 18.6 billion in the second quarter of 1948. For 1950 as a whole, net income of farm proprietors was 13 billion, slightly below the 1949 level.

Although profits rose generally throughout 1950, the rate of rise differed sharply among different industries. During the first half of 1950, and particularly in the second quarter of 1950, the increase in profits was most marked for manufacturers of durable goods. This reflected the relatively greater level of output and demand for these industries. During the second half of the year, the rise in profits was most marked for producers of non-durable goods, where prices rose relatively more than for the durable goods producers. But, during the third quarter, profits before taxes were higher than in the two previous quarters for every major manufacturing group.

In addition, the sharp rise in over-all profits was reflected in a striking improvement in the position of small firms. In the third quarter of 1950, the smallest manufacturing corporations, those with assets of less than 250,000 dollars, showed the largest relative improvement in their profits after taxes, compared with the corresponding quarter of 1949. However, on a before tax basis the return on net worth and on sales for these firms continued to be below that of the larger corporations. Particularly in the case of return on sales, the smallest firms in the third quarter earned 6 percent on sales before taxes, compared with 16 percent for those firms with assets of 100 million dollars and over. On an after tax basis, the smallest firms in the third quarter had a return on net worth somewhat above that for the larger firms, while their return on sales continued to be substantially below that for the larger firms.

TABLE 4.—*Corporate profits as a source of funds after allowing for changes in costs of replacing inventories*

[Billions of dollars, annual rates, seasonally adjusted]

Period	Corporate profits		Changes in costs of replacing inventories <sup>1</sup>	Net funds available from corporate profits after allowing for changes in costs of replacing inventories
	Before taxes	After taxes		
1946.....	23.5	13.9	5.2	8.7
1947.....	30.5	18.5	5.8	12.7
1948.....	33.9	20.9	2.0	18.9
1949.....	27.6	17.0	-2.2	19.2
1950 <sup>2</sup> .....	40.2	21.9	4.7	17.2
First half.....	33.3	19.7	1.6	18.1
Second half <sup>2</sup> .....	47.0	24.0	7.7	16.3

<sup>1</sup> Inventory valuation adjustment with sign reversed.

<sup>2</sup> Estimates based on incomplete data; by Council of Economic Advisers. Profits after taxes include an estimate for the effects of higher income taxes, including excess profits taxes.

Source: Department of Commerce (except as noted).

In appraising the availability of profits as a source of funds, account must be taken of the effects of changes in prices, particularly in the replacement costs of inventories. (See table 4.) In periods of rapid price increase such as 1950, more funds are needed to finance inventories even without any increase in the physical volume of stocks held. Such requirements reduce the availability of profits for such purposes as expansion of plant, dividends, the financing of accounts receivable, and the building-up of liquid assets.

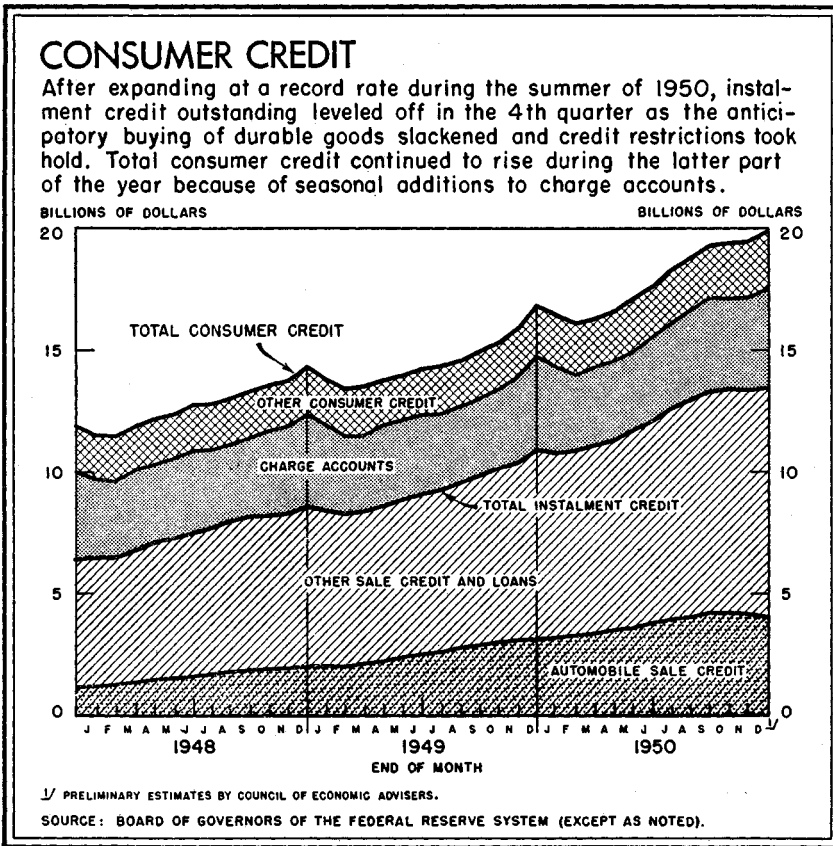
The net availability of funds from corporate profits after taxes, after allowing for the change in costs of replacing inventories was 17.2 billion dollars in 1950, about 10 percent below 1949, the previous peak. There was also a large use of bank credit, as well as considerable flotation of security issues, to finance the tremendous expansion in business activity. (See appendix table A-37 and "Corporate Finance" in the section on *Business Investment and Finance*.)

#### MONEY AND CREDIT

The expansion of outstanding public and private credit during 1950 reflected the speed, dimension, and directions of growth in the nation's output. The movement was almost entirely in business, consumer, and State and local government indebtedness. Several types of private credit increased with extraordinary rapidity, especially during the third quarter, and many reached new highs during the year. On the other hand, the gross Federal debt declined slightly.

The housing boom stepped up the growth in the outstanding volume of residential mortgage debt, from an annual rate of 11 percent in 1949 to 17

CHART 23



percent in 1950. Consumer instalment credit, which helped implement the strong demand for automobiles and other durables, increased 2.4 billion or 22 percent during the first nine months of 1950, compared to 1.3 billion or 15 percent during the same period of 1949. During the third quarter of 1950, when buying of consumer durables reached its peak, the instalment debt of consumers expanded almost as much as during the first three quarters of 1949. (See chart 23 and appendix table A-26.)

Total loans and investments of commercial banks expanded not much more in 1950 than in 1949, but there were marked differences in the movements of the various components. In 1949 the rise of 5.9 billion dollars, or 5.2 percent, in the earning assets of banks was mainly in holdings of Government securities and other investments, which increased 5.4 billion or 7.5 percent, while the increase in loans was but 0.5 billion or 1.2 percent. In contrast, the increase of 7.0 billion, or about 5.8 percent, in loans and investments of all banks during 1950 resulted entirely from new loans, chiefly to business. Loans to all classes of borrowers jumped nearly 10 billion dollars, or 22 percent, while investments in Government and private securi-

ties dropped about 2.7 billion or 3.5 percent. (See appendix table A-27.) Business loans of commercial banks, after a somewhat less than usual seasonal decline in the first half of the year, moved upward more than seasonally during the second half. These loans attained the record high of more than 22 billion in December, about 30 percent above the December 1949 total. During 1949 business loans outstanding had dropped nearly 10 percent.

Total bank deposits and currency held by individuals, business firms and State and local governments increased by about 6.4 billion dollars in 1950, the largest expansion since 1946, to reach an all-time high of more than 176 billion at the end of the year. Though some factors such as gold exports and a net drop in the ownership of Government securities by the banking system as a whole, tended to pull the volume of deposits and currency down, these factors were far more than counterbalanced by the growth of loans and by bank investments in State and private securities. (See table 5.) Adjusted demand deposits, which had increased only slightly between December 1948 and December 1949, declined 0.7 billion during the first half of 1950, partly because of seasonal tax payments. During the latter half of the year demand deposits climbed more than 7.0 billion dollars, principally because of loan expansion, to about 92 billion, which was more than 7 percent above the December 1949 level. During the first half of 1950 time deposits increased 1.1 billion, but they were drawn down 0.8 billion in the second half. The net increase in time deposits in 1950 was 0.3 billion compared with 1.1 billion in 1949. (See appendix table A-28.)

TABLE 5.—Factors changing the volume of deposits and currency

[Billions of dollars]

Factors	Changes in volume <sup>1</sup>						
	1948, total	1949			1950		
		Total	First half	Second half	Total <sup>2</sup>	First half	Second half <sup>2</sup>
Loans of commercial and mutual savings banks.....	+5.2	+1.4	-1.1	+2.5	+11.3	+2.5	+8.9
Securities of U. S. Government held by banking system <sup>3</sup> .....	-6.0	-.2	-3.3	+3.1	-3.9	-1.7	-2.3
Securities of State and local governments held by commercial and mutual savings banks.....	+.7	+1.2	+5	+7	+1.9	+1.0	+9
Treasury deposits <sup>4</sup> .....	-1.3	-.5	+.8	-1.3	+.5	-.7	+1.2
Monetary gold stock.....	+1.5	+2	+3	-.1	-1.6	-.2	-1.4
Other factors, net.....	-1.0	-1.4	-.7	-.7	-1.8	-.7	-1.1
Net change in deposits and currency <sup>5</sup> .....	-.9	+7	-3.5	+4.2	+6.4	+2	+6.2

<sup>1</sup> Signs preceding figures in columns indicate change from the previous period. An increase is denoted by a positive figure and a decrease by a negative figure for all factors except Treasury deposits, where the reverse is true.

<sup>2</sup> Estimates based on incomplete data; second half by Council of Economic Advisers.

<sup>3</sup> Includes commercial banks, mutual savings banks, and Federal Reserve banks.

<sup>4</sup> See footnote <sup>1</sup> above.

<sup>5</sup> See appendix table A-28 for aggregate money supply and its components.

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

Source: Board of Governors of the Federal Reserve System (except as noted).

During the first half of 1950, credit expansion supported consumer and business demand to a degree that was not generally excessive for a recovery period, though it contributed to higher prices for some commodities. After the Korean outbreak, with the accelerated growth of business and consumer credit, heavy liquidation of accumulated savings and rising personal income, private demand surged to an inflationary level. In the second half of 1950 the growth of credit was subjected to several restraints. Federal and State bank supervisory authorities pressed banks to restrict their loans and investments. In August, the Federal Reserve System raised rediscount rates from  $1\frac{1}{2}$  to  $1\frac{3}{4}$  percent, and at the same time modified its program of open market operations. The purpose of the increase in discount rates was to make borrowing additional reserves more costly for member banks. The objective of the new open market policy, without which the discount rate rise would have little effect, was to limit sales of Government securities by banks and others and thus restrict creation of new bank reserves which could be used as a basis for further credit expansion. At the end of December, the Federal Reserve Board announced increases, effective in January and February, 1951, in the cash reserves required of member banks.

Though interest rates, in general, rose only slightly during the first half of 1950, the policy adopted by the Federal Reserve System in August brought sharp increases in short-term rates. The rate on Treasury bills, which rose from 1.09 percent at the beginning of the year to 1.17 percent at the end of July, reached 1.38 percent by the end of December. The yield on 9-12 month Government issues averaged 1.44 percent in the fourth quarter of 1950, compared to 1.09 percent in the fourth quarter of 1949. Rates on short-term open market loans to private borrowers moved with the rates on Government obligations of like maturity. (See appendix table A-31.)

Selective controls on consumer and real estate credit were also imposed. In September the Federal Reserve Board applied regulations to consumer instalment credit which required minimum downpayments and set maximum maturities on instalment loans for the purchase of automobiles and other durables. In October, terms were substantially tightened. As a result of the regulation, and the subsidence of late summer buying which began before the regulation was put into effect, total instalment credit increased less than 2 percent during the fourth quarter of 1950, compared to 10 percent during the same period of 1949.

Action to restrict residential construction was first taken on July 19, when terms were tightened on Government insured or guaranteed real estate loans. In October, under authority granted by the Defense Production Act, a more comprehensive regulation was put into effect. Minimum downpayments and maximum loan maturity periods were prescribed for new conventionally financed one- and two-family houses, and the same terms, with some preference for veterans, were applied to new and existing houses insured by the Federal Housing Administration and the

Veterans Administration. On all types of housing the severity of the terms increased progressively with the price of the house. In general, the terms required by the October regulations were substantially more stringent than typical terms charged by lenders previously. The actions taken to tighten housing credit terms have contributed to a large drop in the volume of applications for Government insured or guaranteed loans. At the present time multi-family structures are being brought under a credit regulation. But because of the large construction backlog not affected by the new regulations it will be a number of months before the regulations can result in substantial decline in housing production.

#### THE FLOW OF GOODS AND PURCHASING POWER

##### *Personal income, consumption expenditures, and saving*

*Personal income.* Personal income attained an annual rate of 233.4 billion dollars, seasonally adjusted, in the fourth quarter of 1950. This was 14 percent higher than during the same period of 1949, and more than 8 percent higher than the second quarter of 1950. The rise was most impressive between the second and third quarters when increases in economic activity and prices pushed the total up from 215 to 225 billion dollars (annual rate), despite a 3 billion decline in transfer payments. From the third to the fourth quarter there was a further rise of about 8½ billion dollars in total personal income. (See chart 24.)

Wage and salary receipts and other labor income rose rapidly in the second half of 1950, attaining a peak level of 156 billion dollars in the fourth quarter, or more than 20 billion dollars above a year earlier. A gain of 7.3 billion dollars between the second and third quarters resulted for the most part from longer hours and rising employment. A further gain of 7.5 billion dollars from the third to the fourth quarter was due largely to rising wage rates.

Farm income, which had dipped to a postwar low in the second quarter of 1950, gained over 2 billion dollars (annual rate) between the second and fourth quarters, rising to the level of 14 billion dollars. Rising farm prices were largely responsible for the increase. However, while all of the other major components of income were at higher levels in the fourth quarter of 1950 than in 1948, farm income was only 79 percent of its 1948 level.

Business and professional income advanced 2.4 billion dollars between the second and third quarters of 1950 to a peak of 24.7 billion dollars (seasonally adjusted annual rate). Profits in retail trade showed the greatest gain, owing to the greatly increased volume of consumer purchases. In the fourth quarter there was some decline. Dividends increased substantially in the second half of this year, reflecting a 14 billion dollar increase in corporate earnings.

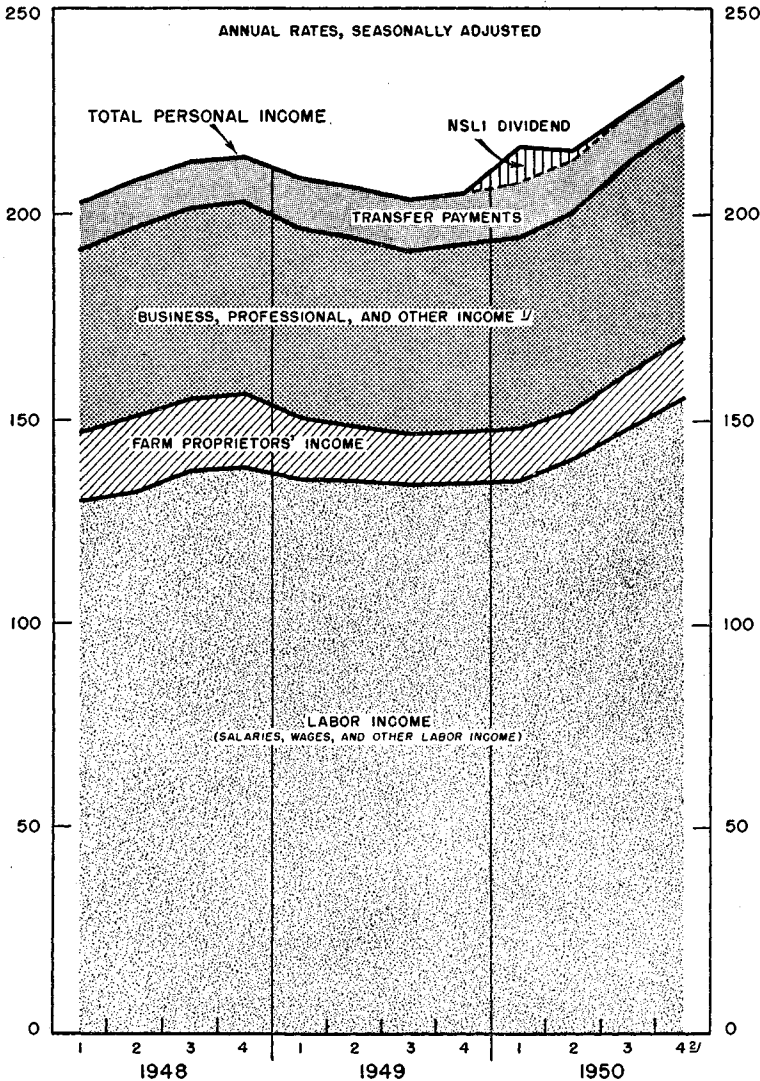
The volume of Government transfer payments fell, from an annual rate of 17.6 billion in the first half of the year to the more normal level of 11.2

CHART 24

# PERSONAL INCOME

Personal income increased by 16 billion dollars between 1949 and 1950, with all categories except farm proprietors' income participating in the rise. The increase was most marked in the 2nd half. Total income reached a record high of over 233 billion dollars (seasonally adjusted annual rate) in the final quarter.

BILLIONS OF DOLLARS BILLIONS OF DOLLARS



∩ OTHER INCOME CONSISTS OF RENTS, INTEREST, AND DIVIDENDS.

▨ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED).

billion in the third quarter, as payment of the National Service Life Insurance dividend was completed. In the fourth quarter, the statutory increase, about 70 percent, in the average benefit paid recipients of Old-Age and Survivors' Insurance was offset by declines in benefits to the unemployed and other payments.

Personal tax payments rose by 2 billion dollars (annual rate) from the first to the second half, due partly to rising incomes and partly to the increase in withholding rates on October 1. The rise in tax liabilities was considerably greater than the increase in collections, and there will be a sharp step-up in collections in the first half of this year.

Owing to rising tax payments, the increase in personal income after taxes from the first to the second half was only 11.0 billion dollars, compared to an increase of 13.3 billion in total personal income. A considerable fraction of the rise in income was offset by a rise in prices of consumer goods, but when disposable income is adjusted for changes in prices, there was a gain from the first to the second half of about 2 percent in purchasing power. This places the second half about 8 percent above the 1948 level. On a per capita basis, real income in the second half of this year (annual rate) was about 4 percent above 1948. (Appendix tables A-5 through A-8 give further detail on personal income.)

*Personal consumption expenditures.* The annual rate of consumption expenditures almost reached the 200 billion dollar mark in the third quarter of 1950, and receded only slightly in the fourth quarter as purchases of durables and nondurables reached heights surpassing those of any previous period. A spurt in consumer purchasing took place between the second and third quarters, when news of the crisis in Korea transformed a moderate upward trend into a buying spree for durable and semi-durable commodities. The quarterly rise of 13 billion dollars (annual rate), or 7 percent, was the greatest on record, both in dollar terms and percentage-wise. In 1946, when similarly large increases were recorded, a larger part of the rise was the result of higher prices. (See appendix table A-2.)

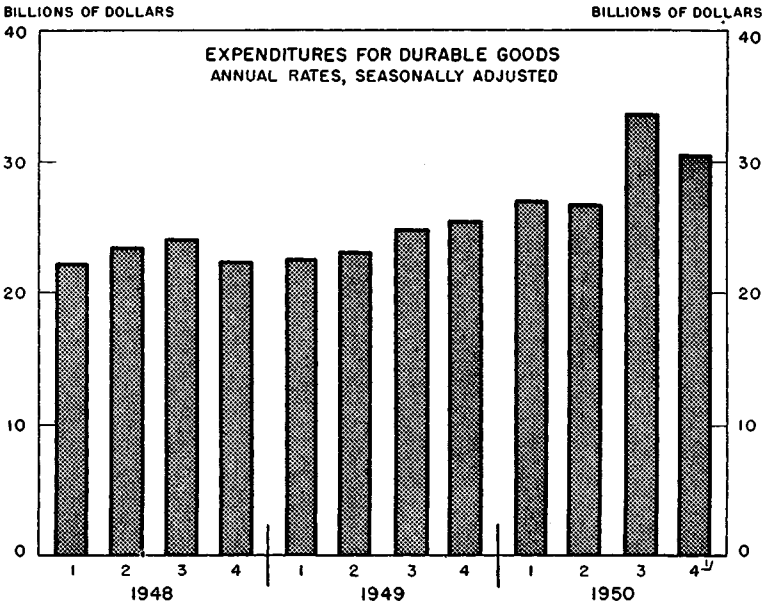
Over one-half of the increase from the second to the third quarter was accounted for by purchases of durable goods. Even in the first half of the year, durable goods purchases had accounted for a higher percent of disposable income than in any previous period. This may be attributed, at least partially, to the distribution of the veterans' insurance dividend. In the third quarter, durable goods expenditures rose to 16.9 percent of income, or an annual rate of 33.5 billion dollars. (See chart 25.)

The fourth quarter rate of total consumption expenditures was somewhat below that in the third quarter. Increases in the nondurable goods category and in services partially compensated for a moderate decline in purchases of durable goods.

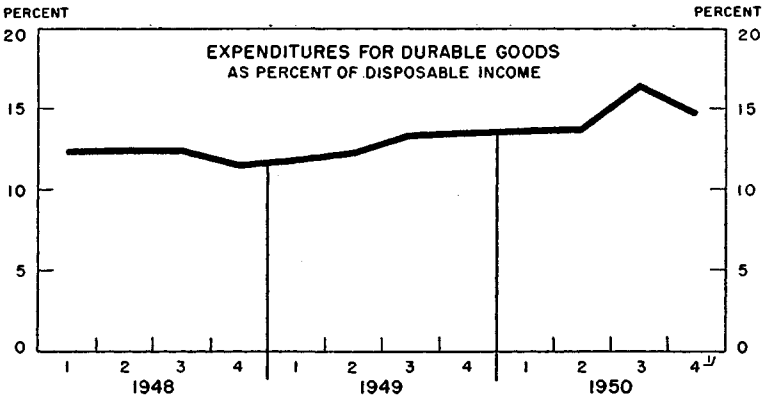
The first buying wave for durable and household goods prospectively in short supply began in July and had apparently subsided somewhat before the Regulation W credit restrictions were imposed on September 18. Con-

## CONSUMPTION EXPENDITURES FOR DURABLE GOODS

Expenditures for durable goods in the last half of 1950 were 5 billion dollars (seasonally adjusted annual rate) above the 1st half of the year and 7 billion above the last half of 1949.



The proportion of disposable income spent for durable goods rose to over 16 percent, an all-time high, in the 3rd quarter of 1950.



<sup>U</sup>PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED).

trols were tightened on October 14 to restrict demand further. Nevertheless, durable goods purchases in the fourth quarter were still in excess of any previous period except the immediately preceding quarter.

The general rises in the prices of consumer goods in the second half of 1950 were probably sufficient to account for about half of the increase in dollar volume, limiting the increase in the physical volume of consumption to about 3½ percent, between the first and second half of the year.

*Personal saving.* The volume of personal saving dropped from an annual rate of 10.4 billion dollars in the second quarter to 6.4 billion dollars in the third quarter during the post-Korean wave of consumer spending. (See appendix table A-7.) Saving in the first half of the year, in which personal income was augmented by the National Service Life Insurance dividend, had averaged 6.5 percent of disposable income, a fairly high rate for peacetime. In the third quarter, consumer instalment credit mounted rapidly, savings accounts were drawn down, and redemptions of Series E bonds ran considerably in excess of sales. Unspent portions of the NSLI dividend were in many cases added to spending. As a result, savings dropped to 3.1 percent of income in the third quarter. (See chart 26.) However, in the final quarter of the year, despite a rise in tax collections, saving rose to a rate of 6.4 percent of income.

*The distribution of income, expenditure, and saving.* There was an increase of 2 million spending units receiving money incomes of less than \$2,000 from 1948 to 1949, despite the fact that total personal income declined only about 1½ percent. Higher unemployment, a substantial drop in farm income, and greater frequency of farm and business losses were mainly accountable for the increase in the number of spending units with very low incomes. While unemployment averaged only 5½ percent of the labor force in 1949, three out of every ten employees in the major occupational groupings were unemployed one month or more during the year.

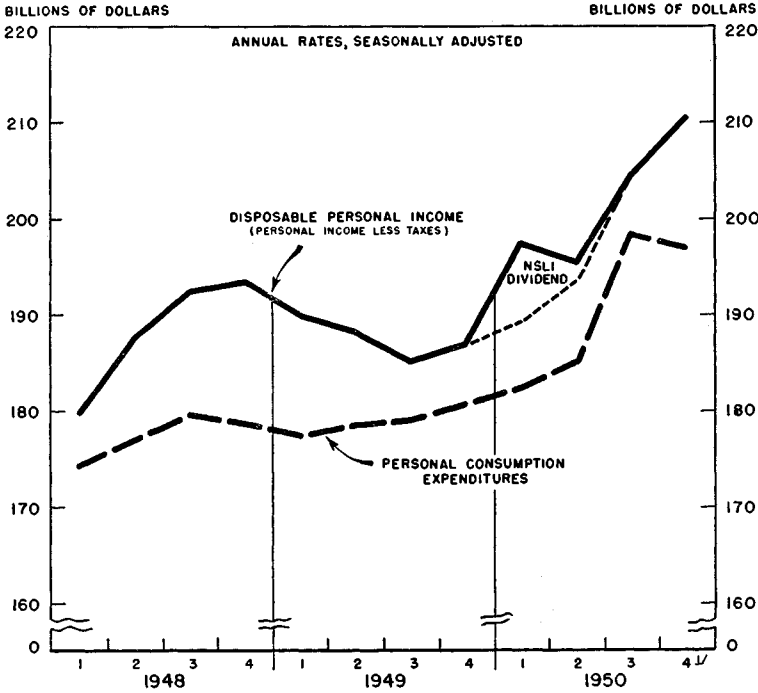
In 1950, expanded economic activity benefited many lower-income families. However, many other families at the lower end of the income scale, particularly fixed income recipients, do not benefit from a rise in economic activity, while they do suffer from concomitant price rises. According to the Survey of Consumer Finances, sponsored by the Board of Governors of the Federal Reserve System, pensions, allowances, annuities, or contributions are the chief source of income for about one-fifth of all units having annual money incomes of less than \$1,000. In October, a long-recommended step was taken to raise the income of one large group of fixed income receivers, the recipients of benefits from old-age and survivors' insurance. The average benefit for aged couples was raised from \$41 to about \$75 per month, and the eligibility requirements were relaxed.

In 1950, as in previous years, the expenditures of the two-fifths of the population with lowest incomes probably exceeded their incomes. In 1949, as shown in table 6, the lowest one-fifth of the nation's spending units, those with incomes below \$1,280, dissaved an amount equal to over one-half of

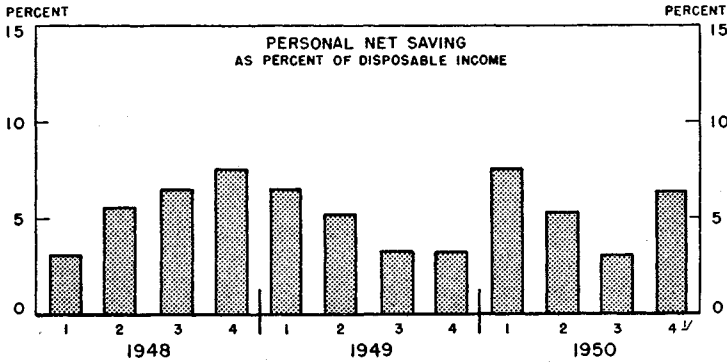
CHART 26

## PERSONAL INCOME, SPENDING, AND SAVING

Personal consumption expenditures declined somewhat in the 4th quarter of 1950 after reaching a peak of over 198 billion dollars (seasonally adjusted annual rate) in the 3rd quarter. Disposable income continued to rise.



The rate of saving dropped sharply immediately after the Korean outbreak but increased again in the 4th quarter.



1/ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED).

their income. Only the top two-fifths, those with incomes in excess of \$3,200, saved an appreciable amount.

The dissaving in the lowest income quintile is attributable to only about 40 percent of the spending units in the quintile; about 20 percent of the units just "make ends meet," and an additional 35-40 percent have positive savings. A high proportion of the dissaving in the lowest income brackets is done by a relatively few units with low or negative incomes but large assets. The exceptionally heavy dissaving on the part of lower income groups in 1949 to some extent reflects the fact that many farmers and businessmen suffered income declines during the year, which brought them into income brackets below their accustomed level.

The acquisition of durable goods on a wide scale in the postwar period has been the major cause of dissaving by many families. In 1949, 66 percent of families with negative saving also purchased consumer durables, which is considered a consumption expenditure. The volume of consumer debt has risen consistently, while many families have reduced their holdings of liquid assets in the postwar period. The median size of liquid asset holdings (Government bonds, bank deposits, and saving and loan shares) per family has declined each year since 1947, and there has been an increase in the number of units with no assets. Owing to the fact that the number of spending units has been increasing, total liquid asset holdings have grown somewhat. According to the most recent Survey of Consumer Finances, the median liquid asset holding in early 1950 was about \$250. (Statistics on the distribution of income and saving may be found in appendix B.)

TABLE 6.—Proportion of income spent or saved, by income groups, 1949

Spending units ranked by size of annual money income	Income range	Percent of income of each fifth used for—				
		All uses	Federal income tax liability <sup>1</sup>	Selected durable goods expenditures <sup>2</sup>	All other expenditures	Net saving <sup>3</sup>
Lowest fifth.....	Under \$1,280	100	2	16	139	-57
Second fifth.....	\$1,280-2,289	100	4	11	91	-6
Third fifth.....	\$2,290-3,199	100	5	11	84	(4)
Fourth fifth.....	\$3,200-4,499	100	6	10	79	5
Highest fifth.....	\$4,500 and over	100	12	9	63	16
All spending units.....	.....	100	8	11	76	5

<sup>1</sup> Estimated personal tax liability on income, apart from capital gains and losses. Other taxes are included in "all other expenditures."

<sup>2</sup> Includes automobiles, furniture, radios, television sets, and household appliances.

<sup>3</sup> The definition of saving used here is not identical with that of personal net saving as defined for the national income accounts. See *1950 Survey of Consumer Finances, Part IV, Appendix I*.

<sup>4</sup> Less than one-half of 1 percent.

Source: Board of Governors of the Federal Reserve System.

### *Business investment and finance*

During the second half of 1950, gross private domestic investment in construction, equipment, and additions to inventory rose to the all-time record level of nearly 53 billion dollars at a seasonally adjusted annual

rate. (See table 7 and chart 27.) This was an increase of 19 percent from the first half of 1950 and 67 percent from the second half of 1949. The corresponding increases in consumer expenditures were only 8 and 10 percent, respectively.

TABLE 7.—*Gross private domestic investment*<sup>1</sup>

[Billions of dollars, annual rates, seasonally adjusted]

Period	Total gross private domestic investment	Construction and equipment				Increase in inventories
		Total	Nonfarm residential construction	Other private construction	Producers' durable equipment	
1948.....	43.1	37.6	8.6	9.1	19.9	5.5
1949.....	33.0	36.8	8.3	9.0	19.5	-3.7
1950 <sup>2</sup> .....	48.5	46.2	12.4	9.3	24.5	2.4
1949—First half.....	34.4	36.9	7.7	9.3	20.0	-2.5
Second half.....	31.6	36.6	8.9	8.6	19.0	-5.0
1950—First half.....	44.3	41.7	11.6	9.0	21.1	2.7
Second half <sup>2</sup> .....	52.7	50.7	13.2	9.6	27.9	2.0
1949—First quarter.....	37.5	37.2	7.8	9.4	20.1	.3
Second quarter.....	31.3	36.6	7.6	9.2	19.8	-5.3
Third quarter.....	32.1	36.3	8.2	8.7	19.4	-4.2
Fourth quarter.....	31.2	36.9	9.5	8.6	18.7	-5.7
1950—First quarter.....	41.7	39.8	11.0	8.9	19.9	2.0
Second quarter.....	46.9	43.6	12.2	9.1	22.3	3.4
Third quarter.....	48.4	50.0	13.5	9.4	27.1	-1.5
Fourth quarter <sup>2</sup> .....	57.0	51.5	12.9	10.0	28.7	5.5

<sup>1</sup> See appendix table A-3 for further details.

<sup>2</sup> Estimates based on incomplete data; fourth quarter by Council of Economic Advisers.

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

Source: Department of Commerce (except as noted).

In the fourth quarter of 1950, gross private domestic investment was running at a seasonally adjusted annual rate of 57 billion dollars, or 19 percent of the total national output of goods and services. This is the highest proportion yet on record.

The most dynamic major component of business investment in the latter half of 1950 was the purchase of producers' durable equipment, which rose abruptly to a record rate nearly 32 percent higher (after allowance for normal seasonal variation) than that of the first half of 1950 and 47 percent above the second half of 1949. At the end of the year, equipment purchases were at or near all-time record levels, and the inflow of new orders for machinery still exceeded deliveries.

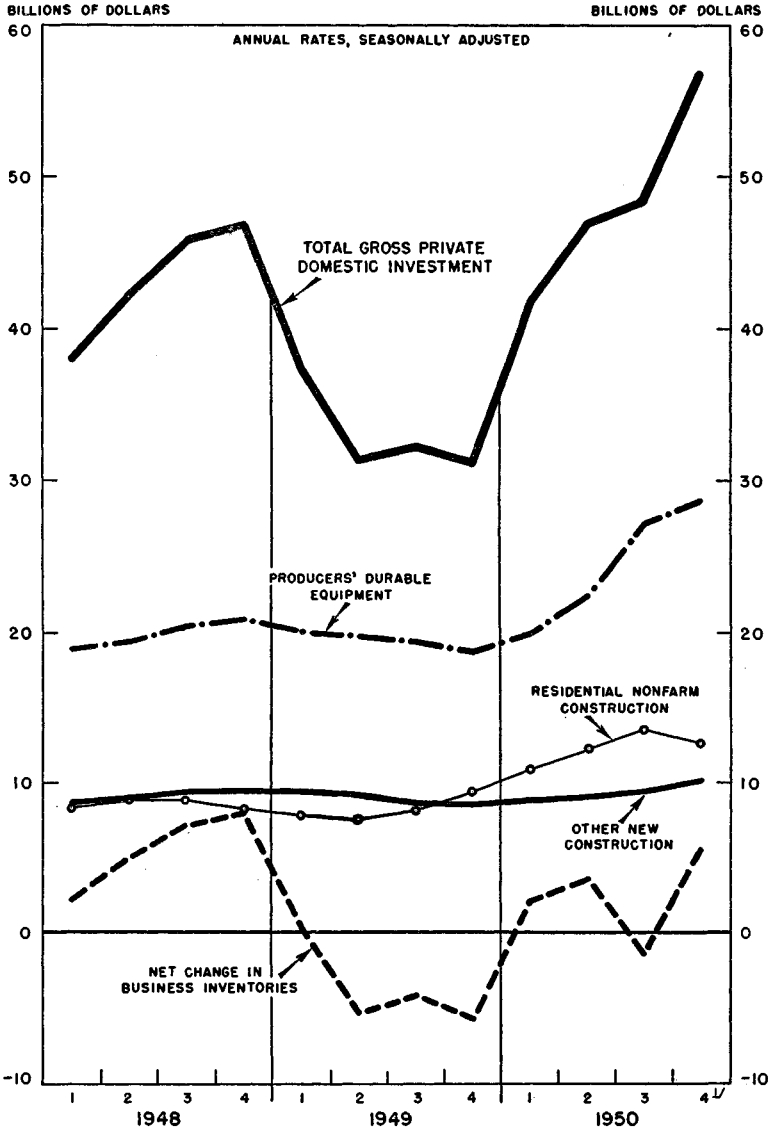
Government restrictions imposed in the summer and fall curtailed some types of construction, primarily housing, although the momentum of previous starts kept house building at the year's end above the level of a year earlier. Nonresidential building activity rose steadily through the year, to reach a record level of outlays in the fourth quarter.

Inventory accumulation proceeded at a moderate rate during the first half of 1950, in contrast with the sharp liquidation that had prevailed through most of 1949. The sudden post-Korean upsurge of consumer and

CHART 27

# BUSINESS INVESTMENT

Private outlays for producers' equipment, housing, and nonresidential construction all rose to record levels in 1950. Inventory accumulation was only briefly interrupted by the post-Korean buying rush.



business demand temporarily depleted inventories, but by the end of the third quarter inventories were growing again. During the fourth quarter, there was a rapid accumulation of inventories as sales leveled off and production continued to rise.

*Plant and equipment.* A significant revival in business investment in productive facilities became evident during the second quarter of 1950. This played an important part in the general upsurge of production, employment, and income after the 1949 recession. By the second quarter, the rate of outlays for producers' construction and equipment was nearly back to peak 1948 levels, and was rising rapidly. (See appendix tables A-3 and A-19.) The dollar value of new orders for machinery already exceeded that of any previous time since World War II, and contracts for nonresidential building, in terms of floor space, were at a new high since late 1947.

The stimulus of the expanding defense program in the second half of 1950 was thus superimposed on an already buoyant investment trend. As it became clear that for a considerable period existing capacity would be inadequate to meet demands and that the construction and equipping of facilities might become progressively more costly and difficult, business hastened to step up its plans and commitments for investment. The major emphasis was on purchases of machinery and other equipment, which rose from 19.9 billion dollars (seasonally adjusted annual rate) in the first quarter, and 22.3 billion in the second quarter, to 28.7 billion in the fourth. Even after allowing for price increases, this rate of private investment in equipment far exceeded the previous peak reached in 1948. New orders for machinery, by August, were being placed at more than double the rate of a year previous. Though ordering slackened off slightly after the initial post-Korea rush, it continued through the rest of 1950 to run well ahead of the rate of deliveries. (See chart 2 on page 36.) The unfilled-orders backlogs of machinery producers, which had touched a postwar low at the end of 1949, rose gradually in the first half of 1950 and very rapidly in the second half, to levels not experienced since early 1948.

Foremost in the investment boom of the latter half of the year were the manufacturing industries. Purchases of railroad and highway transport equipment also rose rapidly and the expansion of utilities continued at a rapid pace.

As the year ended, business was planning to continue investment in plant and equipment at a high rate. Private and Government surveys of investment plans for 1951, made late in 1950, indicated a substantially larger total outlay in 1951 than in 1950, particularly in the industrial sector. (See appendix table A-19.) With continued high earnings and readily available outside capital, business seemed likely to continue spending on plant and equipment at very high rates, subject to the influence of materials shortages and Government controls.

*Nonfarm inventories.* The resumption of inventory accumulation during the first half of 1950 was an important factor contributing to business

recovery. By the second quarter of the year, nonfarm inventories were being accumulated at an annual rate of 4.0 billion dollars, compared with a rate of liquidation of 4.7 billion dollars a year in the fourth quarter of 1949. There was thus a net change of nearly 9 billion dollars in terms of seasonally adjusted annual rates. (See appendix tables A-3, A-20, and A-21, and chart 27.)

Economic developments following the outbreak in Korea increased the desire of business to build up inventories, but made it more difficult to do so. Despite the sharp rise in output during the third quarter and the enormous increase in new orders, consumer buying was so great that stocks fell off slightly. During the third quarter, nonfarm inventories were being reduced at an annual rate of about a billion dollars.

This reduction was primarily in manufacturers' stocks of finished goods. The book value of finished-goods inventories held by manufacturers declined by more than 9 percent during July and August. During the same interval, there were increases of about the same percent in stocks of raw materials and goods in process. These increases were in part necessary to maintain the higher levels of output, though the sharp rise in materials prices provided additional inducement to accumulate materials.

The book value of retailers' inventories was higher at the end of the third quarter than at the beginning, but the rise was not steady. (See appendix tables A-20 and A-22.) In July, inventories declined; in August, the mounting tide of deliveries overtook the rate of consumer buying, and inventories began to rise again. The increase was greater in nondurable than in durable goods lines.

In the last five months of the year, with the leveling-off in consumer buying from the summer peak and the continued rise in output, inventory accumulation was resumed in both trade and manufacturing. In the fourth quarter it reached a seasonally adjusted annual rate of 6.0 billion dollars, the highest since 1948. (See appendix tables A-3 and A-20.) Particularly noteworthy was the increase in nondurable goods inventories.

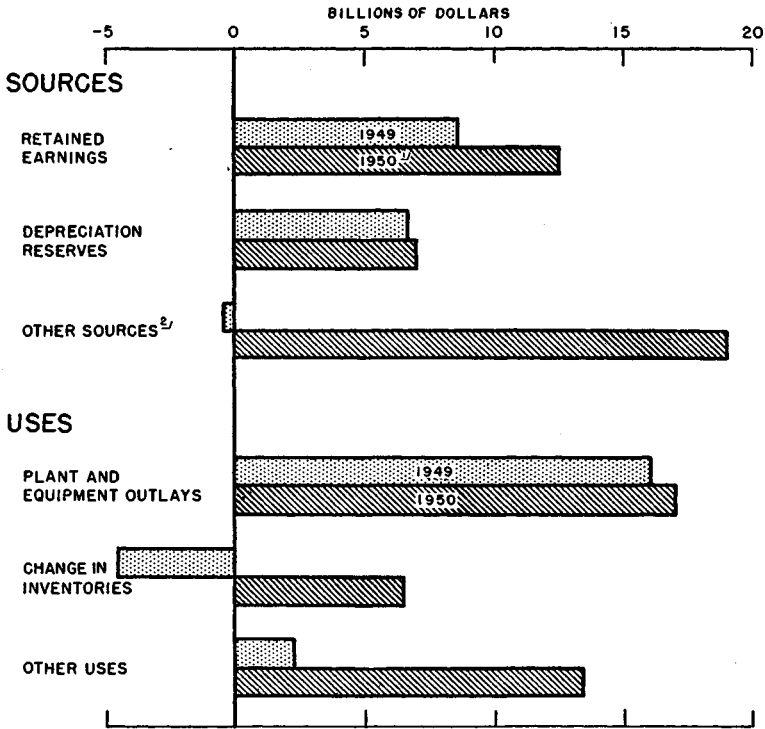
*Corporate finance.* In 1950, the use of capital funds by non-financial corporations was higher than in any previous year, and almost 24 billion dollars above 1949. Plant and equipment outlays, which by the end of the year had reached the 1948 peak rate, accounted for nearly half of this total. The other half was required for a sizable expansion of inventories and customer accounts and for a substantial addition to corporations' liquid asset holdings. The shift from a 5-billion-dollar liquidation of inventory book values and accounts receivable in 1949 to an expansion of 13 billion dollars in 1950 involved an 18-billion-dollar increase in the need for funds. At the end of the year, corporations' total holdings of Government securities were about as large as at the end of World War II.

Corporations were able to finance more than half of their total requirements internally, from retained earnings and depreciation allowances. Despite record disbursements of dividends, accounting for about 40 percent

CHART 28

## SOURCES AND USES OF CORPORATE FUNDS

In 1950, total corporate expenditure on fixed and working capital was at a record level. More than half of the expenditure was financed from retained earnings and depreciation reserves.



<sup>1/</sup> PROFIT ESTIMATES FOR 1950 BY COUNCIL OF ECONOMIC ADVISERS.

<sup>2/</sup> NEGATIVE ITEM IN 1949 RESULTED FROM DECLINE IN TRADE PAYABLES, FEDERAL INCOME TAX LIABILITY, AND BANK LOANS.

SOURCES: DEPARTMENT OF COMMERCE ESTIMATES BASED ON SECURITIES AND EXCHANGE COMMISSION AND OTHER FINANCIAL DATA (EXCEPT AS NOTED).

of earnings after taxes in 1950, compared with 45 percent in 1949 and about 35 percent in 1948, 12.5 billion dollars of earnings were retained for investment, an amount which was only slightly exceeded in 1948. Because of the increase in tax rates and sharply rising corporate profits, corporation tax liabilities rose 7.0 billion dollars.

External sources of funds provided about 19 billion dollars, the largest amount in any postwar year. Bank loans increased by about 2.5 billion dollars, and trade debt by about 3.5 billion, much larger expansions than occurred in 1948. This was in sharp contrast to 1949, when corporations were retiring both bank and trade debt. (See chart 28 and appendix table A-37.)

Total net new issues of securities in 1950 were about 1.5 billion dollars smaller than in 1949, and nearly 2 billion smaller than 1948. The volume of stock issues, on the other hand, was larger than in either of the two previous years, due mainly to the more favorable market for floating new stock issues. However, corporations were still not using the stock market as a major source of capital.

*Construction.* Total new construction in 1950 reached a record level of 27.7 billion dollars, compared with 22.6 billion in 1949, the previous high. This was an increase of 23 percent. The pattern was one of expansion through most of 1950, with declining tendencies beginning to appear toward the end of the year. (See appendix table A-18.)

In December 1950, total new construction was running at a seasonally adjusted annual rate of 29.7 billion dollars, or 21 percent above the level of a year earlier. Private construction was at an annual rate of 21.2 billion dollars, a rise of 20 percent, while public construction was at an annual rate of 8.5 billion, an increase of 24 percent.

The trends of major categories were sharply different in 1950. Private new construction increased greatly through October, thereafter declining slightly as a substantial drop in residential construction was not wholly compensated by large increases in industrial and commercial construction. Public construction fluctuated within a narrow range through August, but then rose sharply in each succeeding month. Total construction increased steadily until December, when it fell off slightly, with the increase in public outlays more than offsetting the decrease in private outlays during the last few months.

More nonfarm housing units were started in 1950 than in any previous year. The total was over 1.3 million, more than 30 percent higher than the slightly more than 1 million started in 1949, the previous peak year. But there was a sharp reversal of trend during the year. The peak of 149,000 monthly starts was reached in May and a level of over 140,000 starts was maintained through August. Thereafter, in part under the impact of the credit restrictions on residential construction, housing starts declined sharply and in the last three months of the year fell below the levels of the corresponding months in 1949.

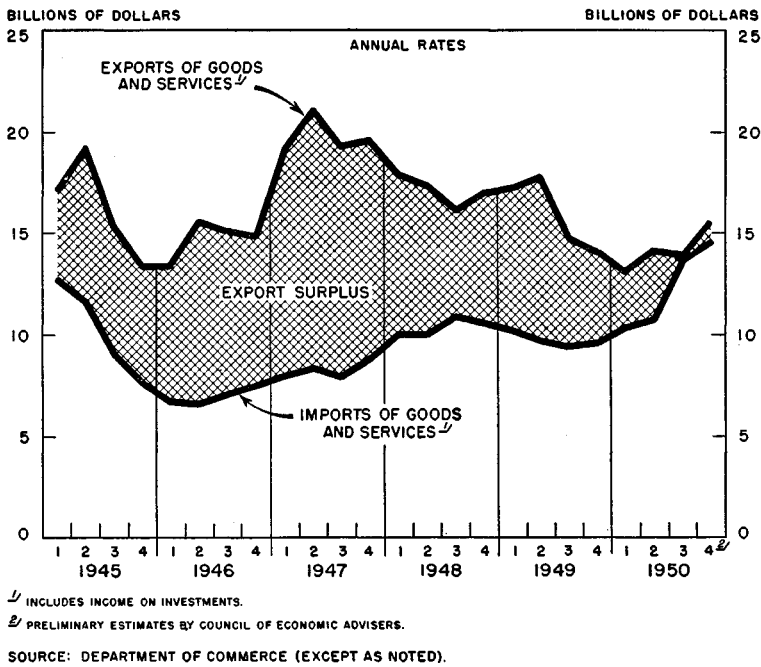
Beginning in the spring of 1950, private nonresidential construction climbed steadily. Increases in industrial and commercial construction accounted for much of the increase during the final months of the year. New recreational construction tapered off following the National Production Authority's October order designed to eliminate most types of such construction, but this category represents only a very small fraction of total construction. Electric and gas utility construction totaled about the same in 1950 as in 1949; construction of railroad and telephone and telegraph facilities declined.

The largest increases in new public construction between 1949 and 1950 were for schools, highways, and for military and naval construction which

CHART 29

## EXPORTS AND IMPORTS OF GOODS AND SERVICES

A rapid growth in imports practically eliminated the U. S. export surplus in the 2nd half of 1950.



had begun to reflect the impact of the defense program by the end of the year. A major step-up in military and naval construction will appear during this year.

During 1950, the Department of Commerce composite index of construction costs rose about 9 percent. The increase in the wholesale price of lumber was about 20 percent. In the hourly earnings of construction workers, it was about 4 percent.

The seasonally adjusted composite index of the production of building materials increased by about 19 percent during 1950. For the year as a whole, nearly all such materials were produced in record volume.

### *International transactions*

Although the expansion of domestic economic activity and the rise of prices in the second half of 1950 were the result of international developments, these developments made their influence felt on the economy mainly

by stimulating domestic demand, rather than by increasing foreign purchases here or by reducing the supplies available to us from abroad. In fact, 1950 saw a reduction in the net demands upon American output arising from international transactions.

In early 1950, exports of goods and services were at the lowest levels since termination of the Lend-Lease program after World War II. Although a rise began late in the summer of 1950, such exports were nearly 1.9 billion dollars less for the year as a whole than they were in 1949. Imports of goods and services, on the other hand, which had been rising steadily since the summer of 1949, rose even more sharply in the second half of 1950 than in the first half, and for the year as a whole were 2.6 billion dollars higher than in 1949. As a result of these changes, the surplus of United States exports over imports of goods and services, which had amounted to 6.2 billion dollars in 1949, fell to an annual rate of 3.0 billion in the first half of 1950, and to an estimated annual rate of 600 million dollars in the second half of the year. (See table 8 and chart 29; also appendix tables A-38 through A-47 for detailed statistics on international transactions.)

TABLE 8.—United States exports and imports of goods and services  
[Billions of dollars]

Period	Exports of goods and services <sup>1</sup>	Imports of goods and services <sup>1</sup>	Surplus of exports of goods and services <sup>1</sup>
1946.....	14.7	7.0	7.8
1947.....	19.8	8.3	11.5
1948.....	17.1	10.4	6.7
1949.....	16.0	9.7	6.2
1950 <sup>2</sup> .....	14.1	12.3	1.8
Annual rates:			
1949—First half.....	17.5	9.7	7.6
Second half.....	14.4	9.5	4.9
1950—First half.....	13.6	10.6	3.0
Second half <sup>2</sup> .....	14.7	14.1	.6

<sup>1</sup> Includes income on investments.

<sup>2</sup> Estimates by Council of Economic Advisers; based on incomplete data.

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

Source: Department of Commerce (except as noted).

There were substantial increases both in the quantity of goods brought into the country and in their prices. Although merchandise imports had been rising steadily throughout the first half of the year as domestic business activity rose, they were given a sharp impetus, following the aggression in Korea, by the decision of the United States and its North Atlantic Treaty partners to strengthen their defenses. These developments gave rise to large purchases abroad to meet the needs of current and expected increases in production, and for stockpiling purposes. Imported raw materials such as rubber, wool, tin, wood pulp, burlap, and other products rose sharply in price, in some cases to twice their June levels. These price rises have not yet been fully reflected in the dollar value of our imports. (See chart 30.)

Foreign countries were able to get along with a smaller volume of net

goods and services from the United States, in large part because of continued increases in Western European production. For Western Europe itself, this made possible a reduction in its total imports of certain major products and an expansion of exports without impairment of domestic consumption or investment. For countries in other areas, it made possible a shift of imports from the United States to Western European sources of supply.

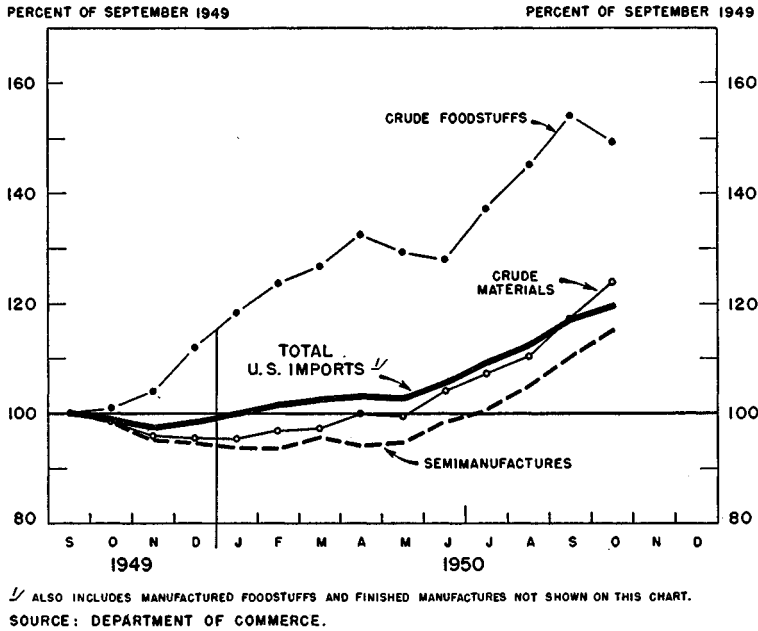
The changes in our merchandise trade, which brought it into virtual balance in the second half of the year, greatly reduced the dollar difficulties of foreign countries which had characterized earlier postwar years. The expanded United States demand for foreign products has vastly increased foreign earnings in this country. Many of the Western European countries and Japan have been able not only to increase their direct sales to the United States, but also to improve their competitive position in other areas because of the relative fall in their export prices resulting from devaluation, the rise in our export prices, and the tighter supply situation in the United States. South America, the Far East, and Africa were able to earn dollars on balance in their merchandise trade with the United States. Western Europe was able to cut its trade deficit with us drastically between the first and second halves of the year. Moreover, the financial position of some Western European countries, the United Kingdom in particular, was greatly aided by the increase in dollar earnings of raw-material-producing countries whose monetary reserves they hold or in which they have investments.

In the first half of 1950, the United States export surplus was less than our foreign aid. In the second half of 1950, the export surplus fell still further below the volume of our aid, although this aid itself was reduced during the course of the year. (See appendix table A-38.) Partly because our aid exceeded our export surplus, but also partly because of a speculative outflow of capital in the third quarter of the year, foreign countries in the aggregate were able to accelerate greatly the process of rebuilding their depleted gold and dollar reserves. The main increases were in the sterling area and Canada. Japan and a number of raw material exporting countries outside the sterling area, chiefly in Latin America, also made large relative gains or were able to pay off short-term debts. The rebuilding of these reserves proceeded during the second half of 1950 at an even more rapid rate than it had in the nine months between the widespread devaluations of foreign currencies and the middle of 1950. The rapidity of improvement in the financial position of the United Kingdom was so great that it was possible to suspend aid to it under the European Recovery Program.

The decision to increase the defensive strength of the Western World, coming on top of a recovery of economic activity in the United States, has created a new problem of inflationary pressures on a world-wide scale. In many countries a considerable degree of internal financial stability had been achieved, though often the stability was a precarious one. In the

## PRICES OF IMPORTS

Prices of U.S. imports (average unit value) have risen 20 percent since the currency devaluations of September 1949, and 13 percent since June 1950, when hostilities broke out in Korea.



second half of 1950, expanded defense needs were beginning to reduce supplies available for civilian use by absorbing manpower, materials, and industrial facilities. At the same time, actual and anticipated increases in defense expenditures were increasing effective money demand in countries accounting for the bulk of the world's consumption. Thus, inflationary pressures were again being activated throughout the world.

### Government transactions

Total cash payments of Federal, State, and local governments in the second half of the calendar year 1950 were running at a seasonally adjusted annual rate of almost 60 billion dollars. This was about 3 billion dollars lower than in the first half of the calendar year. Cash receipts were running at an annual rate of about 4 billion dollars higher than in the first half of the year. The reduction in public payments changed a total cash deficit of more than 4 billion dollars for the first half of 1950 into a surplus of around 3 billion dollars for the second half. (See chart 31 and table 9.)

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

[Billions of dollars, annual rates, seasonally adjusted]

Receipt or payment	Calendar year 1949	Calendar year 1950		
		Total <sup>1</sup>	First half	Second half <sup>1</sup>
<b>Cash receipts:</b>				
Federal.....	41.3	42.4	41.1	43.8
State and local.....	16.3	18.4	17.7	18.9
Total cash receipts.....	57.6	60.8	58.8	62.7
<b>Cash payments:</b>				
Federal.....	42.6	41.9	44.0	39.9
State and local.....	17.5	19.5	19.0	19.9
Total cash payments.....	60.2	61.4	63.0	59.8
<b>Surplus (+) or deficit (-):</b>				
Federal.....	-1.3	+ .5	-2.9	+3.9
State and local.....	-1.3	-1.1	-1.3	-1.0
Total, surplus (+) or deficit (-).....	-2.5	-.6	-4.2	+2.9

<sup>1</sup> Estimates based on incomplete data.

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

Source: See Appendix C.

The counter-inflationary impact of the surplus on the expansion in economic activity was lost in the effect of the large amounts of contracts placed both by Government and by consumers and business acting in anticipation of an enlarged defense program. The accelerated pace of economic activity after the outbreak of the Korean war was in fact largely due to the actual and anticipated increase in defense activities of the Government. Government expenditures have not yet reflected much of the increase in these defense activities, but a rapid increase in expenditures must be expected to occur during the course of 1951.

*Cash payments by the Federal Government.* The decrease in Federal cash payments to the public, between the first and the second half of the calendar year 1950 was due to the large National Service Life Insurance dividend paid out in the first half of the year. Excluding the NSLI dividend, cash payments were running at an annual rate of about one billion dollars higher in the second half of the year than in the first half. Significant declines took place in expenditures for the price support program, in payments to veterans and international programs, and in the net purchase by the Federal National Mortgage Association of government-insured and guaranteed mortgages. Increases occurred in social security payments, particularly because of the increased benefits under the amended Social Security law.

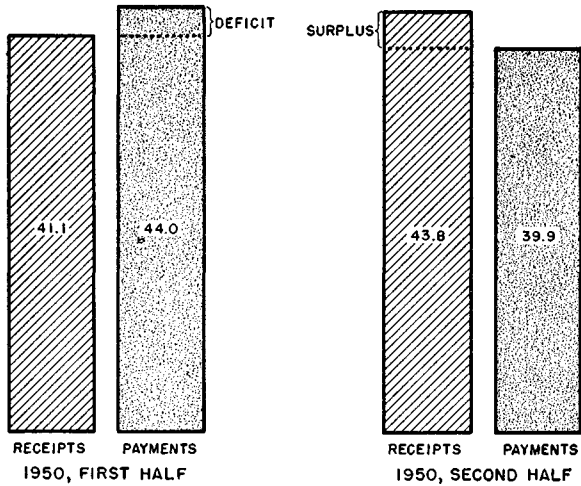
Expenditures by the military services, which declined in the first half of the calendar year, increased by an annual rate of 3.5 billion dollars in the second half of the year. But until the beginning of the fourth quarter, they were running only about the level of the year 1949.

## GOVERNMENT CASH RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

Federal cash payments to the public in the 1st half of 1950, including the National Service Life Insurance dividend, exceeded receipts by 2.9 billion dollars (seasonally adjusted annual rate). In the 2nd half of the year receipts were 3.9 billion larger than payments. State and local governments had cash deficits in both periods.

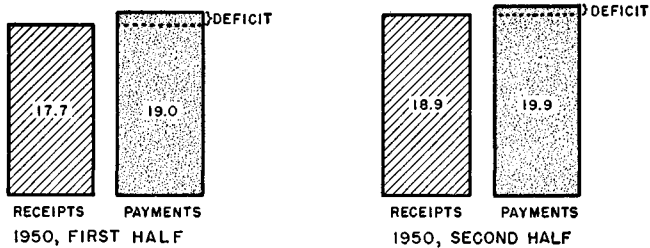
### FEDERAL

BILLIONS OF DOLLARS, ANNUAL RATES, SEASONALLY ADJUSTED



### STATE AND LOCAL

BILLIONS OF DOLLARS, ANNUAL RATES, SEASONALLY ADJUSTED



CALENDAR YEAR

SOURCE: SEE APPENDIX C.

TABLE 10.—Federal cash payments to the public by function  
[Billions of dollars, annual rates, seasonally adjusted]

Function	Calendar year 1949	Calendar year 1950		
		Total <sup>1</sup>	First half	Second half <sup>1</sup>
Military services.....	12.9	13.7	11.9	15.4
International security and foreign relations.....	6.0	4.1	4.4	3.9
Veterans' services and benefits.....	7.1	8.9	11.8	6.1
Social security, welfare and health.....	2.7	3.3	3.1	3.5
Agriculture and agricultural resources.....	3.0	1.3	2.4	.2
Interest.....	4.3	4.1	4.2	4.1
Other.....	7.1	6.9	7.2	6.6
Deductions from Federal employees' salaries for retirement.....	-.3	-.4	-.4	-.4
Clearing account for outstanding checks and telegraphic reports.....	-.2	-.1	-.7	+ .5
Total Federal cash payments to the public.....	42.6	41.9	44.0	39.9

<sup>1</sup> Estimates based on incomplete data.

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

Source: See Appendix C.

A month by month comparison shows that the expenditures for defense began to rise appreciably only during the last quarter of the year. Expenditures by the military services were 1.6 billion dollars in December 1950, compared with about 1.0 billion dollars in June 1950, the last month before the Korean outbreak. The increase in expenditures does not, however, fully reflect the actual progress in military programs. During the five-month period from July through November, obligations incurred by the Defense Department for military purposes exceeded comparable expenditures by about 7.5 billion dollars. Procurement has an impact on the economy when contracts are placed as well as when payments are made. In the initial period, work on contracts is financed largely by business funds, and is only later reflected in Government expenditures. (See tables 10 and 11.)

TABLE 11.—Federal cash payments to the public by type of recipient and transaction  
[Billions of dollars, annual rates, seasonally adjusted]

Classification of payment	Calendar year 1949	Calendar year 1950		
		Total <sup>1</sup>	First half	Second half <sup>1</sup>
Direct cash payments for goods and services; excluding military services:				
To individuals for services rendered.....	3.3	3.2	3.3	3.2
To business and international institutions for goods and services.....	3.0	3.4	3.3	3.6
Loans and transfer payments to individuals.....	11.3	13.5	16.4	10.6
Loans, investments, subsidies and other transfers to business and agriculture.....	6.9	4.8	6.1	3.6
Loans and transfer payments to foreign countries and international institutions.....	5.8	3.9	4.2	3.6
Military services—cash payments for goods and services <sup>2</sup> .....	12.5	13.1	11.4	14.8
Clearing account for outstanding checks and telegraphic reports.....	-.2	-.1	-.7	+ .5
Total Federal cash payments.....	42.6	41.9	44.0	39.9

<sup>1</sup> Estimates based on incomplete data.

<sup>2</sup> Differs from the estimate of military service payments in table 10 above by the exclusion of certain transfer items here included with loans and transfer payments to individuals.

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

Source: See Appendix C.

*Federal cash receipts.* The increase in cash receipts from calendar year 1949 to calendar year 1950, and especially from the first to the second half of 1950 (seasonally adjusted), largely reflected the increase in economic activity. In addition, the increase in rates of employment taxes that became effective January 1, 1950, added to cash collections. Because of lags in collection, the additional revenue resulting during the last few months of the year from the Revenue Act of 1950 was only a modest amount, collected through increased withholding tax rates. The 1950 collections of the corporate income tax reflected the lower profits of the recession year 1949, and collections from corporate income taxes will increase substantially this year, reflecting both the high profits of 1950 and the increases in tax rates. (See table 12.)

TABLE 12.—*Federal cash receipts from the public*  
[Billions of dollars, annual rates, seasonally adjusted]

Source of cash receipts	1949	1950		
		Total <sup>1</sup>	First half	Second half <sup>1</sup>
Direct taxes on individuals.....	18.4	19.3	18.4	20.1
Direct taxes on corporations.....	12.0	9.9	9.9	9.9
Employment taxes.....	2.5	3.4	3.4	3.4
Excises and customs.....	7.9	8.6	8.2	9.0
Surplus property receipts.....	.5	.2	.3	.1
Deposits by States, unemployment insurance.....	1.0	1.2	1.1	1.3
Veterans' life insurance premiums.....	.4	.5	.5	.5
Other.....	1.4	1.5	1.4	1.6
Refunds of receipts.....	-2.8	-2.2	-2.2	-2.2
<b>Total Federal cash receipts from the public.....</b>	<b>41.3</b>	<b>42.4</b>	<b>41.1</b>	<b>43.8</b>

<sup>1</sup> Estimates based on incomplete data.

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

Source: See Appendix C.

*The Federal budget deficit, the cash surplus, and changes in the national debt.* The foregoing analysis has been in terms of the consolidated cash statement of Federal cash payments and Federal receipts. While the consolidated cash statement is a preferable means of measuring the impact upon the economy of government transactions on the flow of funds and incomes, it is also important to consider the conventional budget. (See table 13.) Surpluses or deficits in the conventional budget decrease or increase the national debt held by the public and Government trust accounts. The conventional budget is the basis of the appropriations recommended by the President and voted by Congress.

In calendar 1950 the budget, measured in conventional terms, showed a deficit of 422 million dollars. There was an excess of cash receipts from the public over cash payments to the public of about 500 million dollars. Though there was a deficit in the conventional budget, the gross public debt dropped 423 million dollars in calendar 1950 because of a surplus of trust and clearing account receipts, and a drop in the Treasury's general

TABLE 13.—Federal receipts and expenditures: Budget totals and consolidated cash totals

[Billions of dollars, annual rate]

Receipt or expenditure	Calendar year 1949	Calendar year 1950		
		Total <sup>1</sup>	First half	Second half <sup>1</sup>
Budget totals, not adjusted for seasonal variation:				
Receipts (net).....	38.1	37.8	38.7	36.9
Expenditures.....	41.7	38.3	38.4	38.1
Budget surplus (+) or deficit (—).....	—3.6	— .4	+ .4	—1.2
Consolidated cash totals:				
Not adjusted for seasonal variation:				
Cash receipts from the public.....	41.3	42.4	43.0	41.8
Cash payments to the public.....	42.6	41.9	43.7	40.1
Cash surplus (+) or deficit (—).....	—1.3	+ .5	— .8	+1.7
Adjusted for seasonal variation:				
Cash receipts from the public.....	41.3	42.4	41.1	43.8
Cash payments to the public.....	42.6	41.9	44.0	39.9
Cash surplus (+) or deficit (—).....	—1.3	+ .5	—2.9	+3.9

<sup>1</sup> Estimates based on incomplete data.

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

Source: Treasury Department and Bureau of the Budget.

fund. In the calendar year 1949 the public debt had increased 4.3 billion dollars. (See appendix tables A-29 and A-30.)

*State and local transactions.* State and local government expenditures, after a very rapid rise in the immediate postwar years, increased at a slower pace in 1949 and 1950, although demands for additional school, highway, and other facilities remained pressing. To a large extent, this flattening of the trend was forced by a reversal of the favorable financial position in which most State and local governments emerged from World War II. (See table 9 above.)

The expansion of general business activity, beginning in 1950 and accelerating sharply after the Korean invasion, had a marked effect upon many types of State and local revenue. The sales tax, an important revenue source in many States, showed rapidly increasing yields. During the second half of calendar year 1950, State and local cash expenditures advanced moderately above the level of the previous year or of the first half of 1950 despite delay in some projects because of increasing costs of construction. Cash deficits of State and local governments for the second half of the calendar year 1950 are estimated at an annual rate of 1.0 billion dollars, somewhat smaller than the deficit of the preceding half-years.

#### *Summary: The Nation's Economic Budget*

In order to form a statistical picture of the total domestic economy, it is necessary to bring together in a single statement the description of the flow of receipts and expenditures within the separate segments of the economy, under the influence of the forces and events which have been discussed in this part of the Review with respect to each segment.

This comprehensive statement, The Nation's Economic Budget, is set forth and treated in great detail in Appendix C. Being a double entry statement, it must always be in balance, and for every change in any item there must be compensating changes in one or more of the other items. It is presented in three divisions, for the year 1949, for the first half of 1950, and for the second half of 1950. Sharp changes in economic currents have taken place between each of these periods, and the Economic Budget shows how these changes have affected, in quantitative terms, the money flow within and among the principal sectors of the economy. It also indicates how the necessary balancing changes have actually occurred during the past year. (See chart 32 and table 14.)

TABLE 14.—*The Nation's Economic Budget, calendar years 1949 and 1950*  
[Billions of dollars, annual rates, seasonally adjusted]

Economic group	1949			1950, first half			1950, second half <sup>1</sup>		
	Re- ceipts	Ex- pend- itures	Excess of re- ceipts (+) or expend- itures (-)	Re- ceipts	Ex- pend- itures	Excess of re- ceipts (+) or expend- itures (-)	Re- ceipts	Ex- pend- itures	Excess of re- ceipts (+) or expend- itures (-)
<b>CONSUMERS</b>									
Disposable income.....	187.4			196.6			207.6		
Consumption expenditures.....		178.8			183.8			197.7	
Personal net saving (+).....			+8.6			+12.7			+10.0
<b>BUSINESS</b>									
Retained receipts.....	30.2			30.1			28.4		
Gross private domestic invest- ment.....		33.0			44.3			52.7	
Excess of receipts (+), or in- vestment (-).....			-2.8			-14.2			-24.3
<b>INTERNATIONAL</b>									
Cash loans abroad.....	1.1			-.2			.1		
Net foreign investment.....		.4			-1.8			-3.4	
Excess of receipts (+), or in- vestment (-).....			+7.7			+1.6			+3.5
<b>GOVERNMENT</b>									
Cash receipts from the public.....	57.6			58.8			62.7		
Cash payments to the public.....		60.2			63.0			59.8	
Cash surplus (+), or deficit (-).....			-2.5			-4.2			+2.9
<b>ADJUSTMENTS</b> (To arrive at gross national product)									
For receipts <sup>2</sup> .....	-20.7			-18.5			-8.2		
For expenditures <sup>3</sup> .....		-16.8			-22.5			-16.2	
Difference between adjust- ments.....			-4.0			+4.1			+7.9
<b>Total gross national product.</b>	<b>255.6</b>	<b>255.6</b>		<b>266.8</b>	<b>266.8</b>		<b>290.6</b>	<b>290.6</b>	

<sup>1</sup> Estimates based on incomplete data.

<sup>2</sup> Includes receipts which do not arise from current production and hence are not a part of the national income: Transfers to individuals, Government interest, cash loans abroad, and the difference between tax liabilities and cash receipts. Also includes statistical discrepancy.

<sup>3</sup> Includes all cash payments which are not payments for goods and services and hence are not included in the gross national product.

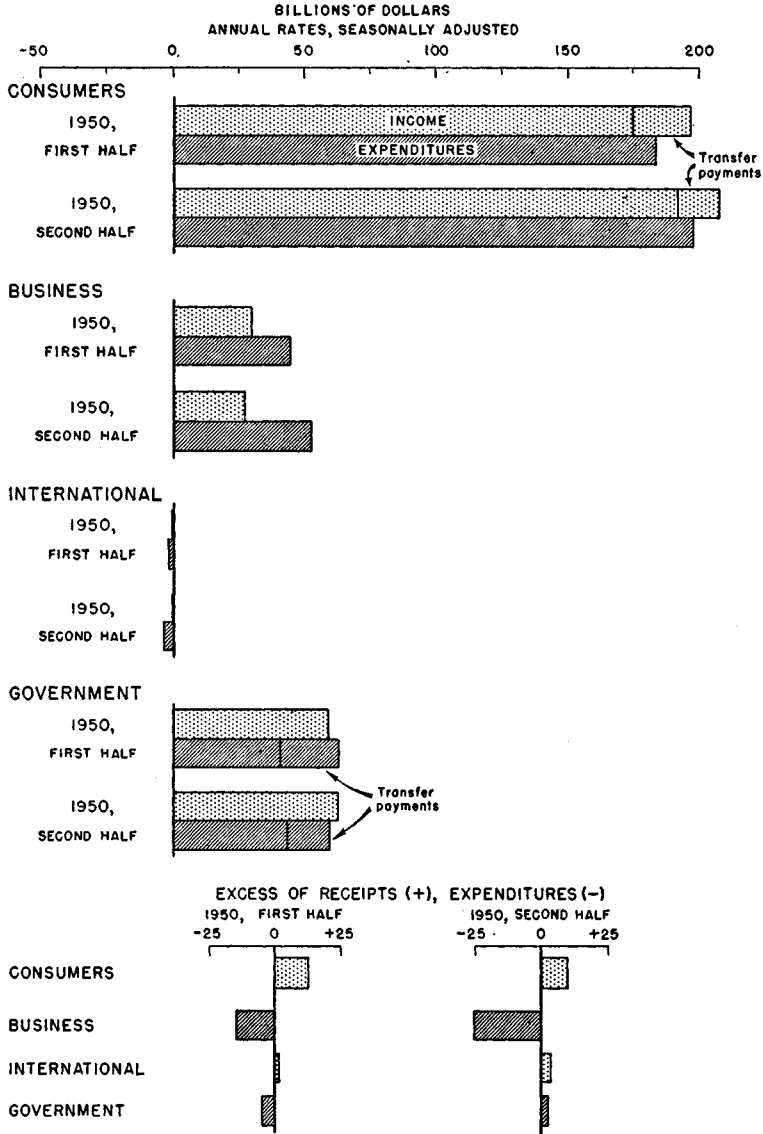
NOTE.—Detail will not necessarily add to totals because of rounding.

Source: See Appendix C for more detailed treatment of the Nation's Economic Budget.

CHART 32

# THE NATION'S ECONOMIC BUDGET

Business and consumer expenditures rose more than receipts from the 1st to the 2nd half of 1950, while the Government cash deficit gave way to a small surplus.



SOURCE: SEE APPENDIX C.

For the second half of 1950 as a whole, gross national product, at a seasonally adjusted annual rate, which appears as the total figure in the Nation's Economic Budget, reached a record level of about 290 billion dollars. This was nearly 9 percent above the rate of 267 billion dollars in the first half of the year. About half of this rise was due to price increases; the growth in physical volume of output was less than 5 percent.

The decision of the United States to undertake a large-scale preparedness program had its impact on the economy, in 1950, largely through anticipations of businessmen and consumers. In terms of actual Government expenditures, national defense, and international programs rose only 3 billion dollars (at an annual rate) in the second half of the year. Total Government payments even showed a decline, while receipts rose.

The increase in activity and in inflationary pressure between the first and the second half of the year was thus primarily attributable to private spending. While all categories of consumer expenditures increased, expenditures for durable goods, which were already at unparalleled high rates, rose 20 percent, compared with a rise of 5 percent for nondurable goods and services. Expenditures for producers' durable equipment advanced 32 percent. Total private domestic investment reached a level of nearly 53 billion dollars (annual rate) in the second half of the year, an increase of nearly 20 percent over the first half.

The rise in private incomes, while impressive, was less rapid than that in expenditures. The rate of personal net saving declined from an annual rate of 12.7 billion dollars in the first half of 1950 to 10.0 billion in the second half, partly as a result of expanding consumer credit and cashing of Government bonds by many families. In the business sector, investment expenditures exceeded retained receipts by 24.3 billion dollars (annual rate) in the second half of 1950, compared with 14.2 billion in the first half.

The Nation's Economic Budget, in summary, portrays an economy which is undergoing a boom in expenditures for both producers' and consumers' durable equipment, stimulated by anticipation of a large and expanding defense program.