To the Congress of the United States:

We face enormously greater economic problems, as I transmit this fifth annual Economic Report, than at any time since the end of World War II. Although our economic strength is now greater than ever before, very large new burdens of long duration are now being imposed upon it.

The United States is pledged and determined, along with other free peoples, to check aggression and to advance freedom. Arrayed against the free world are large and menacing forces. The great manpower under the control of Soviet communism is being driven with fanatic zeal to build up military and industrial strength. We invite disaster if we underestimate the forces working against us.

The economic strength of the free peoples of the world is, however, superior to that of their enemies. If the free nations mobilize and direct their strength properly, they can support whatever military effort may be necessary to avert a general war or to win such a war if it comes. The resources are on our side. The only question is whether they will be used with speed and determination. The answer will depend upon unity of purpose and of action—unity among the free nations, unity here in the United States.

Unity is imperative on the economic front. On this front, under the American system, everybody is involved—every businessman, worker and farmer; every banker and scientist and housewife; every man and woman. We can win our way through to ultimate triumph if we all pull together. Decisive action, essential to our safety, should not be halted by controversy now.

It is in this spirit that I transmit this Economic Report to the Congress.

The Nature of the Task

We must understand the nature of our defense effort here at home. Our job has three parts.

In the first place, we must achieve a large and very rapid increase in our armed strength, while helping to strengthen our allies. This means more trained men in uniform, and more planes, tanks, ships, and other military supplies. Second, we must achieve, as rapidly as possible, an expansion of our *capacity* for producing military supplies. Thus must be substantially greater than would be required to achieve our present targets for armed strength; it must be large enough to enable us to swing rapidly into full-scale war production if necessity should require. And third, we must maintain and expand our basic economic strength—important both to military production and to our civilian economy—so that we can continue to grow stronger rather than weaker if it should prove necessary to continue a defense effort of great size for a number of years.

The first part of this task—the primary military build-up—imposes the major immediate burden on the economy.

For the fiscal years 1951 and 1952 combined, new obligational authority enacted or anticipated for our primary national security programs—for our military forces, for economic and military aid to other free nations, for atomic energy and stockpiling, and for related purposes—will probably total more than 140 billion dollars. Actual expenditures on these programs in the fiscal year 1950, the last full year before the Korean outbreak, totaled about 18 billion dollars. At the present time, they are running at an annual rate of somewhat more than 20 billion dollars. By the end of this calendar year, they should attain an annual rate between 45 and 55 billion dollars, or from 25 to 35 billion dollars above the present rate. The actions we are taking should enable us, within twelve months, to expand this rate of expenditure very rapidly if necessity should require.

Current expenditures for these purposes now represent about 7 percent of our total national output. By the end of this year, this proportion may rise to as much as 18 percent. This compares with the roughly 45 percent of our total output that we were devoting to defense during the peak year of World War II. While the present program is thus very substantially short of the requirements imposed by full-scale war, it nonetheless requires a major diversion of effort. Furthermore, there will be a much more severe drain on some particular supply lines. By the end of the year, our expanding defense programs, including stockpiling, may be absorbing up to a third or more of the total supply of some of our basic commodities, such as copper, aluminum, and natural rubber. While direct defense requirements for steel may not total more than 10 percent of total output, the needed expansion of our essential industrial capacity will require a much greater diversion of steel from ordinary civilian uses.

In terms of manpower, our present defense targets will require an increase of nearly one million men and women in the armed forces within a few months, and probably not less than four million more in defense production by the end of the year. This means that an additional 8 percent of our labor force, and possibly much more, will be required by direct defense needs by the end of the year.

These manpower needs will call both for increasing our labor force by reducing unemployment and drawing in women and older workers, and for lengthening hours of work in essential industries. These manpower requirements can be met. There will be manpower shortages, but they can be solved.

The second part of the job is to build up our *capacity* for producing military supplies—our military production base. For example, our present aircraft program calls for capacity to produce 50,000 planes a year. Our present program for tanks calls for the capacity to produce 35,000 tanks a year. We are not now placing orders for that many planes or tanks, but we are getting ready to produce them if we need them.

There are many cases where our immediate production needs will require the diversion of plants now devoted to civilian production, but we cannot be satisfied with this solution alone. We must increasingly create new capacity to meet defense production targets. This will give us more economic strength, which means more power in reserve for any contingency. The job is made easier because we still have substantial reserve plant and equipment, as a result of the industrial reserve policy instituted at the close of World War II. It is a great program, but we can meet it.

The third part of the job is to increase our basic industrial strength—to build up our facilities for the production of steel, aluminum, power, and other basic commodities and services. This ability should be brought to a level where it can carry the present defense burden without the necessity for irksome controls extending over a long period. This will also increase our ability to meet any requirements for a greater military effort.

In the case of steel, for example, we must raise the capacity of the industry from its present level of about 103 million ingot tons a year by enough to support our defense effort and to sustain our civilian economy. The Council of Economic Advisers estimates that this will require an increase in capacity to about 120 million ingot tons in the next three or four years. This estimate is not necessarily final. But it suggests the kind of growth we are working for in our economy in the years immediately ahead.

To increase our steel supply, we must also increase our supplies of iron ore. Output of the high-grade Lake Superior ore fields can be maintained at present levels for only a few years longer. Thereafter, we shall have to rely more and more on lower-grade domestic ores and on imported supplies. Expansion of domestic plants for treating low-grade ores, and of ore production facilities in Labrador and Venezuela, together with related transportation facilities, is essential.

Electric power is another field in which we must expand capacity promptly. At the present time, electric power is in short supply in the Pacific Northwest, in the Tennessee Valley area, and in some other regions. The supply is expected to become increasingly short 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 areas where the power shortage is most acute. Yet, expansion of capacity now planned in atomic energy, chemicals, and 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, we should plan to increase our generating capacity by well over 20 million kilowatts during the next three years. The major share of this expansion must come from private utility enterprises. The large public hydroelectric projects take more time, but I am recommending the development of additional public power capacity in the Pacific Northwest, in the Tennessee Valley area, at Niagara Falls, along the St. Lawrence River as a part of the seaway and power project, and elsewhere, to contribute needed additions to the power supply as quickly as they can be built.

These are but two examples of the need to build up our productive capacity. If we were now engaged in full-scale war, we could not afford to devote manpower and materials to these longer-range programs. But to fail to do so under present circumstances would be short-sighted and potentially costly. Action now is essential, to make us stronger year by year in all of the components which enter into any military strength that we may need in future.

The Power of the American Economy To Perform the Task

There is no question that our economy can sustain the great exertions outlined above, and still remain strong and grow stronger. The past performance and present condition of the American economy make this plain.

In the ten years since this Nation decided that fascist aggression had to be stopped, the growth of our economic power has been prodigious. Comparing 1950 with 1940, our total output, in actual units of goods and services, is more than 50 percent higher. Farm production is up 25 percent. The total labor supply has increased by 9 million, and civilian employment by 13 million. In addition, we have more and better tools and equipment. Steel capacity is up more than 20 percent; oil refining capacity up 40 percent; electric power capacity up 70 percent. On our farms, there are two or three times as many tractors, trucks, and power-driven machines. Farm use of electric power has gone up three or four times.

It is sometimes thought that most of this economic growth occurred during World War II. True, under the dire necessity of wartime, we expanded with very great speed. But during the past five years, we have added greatly to the productive strength attained before V-J Day. More than 90 billion dollars (in 1950 prices) have been invested by private enterprise in plant and equipment. Total manufacturing capacity has increased by between 25 and 30 percent. Steel capacity is 12 percent higher; that of our chemical and machinery industries, 60 to 70 percent higher. Civilian employment late in 1950 was 8 million above the peak year of World War II, and output per man-hour for the economy as a whole has advanced by about 10 percent.

There has been very recent demonstration of our economic power, and of our capacity for further growth. In the first half of 1950, the upsurge of business recovery from the mild recession of 1949 was swift and comprehensive. This demonstrated the soundness of our economic structure. In the second half of the year, the pace of economic expansion became more rapid. Every part of the economy responded to the challenge of international developments. During these six months, private investment in construction, equipment, and additions to inventory reached the record annual rate of 53 billion dollars. Taking the year as a whole, industrial production was 14 percent higher than in 1949, and by June had exceeded the 1948 peak. The total output of goods and services during the year 1950 was 7 percent higher, in real terms, than during the previous year. It is now running at an annual rate more than 10 percent above the average for 1949. Civilian employment increased by about 1.3 million from 1949 to 1950, and there were more people in civilian jobs at the peak of 1950 employment than ever before.

Our economic history shows that we have risen to our greatest heights in the face of our greatest dangers. From the beginning of World War II to the time of our peak effort, we stepped up farm output by 20 percent, and industrial production by nearly 90 percent. Our total national output rose by more than 60 percent. If it had been necessary, we could have done much more.

We may not be able to add to our production so rapidly in the years immediately ahead. We had more unused resources of manpower, plant, and materials in 1940 than we have now. There are now some relative shortages of raw materials. On the other hand, as long as we avert a total war, we can devote a larger part of our total resources to building up our economy than we did after Pearl Harbor.

The accompanying Annual Review by the Council of Economic Advisers estimates, after careful examination of our economic resources, that we can and should achieve an annual rate of total output more than 7 percent above the current level by the end of this year. The estimates made by the Council at the start of 1950, concerning how much the economy could grow in real terms during the year, were realized. I believe that this progress will continue. We must plan and work together, to increase the total productive strength of our economy by at least 25 percent within the next five years.

We have not reached, and cannot foresee reaching, any final ceiling on our productive power. Throughout the years we have grown, despite ups and downs, and we will continue to grow. We have a growing population. We have business initiative and daring. We have workers of great skill and energy. We have the ability to make practical use of new scientific discoveries and inventions. We have, despite some shortages, bountiful natural resources. Above all, we have faith, justified by accomplishment, in our economic system.

This great vitality of our economy provides the answer to the question of whether we can sustain the burden of our defense program. In relative terms, this burden at present is much less than it was in World War II.

At the peak of World War II, we were devoting about 45 percent of our national output to defense. By the end of this year, we will be devoting about 18 percent to defense. During World War II, even when defense production was at its highest, we maintained a strong economy. Civilians made sacrifices, but they did not suffer.

Our total output today has reached approximately the 1944 peak. More important, we are now maintaining this rate of production with much shorter hours and less strain upon facilities. Our productive potential is not as fully mobilized as at the height of World War II. If we approached the same degree of economic mobilization, our total output would be very much greater, and so would our output of defense items. Our contemplated defense program, even if it were doubled, would still be clearly within our capabilities.

The Inflationary Danger

While it is clear that we have the productive ability to meet even far greater defense demands on our economy, we must not be misled into thinking that we can make the change to a defense economy easily. It will require effort, restraint, and sacrifice by all of us.

The character of our economy must now be changed rapidly to meet the new challenge. Those types of production which support the expanding defense effort must be greatly enlarged. The part of our total national output going into defense should rise from 7 percent to nearly 18 percent, during the year 1951. By the end of the year, the expanding defense program may be absorbing one-third or more of some basic materials.

In some respects, it will be harder to convert to defense production than it was in 1940. Then, there were idle plants and men and materials which could be channeled into the defense effort. Since our economy has recently been running full blast, the defense program will have to pull men and materials, as well as plants, away from existing peacetime uses. This will pull millions of people away from normal peacetime production.

Although we can increase production, we cannot do it quickly enough to expand the defense program, and at the same time still have as much left over for other purposes. We must put heavy restraints upon nonessential business activity. During the past few years, nearly 70 percent of our growing national output has gone into consumption. This has led to higher standards of living, which is the ultimate purpose of a peacetime economy. But the total supply of consumer goods cannot be increased this year, and many types of goods must be sharply curtailed. Yet the population will continue to grow; new families will continue to be formed; and more incomes for practically all groups will be generated by more production, more employment, and longer hours. The excess of consumer demand over available goods will rise by many billions of dollars.

This will cause intense and mounting inflationary pressures, which must be counteracted.

During 1950, even before the defense expansion gathered speed, inflation started to march. Wholesale prices rose almost 15½ percent, and passed the previous all-time peak in the second half of the year. Particular price increases were even more spectacular, with chemicals rising by 21½ percent, and textiles by 24 percent. The average price of goods to consumers rose over 6 percent; and there was over a 4½ percent rise to a new all-time peak in the six months from June to December.

Incomes also started to rise sharply. During the year, real weekly earnings in manufacturing, after adjusting for changes in prices, rose by 10 percent. Corporate profits before taxes rose by about 6 billion dollars above the previous record year. Most types of income, particularly in the second half of the year, rose faster than production.

If inflation continues to gain cumulative force, it will multiply the cost of the defense program. It will undermine production, destroy confidence, generate friction and economic strife, impair the value of the dollar, dissipate the value of savings, and impose an intolerable burden upon fixed income groups. This must not happen.

To fight inflation, demand must be held down until supplies can catch up. This is why we must have a stringent stabilization program. It will mean sacrifices by everybody. But under the conditions now facing us, restraints will serve the interest of all.

Principles for Action

As we prepare ourselves for the stern task which confronts us, we must keep in mind five basic principles. These are: (1) all of us must plan; (2) all of us must serve; (3) sacrifices must be shared fairly; (4) we must develop all our resources wisely; (5) we must work with our allies in the common cause.

All of us must plan

A defense emergency requires far more planning than is customary or desirable in normal peacetime. The military build-up is a planned effort. The mobilization of industrial support for this military build-up is a planned effort. The industrial cutbacks and civilian restraints, necessary to achieve military and economic mobilization, are planned efforts. The major decisions as to how much goods and services must be left over for consumers, to maintain a strong base for the whole undertaking, also require planning. In a defense emergency, all of these problems are interrelated.

In these critical times, it is recognized that Government must assume leadership in this planning. It has the prime responsibility for national security. It has access to the basic information. The most important operation toward this end is the broad programming of various major requirements; the balancing of these requirements against supply; and the development of policies to satisfy needs according to priority of purpose.

But the Government cannot develop these basic plans alone. The necessary experience and know-how are to be found throughout our whole economic system. Through constant consultation, these talents should be drawn into the whole planning effort. After the basic economic plans are outlined, most of them will have to be carried out by businessmen, workers, and farmers. They will be able to carry out these plans better, if they have had a chance to participate in creating them from the start.

These basic economic plans set general targets or goals. The details must be filled in by people all over the country. It may become necessary for the Government to indicate that longer hours of work are desirable. But working arrangements are made between employers and employees. The Government may indicate that more steel is needed. But steel production is in private hands. The Government may indicate that more cotton will be needed. But cotton is grown by farmers.

Businessmen always plan; and now they must plan how they can best help to make their country stronger. Labor organizations always plan; and now they must plan their contribution to the defense effort. Farmers also plan; and they, too, must now plan to play their full role in the national security effort. Government plans can aid, but cannot substitute for, this individual and group planning. To neglect this, would be to undermine one of the greatest sources of our economic strength.

All of us must serve

In a defense emergency, all those on the home front should serve, to the limit of their ability, in the kind of work for which they are best fitted.

Businessmen should serve, by employing their financial resources and managerial skills to produce the greatest possible amount of the goods which the Nation needs. In the period ahead, businessmen will have responsibility for a much larger part of the investment program than during World War II, when a very high percentage of investment in new capacity was made by the Government. Our ability to reach production goals will depend in large measure upon how effectively businessmen do their job.

Farmers should serve, by increasing their output. They have less manpower than before World War II, but far more machinery and fertilizer, and far better scientific methods. They can also serve, by making shifts in output which are responsive to the needs of the defense economy.

Workers should serve, by helping to improve productivity. They should seek out jobs which are essential to the defense effort. They should cooperate by working longer hours wherever it will help the defense effort. More people should seek work than in normal times.

Millions of others, in addition to businessmen, industrial workers, and farmers, are now called upon to do their jobs more efficiently, and to readjust their efforts to the needs of national defense.

For all to serve in full measure, it must be in a common cause and not primarily for personal gain. This does not mean that we should undermine the incentives which lead to more production. But the rewards for increased production cannot be as great under a defense program as they are in normal peacetime. This is because most of the increased production must go into national defense, and consequently cannot be used to improve incomes or lift standards of living.

Each group and individual will be more willing to put forth greater effort, if it appears clearly that everybody is doing the same. Businessmen, workers, and farmers will be willing to work harder, to the extent that they feel that they are working harder to serve their country, and not just to benefit somebody else. There should be a sense of equality of service in the defense program. Public policies must help to assure this.

Service by all is even more important than sacrifice, because it is work, and more work, that increases production.

Sacrifices must be shared fairly

No matter how efficiently we do our jobs, all of us must make sacrifices.

Businessmen must make sacrifices. They must pay much higher taxes. While profits should not be taxed to the extent which would jeopardize production or destroy incentives, businessmen cannot expect to retain profits on the scale which would be expected during normal peacetime prosperity. They must also accept restraints and controls upon many of their business practices—including price policy and the use of materials and manpower—which are not customary in peacetime. They must be willing to withdraw from enterprises which are nonessential and wasteful during a national emergency.

Workers must make sacrifices. They must seek the jobs which need doing, in the locations where these jobs must be done, instead of the jobs which may be most pleasant in the locations which are most convenient. They must accept restraints and controls upon wages, designed to prevent the wage increases which would be attainable if more goods were being produced for wage earners to buy. While the right to bargain collectively will be preserved, workers—along with management—must find ways to settle disputes without stopping essential production.

Farmers must make sacrifices. They should receive their fair share of available national income. But they cannot expect to avoid their fair share of the cost of national defense. Over the past two decades, farm standards of living have risen substantially, and they needed to rise, because farmers had lagged far behind others in sharing the national income. But that rate of progress cannot be continued in these perilous times.

All economic groups must pay much higher taxes.

American families must make sacrifices. They can expect very sharp curtailments in the supply of durable equipment which brings convenience and entertainment to the home. They will have to make their household goods last longer, their automobiles and appliances, their linen and clothes. They must save a larger portion of their incomes. Many of them must postpone buying a new house.

These sacrifices will not prevent us from maintaining a strong and growing economy, capable of supporting the current defense program or any greater program that we may need to undertake. On the contrary, these sacrifices will make for a stronger nation by curbing inflation. They will make us stronger, not only by augmenting our military strength, but also by enabling us to increase the productive facilities which can lighten the economic burden in the long run.

It is essential that the sacrifices which are necessary in these critical times be shared fairly by all groups. Businessmen will be more cooperative in sacrificing peacetime profit objectives and paying more taxes, if it is clear that this is not being done just so farmers and workers can have more income. Farmers will be more cooperative in sacrificing peacetime farm income objectives, if it is clear that this is not being done just so workers can get more wages and businessmen can get more profits. Workers will be more cooperative in sacrificing peacetime wage objectives, if it is clear that this is not being done just to provide more profits for business or more farm income. Professional people, civil servants, office workers, and those living on fixed incomes, will be willing to accept their share of necessary sacrifices, to the extent that it is clear that this is not being done just to provide for other people more profits or wages or farm income. All will be willing to make far more sacrifices for national defense and to keep our economy strong, if the burden is shared on a fair and equitable basis.

We must develop all our resources wisely

The rapid expansion of the defense program must be the first objective in all that we do. But military strength does not depend upon guns and armed forces alone. These forces must be equipped by our industry, fed by our farms, and supported by all the people. There must be a continuing balance between the build-up of military strength and the build-up of economic strength.

In a total war, this balance would be very different from what it should be now. In a total war, we would have total military mobilization, accomplished by considerable depletion of other kinds of strength. In the current situation, we must place considerable stress upon economic strength, or run the danger of being weak at some future time if total military strength should then be required.

With these purposes in mind, we must apportion materials and manpower carefully among military needs, stockpiling, and industrial needs. We must divide industrial supply carefully, so as to expand in some areas while contracting in others. We must divide total civilian supply carefully between industry and consumers, so that we do not weaken manpower while improving tools.

The handling of our natural resources is a vital aspect of this problem. Many projects must be cancelled or deferred, but those necessary for defense and essential civilian needs must go forward. If we allow our agricultural and range lands and our forests to deteriorate, and if we misuse critically needed minerals and supplies of water, we shall become weaker each year instead of stronger. If we do not expand the use of some of these resources—as, for example, through carefully selected power developments—we cannot expect to reach the full potential of our industrial strength. We can cut down enough on the private and public use of materials and manpower for nonessentials to accomplish these essential projects.

Our human resources are our main economic strength. When we finally win in the contest between freedom and slavery, it will not be primarily because of our superior technology. It will be primarily because we value human beings, and because the free man can outproduce the oppressed man.

No danger could be greater than to concentrate so blindly upon building up our military strength that we neglected and impoverished the ultimate sources of that strength. Three examples will illustrate this principle.

First, we cannot afford in the immediate future to devote as large a part of our resources to the improvement of health services and facilities as we had planned to do in normal peacetime. But we cannot maintain a sound base for whatever military mobilization may be needed in the months or years ahead, if we let sickness and inadequate health standards continue to take their heavy toll. We must devote somewhat more of our resources toward improving the health of the general public. Whether the children of today will be the soldiers or civilians of tomorrow, they must grow to a strong and healthy maturity.

Second, we cannot in the immediate future find the materials and manpower to build as many new schools and provide as many new teachers as we had planned to do in prosperous peacetime. But whether the youth of today is to become a soldier or a civilian citizen tomorrow, he must receive the general education for citizenship and the technical training which a modern army, a modern factory, and a modern farm all require.

Third, we cannot expect in the immediate future to achieve all of the expansion of social security which we had planned for in prosperous peacetime. But some of the hazards which social security is designed to guard against are increased by the mobilization effort. Increased protection against these hazards will make the mobilization effort more effective. In addition, the expansion of some contributory social security programs can be an important factor in meeting the stabilization problems we will face during this period, because their immediate effect would be anti-inflationary.

In these three matters, we should give vigorous attention to meeting human needs in such a way as to increase our economic and military strength.

A strong America must be strong throughout.

We must work with our allies in the common cause

To meet the present danger, we must help to strengthen our allies, and they must help to strengthen us.

The effort must be made by the community of free nations, working together, and contributing their common strength in accordance with their ability to do so. As the single most powerful member of the community of free nations, our country has the special responsibility of leadership. We must help other free nations to do their share effectively.

In two world wars, this country has been spared the ravages of war on its own soil. Partly as a consequence, the United States has grown stronger, while some of the other free nations have become relatively weaker. Under these circumstances, it would be wrong for us to shrink from bearing a larger part of the burden now. We are able to bear it. We must bear it.

Since the Korean outbreak we have sharply shifted the emphasis in our economic assistance programs toward supporting the defense programs of the free countries associated with us, and we have greatly enlarged our military assistance program.

There is no water-tight distinction between military assistance and economic assistance. Our friends abroad need both. For their military efforts to be strong, their economies must be strong. When we contribute to their military strength, we leave more of their own resources free to improve their economic strength. When we contribute to their economic strength, we leave more of their own resources free to build up their military strength. The relationship between the two types of assistance should be determined realistically on grounds of efficiency, and not by arbitrary labels.

The programs of economic assistance thus far undertaken have added greatly to the strength of other nations friendly to us—nations believing in freedom and justice. This gain could be dissipated, if the military build-up which they must now undertake should weaken their economies.

The close connection between a nation's economy and its military efforts makes it impossible for peoples to be allies on one front and strangers on other fronts. When we join together for military purposes, we must also cooperate for economic purposes. When we consider jointly the distribution of armed forces, we must consider cooperatively the use of strategic economic assets.

In this whole process of cooperation, the strongest must do the most, but all must do their part. While our resources are great, they are not unlimited. As we make a portion of our resources available for use by others, we expect them to use this aid well and efficiently in the common purpose. In addition, our aid will enable them in many cases to increase their production, for their use and ours, of materials which we do not have, or do not have in sufficient quantity.

Government Economic Policies

The actions of the Government are being redirected to meet the overriding demands of national security. The Budget I shall transmit next week provides only for urgent needs for Government activities and services in this defense period. Many Government programs are being sharply curtailed. The departments and agencies of Government are moving rapidly ahead with their part in the defense effort, and deferring wherever possible any work which is not immediately necessary.

The same principle should guide the Congress in enacting legislation at this time. We must all put first things first.

Certain immediate tasks will confront the Congress at this session, as it enacts the legislation necessary to carry us forward. I mentioned these briefly in my Message on the State of the Union earlier this week. Some of them are discussed more fully in this Economic Report, and in the Budget Message to follow. In a number of cases, however, details are still being worked out, and I shall transmit recommendations in later special messages.

The first priority, of course, attaches to the support of our own military services and of our combined efforts, with other free countries, to build up the strength of the free world. In both cases, we are concentrating on the urgent task of preparing stronger defenses against aggression. At the same time, we are building a foundation for continuous growth in the ability of free men, in our country and elsewhere, to advance the cause of freedom.

Toward these ends, the economic policies of the Government should now be directed.

Expansion of production

Industrial production. Under the Defense Production Act, enacted last September, we have taken the first essential steps to give priority to defense requirements out of current industrial production. In the field of priorities and allocations, where Government action has already been vigorous, steps have already been taken (a) to insure that defense requirements for production materials and facilities are met on schedule; (b) to distribute the remaining available supply of critical materials and products equitably among other users after defense requirements have been satisfied; (c) to provide materials for needed expansion of productive capacities; and (d) to promote conservation of scarce materials and the development of substitutes. The commodities affected have included aluminum, cobalt, cadmium, copper, nickel, rubber, steel, tin, zinc, and other basic materials. Selective rather than general curtailment is now being put into effect, and a comprehensive materials control plan is being prepared for use when necessary. Priorities and allocations powers will have to be renewed by the Congress this year, if our production control program is to be continued. It is, of course, essential that this be done.

In placing orders, the Defense Department and the other agencies concerned are adjusting contracting and subcontracting policies to broaden the supply base and to bring in more small producers. Procurement is being related more closely to geographic availability of manpower, materials, and equipment resources. Procurement cost-price policies are being centered upon efficiency problems. Greater uniformity of standards is being developed for all procurement activities.

In planning and carrying out the military procurement program, the Department of Defense is giving major emphasis to obtaining productive capacity broad enough to support a much larger military procurement program than the one now under way. Thus, the Department is spreading orders among as many contractors as practicable, and tooling-up plants with reserve capacity, so that military procurement can be further enlarged on short notice if necessary.

In addition, we have begun the work of obtaining increased plant capacity in key industries, among them steel and aluminum. Two main types of assistance are now being furnished by the Government to help private industry expand: accelerated amortization under the new tax laws, and long-term Government loans under the Defense Production Act. These aids will help to secure much of the needed expansion.

Under the authorization of the Defense Production Act, Government agencies have received requests for direct loans totaling more than 830 million dollars, and are processing requests for accelerated amortization involving outlays for plant expansions totaling nearly 4 billion dollars. Of those on which approval has already been recommended, 66 from the steel industry alone represent capital outlays of more than 1¼ billion dollars.

Our loan program for expansion of productive capacity and supplies will soon require more funds than have so far been made available. The program will of course need to be continued in operation beyond June 30, 1951, the current expiration date. In addition, our present aid programs will need to be backed up by legislative authority for direct government construction of industrial facilities, in those special cases where private enterprise cannot undertake the job even with the government assistance available.

These and other aspects of our economic mobilization laws are now under review by the Director of Defense Mobilization. After he has completed his investigations, detailed recommendations will be made to the Congress for appropriate revision of the Defense Production Act and other related statutes.

In addition to our efforts to expand industrial capacity, steps are being taken to increase production of essential raw materials, both here and abroad. Through financial aids for exploration and development and long-term expansion loans, authorized under the Defense Production Act, and through our stockpiling and foreign economic aid programs, we are stepping up the production and procurement of critical materials, both at home and abroad.

Iron ore constitutes one of our most serious potential shortages. As the Annual Economic Review points out, we should be receiving large shipments from the new Venezuela and Labrador developments by 1954 or 1955. This is urgently needed to meet the expected decline in ore production from the Lake Superior region. But to avoid extremely high-cost transportation, and hence high-cost steel operations, we should start at once on the St. Lawrence Seaway and Power Project, so that imported iron ore can be shipped efficiently by water to the great steel producing centers of the Middle West.

The St. Lawrence project is vital also to bring in a new source of power for industry in the Northeast. We must have more power, in this and other areas, if we are not to place sharp limits on our industrial capacity.

Agricultural production. Our farms are no less involved in the production effort than our factories and mines. The demand for farm products has increased greatly since the Korean outbreak. Military needs for cotton and wool have risen sharply. Military food requirements are also rising, as more men come into military service. There has been an exceptionally high civilian demand for meats and many other foods, and this is expected to continue.

In the face of these rising demands, we now have low supplies of cotton and wool. Our food supplies, while entirely adequate for the time being, will clearly have to be increased. The Government is moving now to help meet the need for increased production, especially of cotton, corn, wheat, wool, and livestock. Acreage allotments and marketing quotas have been set aside. Price supports at 90 per cent of parity have been announced for cotton and wheat for the 1951 crop year. Every effort is being made to bring the new cotton crop to a level 60 per cent above that of last year.

Our farms are now more mechanized than ever before. To get out the increased crops, they will need a steady supply of farm machinery and spare parts. Fertilizers will be equally necessary to meet expanding production goals. Our farmers are using much more fertilizer than before the war, and will need still more to get the yields that we are after. Many of the things the farmers need will be in short supply. Farm and industry requirements will have to be balanced very carefully. But we will do our best to see to it that the essential farm needs are met.

Manpower. We cannot produce in industry or agriculture without the trained workers to do the job. As the defense production job speeds up, we will have to be increasingly careful about the distribution and use of the skilled labor we have available. We will have to train more and more new workers who are not now in the labor force. Major emphasis should be upon training and recruitment of unmarried women and married women without young children. Support should be extended to nursery schools as an aid to mothers who want jobs.

Additional shifts and longer hours in some defense industries are being encouraged. Industry hiring standards are being reviewed, to provide suitable jobs for more workers. Arrangements are under study to protect the pension and seniority rights of workers who shift to defense jobs. Health, education, rehabilitation, and training programs are being reshaped to concentrate upon problems of defense workers. Existing housing, community facilities, and service programs are being modified, and construction is being shifted to defense areas.

We are already setting up voluntary labor-management committees to work with the United States Employment Service in the principal defense areas. These committees will help to shift workers into essential industries, and will gain cooperation in installing the most efficient hiring practices and promoting the best use of skilled workers on the job. To provide better protection of workers who leave their communities to take defense jobs in other States, the unemployment insurance system should be improved.

It is now quite clear that, just as in World War II, we will need special legislation to provide housing and community facilities and services for defense workers in areas where adequate quarters are not now available.

We will need to encourage private construction of rental housing in these areas. We will need publicly financed construction of housing and related facilities where private enterprise is unable to handle the job. We will need additional aid to community facilities and services in defense production centers. The Housing and Home Finance Administrator has submitted recommendations for legislation to accomplish these purposes. I hope that prompt action will be taken by the Congress.

Health services and education

It is clear that we cannot neglect the education and health of our people, without the most serious results for a long-run defense effort. Obviously, we will not now have available the resources to build or staff as many schools and clinics and hospitals in as many places as we hoped to do in normal times. But the quality of essential services must be maintained and improved, as fast as can be managed. This is imperative for the success of the defense job.

It is not enough to train people as workers—or as soldiers. They have to be healthy enough to get a job and do it effectively. Right now, sickness is keeping about a million workers off the job every day. Right now, failure to meet health standards is making about a quarter of our young men unavailable for military service. During World War II, about six million men were rejected by the armed services for physical or mental disabilities.

We cannot afford this waste of manpower, our most vital resource. As a first step, we must obtain more doctors, more dentists, and more nurses. The growing needs of the armed forces, piled on top of civilian needs, threaten the most dangerous shortages unless prompt action is taken by the Congress.

At the same time, we must expand our local public health services. They are essential to our civil defenses, and to the maintenance of safe health standards in our growing production centers.

As we move into a period when we will have an urgent need for all our trained men and women, we must face the fact that nothing can make up for faulty basic education in our primary and secondary schools. This is as true for the men in military service, as for the factory worker or the farm hand.

Our public school system faces the greatest crisis in its history. More than ever before, we need positive action by the Federal Government to help the States meet their educational tasks. We simply cannot afford to let overcrowding, or lack of equipment or staff impair the basic education of our young people.

Under legislation passed last year, the Federal Government is stepping up its aid to school districts overburdened as a result of Federal activities. But special aid of this type to particular school districts will not come anywhere near meeting the general crisis which exists. Therefore, it is vital that the Congress act now to give the States general aid for school maintenance and operation.

Economic stabilization

The Government has been moving ahead in several ways to stabilize the cost of living and hold down inflation.

Taxation. We should make it the first principle of economic and fiscal policy in these times to maintain a balanced budget, and to finance the cost of national defense on a "pay-as-we-go" basis.

The Congress is to be commended upon the successful completion of two vitally important pieces of tax legislation since the middle of the calendar year 1950. But it was commonly acknowledged that these were only the first steps. We must now, as rapidly as possible, take the next step, and it must be a very big step, in view of the size of the new defense funds which have necessarily been appropriated and the required additions to these funds which will be set forth more fully in the Budget Message. Legislation should be enacted, at this session of the Congress, to increase taxes by very much more than they were increased by the last two major tax bills which the Congress enacted.

These new taxes are required to finance the defense effort; and to help keep total spending within the capacity of current production, so that inflation does not reduce the purchasing power of the defense budget, reduce the real value of people's savings, generate speculative buying and hoarding, and impede essential production. The real economic cost of this defense effort is that we must work harder, reduce consumption, and forego improvements in farm, business, and household equipment. This cost cannot be put off into the future. It must be paid by the people now, one way or another, and it should be paid through taxation, in the manner consciously determined by the Congress and not by the uncontrolled and inequitable incidence of inflation.

The new tax increases, now required, must press harder upon every source of available revenue. Corporations should pay much higher taxes. Individuals should pay much higher taxes. Excise taxes should be higher and more extensive. Many loopholes in the tax laws should be closed. In the near future, after further consultation with legislative leaders, new tax proposals will be transmitted to the Congress.

Taxation must be supplemented by greatly increased saving. Every dollar saved means a dollar less of inflationary price pressure. The alternative to saving is not buying more goods now, because more goods are not now available. The saving will give a nest egg with which to buy the goods at a later time when they again become plentiful. The alternatives to more saving are either more taxes or inflation.

Savings help most in the defense effort, and do the most to hold down inflation, when they are invested in Government bonds. The Treasury will continue its policy of reducing the amount of debt held by banks and placing the maximum proportion of Government securities in the hands of the public, particularly individuals. The savings bond program supports this goal and encourages saving.

Credit controls. Controls over business and consumer credit also help hold down inflation.

Regulations W and X, issued by the Federal Reserve Board, have established higher down payments and shorter repayment periods for those who buy durable goods and new one- and two-family houses on credit. Multifamily housing is now being brought under Regulation X. As the detailed requirements for the defense program and other vital purposes become clearer, it may be necessary to make further changes in these regulations. These regulations are well suited to help deal with moderate reductions in supply. If circumstances force acute reductions, more direct measures will be needed to assure equitable distribution. In the meantime, the authority to control housing credit through Regulation X should be enlarged by the Congress to include credit for the purchase of existing homes exempt under the present law.

The Federal Reserve Board has also taken steps to restrain excessive bank lending, by raising bank reserve requirements and allowing short-term interest rates to rise.

Price and wage controls. We must use direct controls, as well as these tax and credit measures, in order to deal with the problem of inflation.

In the case of prices and wages, considerable work has been done. In addition to the mandatory order affecting automobile prices, substantial progress has already been made through negotiations towards securing effective price stabilization in such basic materials as steel, copper, lead, zinc, and certain basic industrial chemicals. Negotiations to secure effective price stabilization are under way with producers of other basic products. A number of regulations for mandatory action are in preparation.

We must achieve general stability as rapidly as possible, and hold it for the duration of the present emergency. This will require the broad extension of price and wage controls to hold down the upward spiral. The staffs to apply broader controls are now being rapidly gathered.

In the case of prices, the general policy must be to hold the price line with utmost vigor, as the instances are rare indeed where further price increases are needed, either to stimulate production or to provide adequate profit incentives. In these rare cases, some price adjustments subsequent to stabilization may become necessary to stimulate vital production.

It is my confident belief that price adjustments, after stabilization, will not be only in an upward direction. In many industrial lines, extensive additional production, made possible in many instances by military orders added to civilian orders, will result in lower costs, which can be passed on both to civilian buyers and to the Defense Department.

To prevent excessive speculation in farm products, and wide fluctuations in their prices, the Department of Agriculture should be granted authority to control speculative trading and to strengthen its regulation of commodity exchanges.

Price and wage stabilization must both be undertaken, because of the economic connection between prices and wages. It follows from this that neither price action nor wage action can be decided upon in isolation. The decisions must be reconciled. They must be subject to central direction. But it does not follow that prices and wages are precisely similar, or can be treated identically. Prices are only one factor in the incomes of business, which may rise or fall independently of prices. But wages are the very livelihood of millions of families. This makes wage stabilization the more difficult part of the task. But it must be undertaken if prices are to be stabilized.

A more rapid rise of total wages available for spending than of the production of goods which workers can buy will not make more goods available, but rather will add to inflationary pressures. Since the amount of goods available for consumers cannot be increased in the near future, and many types of goods must be severely contracted, the objective should be to limit correspondingly total spending of wages. Strong tax and savings programs are required, but stabilization of wage rates is also necessary. This is particularly necessary because, even with no wage rate increases, there will be an expanding volume of total wages. Hundreds of thousands of new workers will be employed, and hours of work will be longer. Moreover, there are a few kinds of situations where adjustments in wage rates will be necessary and desirable. But this should be done only upon a clear showing of necessity in exceptional circumstances. The predominant general rule should be to achieve stable wage rates until the flow of consumer goods can be increased.

It would be impossible to achieve lasting wage stabilization without holding the line on the cost of living. This makes it all the more important to stabilize the price level. Unless this line is held, it will not be practical to avoid some "cost of living adjustments" in wages in some cases. However, there are many groups which could not be protected in this way. And to extend such adjustments without limitation, even in all those cases where it could be done, would add to the process of wages chasing prices and prices chasing wages. The only way out of this dilemma is to stabilize the cost of living, and to do it quickly.

Wage stabilization also involves the problem of incentives. Without incentives, it would be harder to sustain longer hours of work in defense industries, and to spur on workers toward their participation in efforts to improve productivity. As we look forward to years of constantly increasing effort to strengthen our economy, this problem of incentives cannot be overlooked. Yet the peacetime increases in wages, which normally provide incentives, would under current conditions add to inflationary forces. Consideration should be given to the suggestion that, where some wage adjustments become necessary over the long pull to provide incentives, the increased potential spending power should be diverted from the actual spending stream until inflationary pressures become less serious. Various constructive proposals may be developed to obtain this deferred effect. Wage adjustments related to increased social security contributions would be one method. Other effective savings programs should also be considered.

I firmly believe that effective wage stabilization must draw heavily upon the experience and viewpoint of workers and employers with practical experience. That is the principle underlying the Wage Stabilization Board. The Board is to be commended for its policy of consultation with representatives of labor, management, and the public. I earnestly trust that a sound and fair wage stabilization policy will quickly result. Such a policy will provide the best foundation for effective wage stabilization in detail. The principles which I have outlined can be the starting point for a wage stabilization policy which will receive the cooperation of those who would be affected and which will serve the best interests of the Nation in this emergency.

In the interest of economic stabilization all groups should consider what they receive before taxation. Of course, heavier taxes will make it harder for everybody. But for any group to seek to adjust its income upward, to counteract the higher taxes which the defense program is making necessary, would tend to relieve that group from its share in the cost of achieving national security.

I am sure that every group will be willing to accept the necessary sacrifices in this emergency, if the whole stabilization program is fair and equitable. Effective price and wage controls, much higher taxes on business profits, along with many other restrictions which will affect the whole population, are all aspects of a comprehensive stabilization program in which everyone will do his part.

It is already plain that the present rent control law has been made obsolete, in the light of the necessary curtailment in the rate of housing construction and the current inflationary pressures. Since rents are such a key element in the cost of living, I recommend that the Congress extend and strengthen the rent control law.

International economic programs

Our program of military and economic aid for the strengthening of the community of free nations, including our programs for underdeveloped areas, are of vital importance. They are closely related to other aspects of our foreign economic policy. The defense program increases the importance of strategic raw materials, and we are already working with other free nations to increase the supply of these materials, and to distribute them fairly. We should take cooperative action with the free nations, to make sure that critical materials are used to strengthen the common defense of freedom, and are not diverted to other purposes. In a short time, I shall send to the Congress detailed recommendations on our international economic programs.

Use of export controls and allocations will enable the United States to carry out more effectively its part of international allocations agreements, and to distribute more efficiently other commodities in short supply.

The power to control exports, now scheduled to expire June 30th, should be extended.

International trade policies should be adjusted to joint requirements. While the defense effort will require a wide increase in trade controls, a large part of the world's trade will continue to be conducted in normal channels. The common defense objective can be furthered by the reduction of tariffs, quotas, and other trade barriers. To this end, the Trade Agreements Act should be extended, our customs laws and procedures should be simplified, and the import tax on copper should again be waived.

Summary of Economic Developments in 1950

By June 1950, the economy had almost fully recovered from the mild recession of the previous year. Employment and production were high, and prices were rising. The anticipated expansion of our defense program, following the Korean outbreak, led to still further increases in employment and production. It created strong inflationary pressures.

In this situation, many economic indicators reached record highs, and most of them are still rising. Higher employment, longer hours of work, and overtime payments raised wages and salaries and swelled the already high demand of consumers. On all fronts, strong demand raised prices, and in some shortage areas the price advance was rapid. Increased volume at higher prices boosted business profits. The obvious need for greater productive capacity stimulated business investment. Rising living costs and high business profits led to increasingly successful efforts to obtain wage increases.

The record levels of employment, production, and business investment have demonstrated the vigor of our economy. But the spiraling rise in prices, wages, and profits is a warning that inflation endangers our economic prospects and our defense efforts.

Civilian employment averaged almost 60.0 million persons in 1950, compared with 58.7 million in 1949. The gain in nonagricultural employment was about 1.8 million, but farm jobs declined by about 500 thousand. Employment increased steadily throughout the year, except for a small seasonal drop in the fall months. At the end of the year, employment was at an all-time record for December.

Unemployment, after reaching a peak of 4.7 million persons in February, dropped markedly through most of the year. It reached a low of 1.9 million in October, and then rose slightly in the last two months of the year. At the end of 1950, only 3.6 percent of the labor force was unemployed. This is near a practical minimum for a peacetime economy, but is not irreducible under present conditions.

Production of goods and services as a whole in 1950 was 7 percent greater than in 1949. This was a record for any postwar year, and apparently was close to the record reached in World War II. In the fourth quarter of 1950, total production was 10 percent higher than for the year 1949.

The physical production of goods alone (not including services) was 11 percent greater than in 1949, despite a 2 percent drop in agricultural output. Industrial production increased 14 percent. Gains were especially marked in the case of durable goods. More steel was produced in 1950 than in any previous year. The automobile industry operated at a record rate during most of the year. Electric power rose 13 percent over 1949. Construction, measured in physical terms, reached an all-time high, and averaged 17 percent above 1949.

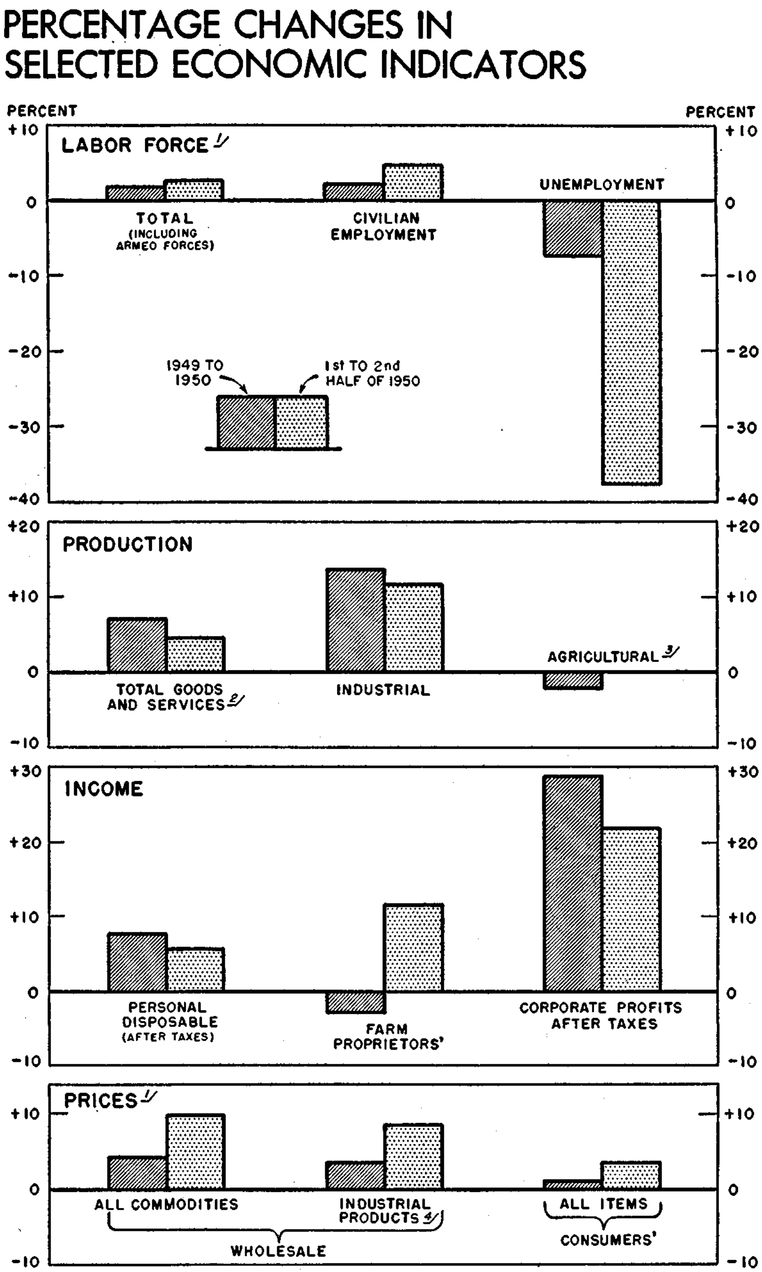
Prices moved upward throughout 1950, the pace of the advance increasing sharply after the Korean developments at midyear.

Wholesale prices in December were at an all-time high, 10.9 percent above the June level and 15.4 percent above December 1949. The price increases were not limited to a few commodities, nor to a few groups. For a few weeks after the Korean outbreak, farm and food prices rose sharply. The rise in industrial prices, while at first less spectacular, was steady and persistent. At times, the violent gyrations in prices of imported raw materials have been in the spotlight. But now the rise in wholesale prices has been quite general, affecting all major categories of goods.

Consumers' prices rose over 6 percent during 1950, the major part of the rise occurring in the latter half of the year. They ended the year at a record level. Rising living costs absorbed a considerable part of the gains in consumer incomes.

Wages and salaries and other labor income rose continuously in 1950, reflecting wage rate increases, longer hours of work, and increased employment. By the fourth quarter, they had reached a record high of 155.9 billion dollars, 16 percent above the level a year earlier. Weekly earnings in all manufacturing industries rose from $54.43 in November 1949 to $62.06 in November 1950, a gain of 14 percent.

CHART I



1/ NOT ADJUSTED FOR SEASONAL VARIATION.
2/ GROSS NATIONAL PRODUCT IN 1950 PRICES.
3/ ONLY AVAILABLE ANNUALLY.
4/ ALL COMMODITIES OTHER THAN FARM PRODUCTS AND FOODS.

SOURCE: APPENDIX TABLE A-48.

Wage increases were widespread and substantial in the second half of the year, being accelerated by a continued rise in the cost of living and by expectations of wage and price controls.

Profits of American business, before taxes, exceeded all records in 1950, reaching 40.2 billion dollars, or 46 percent above the level of 1949. They attained a peak annual rate of 48.0 billion dollars in the fourth quarter. The previous peak rate was 35.3 billion in the third quarter of 1948. The higher profits reflected increased output, greater sales, and higher prices.

Corporate profits after taxes, and net incomes of unincorporated business, also made new records. The net income of farm proprietors rose in the latter half of the year. By the fourth quarter, it was 9.4 percent above the fourth quarter of 1949, although 25 percent below the postwar peak in the second quarter of 1948.

Money and credit expanded with the growth of the Nation's output and the rise in prices. Many components of business and consumer debt reached new highs.

The housing boom stepped up the growth in residential mortgage debt, from an 11 percent increase during 1949 to 17 percent during 1950. Consumer instalment credit increased 22 percent in the first nine months of 1950, compared to a rise of 15 percent in the same period of 1949. Government policies helped restrain the rate of consumer credit expansion during the last quarter of the year.

Total privately-held bank deposits and currency increased by 6.4 billion dollars, reaching 176 billion by the end of the year.

Personal income, at an annual rate of 233 billion dollars in the final quarter of 1950, was 14 percent greater than a year earlier, and more than 8 percent above the second quarter of 1950. Although the annual rate of personal taxes increased by over 2 billion dollars from the first half to the second half of the year, personal income after taxes rose by 11 billion. The rise in prices partly offset this increase, but there was a gain of about 2 percent in consumer purchasing power.

Consumption expenditures in the second half of the year far surpassed those of any previous period, nearing an annual rate of 200 billion dollars. The increase was especially marked in the purchase of durable goods. A substantial part of the increased consumer expenditures was a reflection of higher prices.

Personal net saving dropped from a rate of 6.5 percent of disposable income in the first half of the year to a rate of 3.1 percent in the third quarter, reflecting the first wave of post-Korean buying. Then it rose to 6.4 percent in the final quarter.

Private domestic investment in construction, equipment, and additions to inventory rose very sharply, increasing 19 percent from the first half of 1950 to the second half, and increasing 67 percent from the second half of 1949 to the second half of 1950. In the second half of 1950, this investment reached an all-time record of 53 billion dollars at a seasonally adjusted annual rate. The increase during 1950 was most marked in the case of producers' durable equipment.

The investment trend was already upward before the Korean attack led to an expansion of the defense program, and to a rapid further rise in investment. Private and Government surveys indicate that business plans to spend more for plant and equipment in 1951 than in 1950.

The resumption of inventory accumulation during the first half of 1950 was a factor contributing to business recovery. Economic developments made it difficult for business to build up inventories immediately after mid-year; the strong demand forced some reduction in the third quarter. But in the fourth quarter, inventory accumulation was marked.

The use of capital funds by nonfinancial corporations was almost 24 billion dollars above 1949. Three-fifths of these funds were obtained internally from retained earnings and depreciation allowances.

Construction put in place in 1950 was 23 percent higher than for the year 1949, and greater than in any previous year. The sharpest increase was in housing. A peak of 149,000 new dwelling units was started in May, and approximately that level was maintained through August. In the fourth quarter, starts fell sharply, partly as a result of credit restrictions.

International developments greatly stimulated domestic demand and production, but the pressure of foreign purchases lessened. Exports in 1950 were nearly 1.9 billion dollars less than in 1949. The surplus of exports over imports fell from 6.2 billion dollars in 1949 to an annual rate of 3.0 billion in the first half of 1950. An increase in our imports, after we decided to speed up the rebuilding of our defenses, brought this annual rate down to the probably transitory level of 600 million in the second half.

Both the volume and prices of imports increased substantially. In 1950 our export surplus was less than our foreign aid, but this aid declined substantially from the 1949 level.

Government transactions showed a close balance between receipts and expenditures for the year as a whole. Cash receipts increased while expenditures fell in the second half of 1950. After a cash deficit of 4.2 billion dollars (annual rate) in the first half, there was a surplus of 2.9 billion in the second half. But the effect upon business operations of the anticipated increase in the military program more than offset any counter-inflationary impact of the cash surplus.

An increase of 1.1 billion dollars in Federal cash receipts from calendar year 1949 to calendar year 1950 was due to higher economic activity, to increased employment tax rates, and to higher withholding tax rates on individuals in the closing months of the year. Collections from corporate income taxes will increase substantially this year, reflecting high profits in 1950 and increased tax rates.

HARRY S. TRUMAN.

JANUARY 12, 1951.