The Economic Situation at Midyear 1951

A Report to the President

By the

COUNCIL OF ECONOMIC ADVISERS

LETTER OF TRANSMITTAL

COUNCIL OF ECONOMIC ADVISERS,
Washington, D. C., July 20, 1951.

The PRESIDENT:

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

Respectfully,

Leon H. Keyserling
Chairman.

John D. Clark

Roy Blough

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I. Recent Trends and Their Significance

The Emergence of a Defense Economy

THE invasion of South Korea a year ago decisively altered the course of the United States economy. Until then, our major efforts since the end of World War II had been concentrated on expanding civilian production to meet the high postwar level of demand swollen by the shortages built up during the war, and on maintaining a high level of employment. While furthering this peaceful task at home, we had not neglected the economic plight of other free nations. We made a major contribution to the rebuilding of the war-shattered economies of these nations.

By June 1950, the transition from the aftermath of war had been practically completed. In reaching this position, the path had not been easy, marked as it was by a substantial inflation and many difficult problems of readjustment. But the vigor and resiliency of our economy made it possible to avoid the severe depression which so many had feared. In fact, the downturn in 1949 was no more than a minor digression from the postwar record of growth. The revival which quickly followed brought the prospect of a period of economic stability, with growing levels of civilian production, employment, and consumption.

With the Korean outbreak, we were confronted with the need to chart a new path for the economy. If we were to avoid a new world war, or be ready for one if it came, the obligation became clear to build up our defensive strength at a much more rapid rate and help our allies build theirs. Only in this way could the free world make plain its resolve to resist aggression. Whether we shall be called upon to fight elsewhere than in Korea depends upon plans of others. But the free world must be prepared. It should not be lulled into complacency by ostensible changes in the strategy of the aggressor nations. Only when it is compellingly clear that aggression is no more to be feared can we afford to relax. We are moving into a position of preparedness which may have to be maintained for years. The long ordeal we are embarked upon requires steadiness of nerve and iron patience, as much as material build-up in physical strength.

A basic requirement of national policy in these dangerous years is the firm welding together of the elements of a strong defense economy. With that, military power can be successfully organized as the bulwark of national security. Without it, military strength would languish for lack of support from its economic roots.

This is the third semi-annual Review in which the Council of Economic Advisers has faced the unusual problems of a partly mobilized economy. A year ago, the economic problem implicit in the defense program was already apparent as the response to the Korean aggression began to destroy the economic balance of June 1950. Six months ago, the country was contending with inflation, although defense mobilization was only beginning to have major direct impact on our resources. Most kinds of economic controls existed only in rudimentary form.

In sharp contrast is the economic situation at midyear 1951. (See chart 5.) Four major features have marked the course of the economy during the first half of this year: the brief renewal in January of the general upsurge of demand and prices; the institution of a broad structure of economic controls; the temporary abatement of inflationary pressures; and the rapid expansion of primary defense production. The economic prospect is now further affected by the possibility of a quiescent situation in Korea, although this does not affect the need for the defense build-up.

The Council must now examine the trend of the economy and the problems of national economic policy in a setting which is neither that of full mobilization for war nor that of high-level, dynamic production and employment in a peaceful world.

The General Upsurge in Demand, Output, and Prices

Before the Korean attack, the economy had been rapidly recovering from the 1949 recession. The index of industrial production had regained lost ground and risen to the highest point since 1945. Wholesale prices had also recovered, although for most commodities and especially for farm products and foods they were below 1948 peak levels. Unemployment had been reduced by more than 1 million below the peak of January 1950, although it was still more than 1 million above the level of June 1948. The economic outlook was for further growth in production, and a further decline in unemployment.

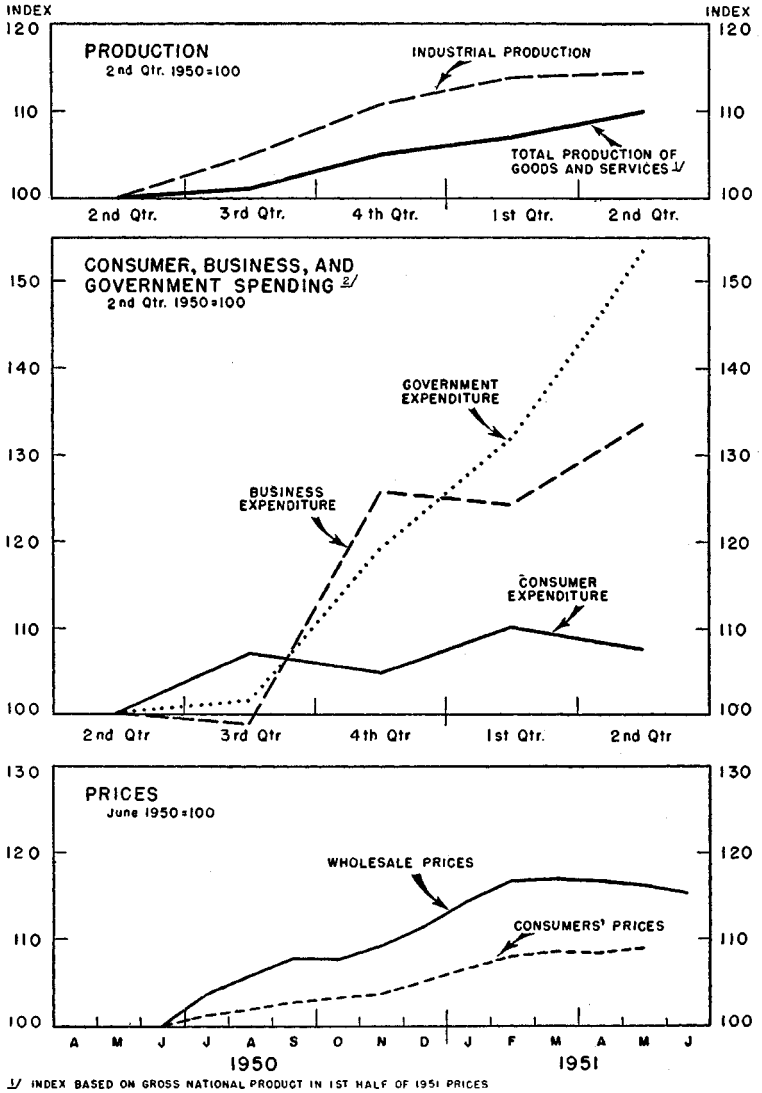
The rise in general demand

The Korean attack and the response by the United States and the United Nations added to an already highly active economy an unprecedented increase in private buying. There were two distinct waves of consumer buying, reflecting the changing fortunes of war in Korea. By early fall, there were signs of some subsidence of the first wave; but following the Chinese intervention on a massive scale in late November, the buying pressure was renewed. The record shows that consumer buying rose to an all-time high in the third quarter of 1950, declined slightly in the fourth quarter, was renewed with great vigor and reached still another all-time high in the first quarter of 1951, and then declined again. (See appendix table B–4.)

CHART 5

PRODUCTION, SPENDING, AND PRICES SINCE MID-1950

While production, spending, and prices are now at much higher levels than those of mid-1950, industrial production has been stable since the first quarter. Consumer spending dropped in the second quarter of 1951, and wholesale prices eased off slightly from March through June.



1/ INDEX BASED ON GROSS NATIONAL PRODUCT IN 1ST HALF OF 1951 PRICES

2/ INDEXES BASED ON EXPENDITURES IN CURRENT PRICES

SOURCES: DEPARTMENT OF COMMERCE, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, DEPARTMENT OF LABOR, AND COUNCIL OF ECONOMIC ADVISERS.

In July 1950, the increase in retail buying was 8.5 percent above that in the preceding month. Retail sales in July and August exceeded the June level by an amount equivalent to 1½ percent of total sales in 1950. This had great effect only because it was superimposed upon a high level of consumer demand. It was followed by some reaction in the autumn, in those lines of goods which consumers had stocked beyond their current needs.

The expansion of private demand for goods came not only from consumers, but also from businesses. At first, it was not possible for business buying to keep up with consumer buying, and inventories declined in July 1950. Thereafter, business inventories mounted steadily. Business demand was reflected also in the rate of expenditures for new plant and equipment, which rose from an annual rate of 17.3 billion dollars in the second quarter of 1950 to 23.3 billion in the fourth quarter, and to an estimated 25.7 billion in the second quarter of 1951. (See appendix tables B–20 and B–21.)

The growth in business demand was undoubtedly stimulated in part by defense contracts, actual and anticipated, and by expectations of market shortages and direct controls which would restrict the accumulation and use of materials. The increased direct demand by the Government in connection with the defense program was a relatively small part of the total, during the first few months following the Korean outbreak. The Federal Government was spending in all less than it had a year before, and was running a cash surplus.

The annual rate of expenditures for security programs rose from 16.3 billion dollars in the second quarter of 1950 to 23 billion dollars in the fourth quarter. These figures, however, do not fully reflect the impact of defense activity. Expenditures occur, in the main, after production is completed. Production takes time; and before production can begin, plans must be drawn, contracts let, plants tooled up, subcontracting arrangements made, material bought, and labor hired. Thus, much of the effort and resources required for an expanding defense program must be expended many months before they are matched by cash expenditures of the Government. Yet the great increase in business spending which extended through the first half of 1951, while conditioned by the defense environment, was running far ahead of primary defense activity. It reflected a broad and ebullient "boom" psychology, an expectation of enlarged market opportunities and higher prices in an economy whose general expansion would be accelerated greatly by international trends.

The financial environment at midyear 1950 and thereafter was very favorable to this rise in private demand, because both liquid assets and bank credit were plentiful. Between 1940 and 1950, the total of currency, demand and time deposits, and Government securities owned by individ-

uals, rose about 225 percent whereas as disposable personal income rose only 170 percent during the same period. In 1950, liquid assets of corporations were at the highest level in history. The increased demand was financed in part by drawing on liquid assets, in part by borrowing, and in part by the increases in income which were the inevitable outgrowth of the larger physical volume of production and the higher prices. (See appendix tables B–30, B–31, and B–39.)

In addition, consumer borrowing rose at a record rate until Regulation W was re-established in the fall. This action discouraged further expansion of instalment credit, and reduced the amount of credit involved in those instalment sales which were made. Business also borrowed heavily. Total business loans of all commercial banks rose 5 billion dollars, or 30 percent, between June and December 1950, and expanded 1.6 billion dollars, or 7 percent, during the first quarter of 1951. Some of the rise in business loans during the second half of 1950 was seasonal, but the rise in early 1951 came at a season when loans usually decline.

The uptrend in private demand was also supported by increased incomes. The growth of personal income during the second half of 1950 was phenomenal. Contrasting the second and third quarters, the rise amounted to about 5 percent. Contrasting the third and fourth quarters, there was a further increase of 5 percent. The first quarter of 1951 brought an additional increase of about 3 percent, followed by an additional 2.5 percent in the second quarter. (See appendix table B–7.)

The general upsurge in the desire to buy, backed by the funds to do so, was responsive to the expansionary environment which existed at mid-year 1950, and was greatly augmented by international developments. The impelling reason for the spurts in buying during the third quarter of 1950 and the first quarter of 1951 was the expectation of shortages and price increases. Consumers projected into the future the vivid memories of lack of goods during and immediately after World War II. Businessmen foresaw glowing profit opportunities in brisk markets and rising prices. In the intense reaction after the first Korean aggression, and again after the Chinese onslaught, consumers and businesses alike tried, by prompt private stockpiling, to protect themselves against the possibility of empty shelves, rationing, quality deterioration, and rising prices. Fear of being thwarted by the competing demands of others intensified the buying waves. The ensuing inflation in prices led to anticipation of further price increases, and accelerated the buying rush to beat the rise.

While these spurts have an important bearing upon the current outlook, they are not more significant for the long run than the more permanent trend reflecting more basic factors.

The rise in total output

Immediately after the Korean outbreak, it became clear that one of our most important economic tasks was to expand production of essential goods. The President's Midyear Economic Report in July 1950 opened with these words: "Recent international events make it more important now than ever before that we maintain and expand our strength on the home front. For the sinews of all our strength, everywhere in the world, are found in what we achieve here at home. We must make full use of our great productive resources, our ever-improving industrial and scientific techniques, and our growing labor force. We must redirect a part of these resources to the task of resisting aggression."

Viewing the past 12 months as a whole, the upsurge of demand has been accompanied by a remarkable further increase in total production from the high levels already existing in June 1950. The output of goods and services in real terms, i. e., after full allowance for price changes, increased by about 10 percent, comparing the second quarter of 1950 with the second quarter of 1951. (See chart 5 and appendix table B–3.) This meant the highest peacetime level ever recorded, and exceeded the peak year of World War II. It has been a major accomplishment of American enterprise during the past year to meet the requirements of a growing defense production, to invest at record rates in inventories and in new plant and equipment, and at the same time to furnish the highest level of consumption in history.

By far the largest part of the growth in output took place during the first 7 months after the Korean aggression. The advance was spectacular. The index rose from a level of 199 (1935–39=100) in June to 218 in December, a rise of more than 9 percent, with a further jump to 221 in January 1951. Total real output, however, rose by only about 4½ percent, comparing the second quarter of 1950 with the fourth quarter.

Since initially the volume of total production grew more rapidly than the volume of defense production, civilian production was also increasing. New peaks were reached in the production of automobiles, washing machines, vacuum cleaners, and other consumer durable goods. The rate of gross private domestic investment also continued to reach new peaks; a substantial part of this was undoubtedly in preparation for defense production.

The unusual record of growth from June 1950 through January 1951 was sparked mainly by the increase in demand on the part of both consumers and business, which has already been reviewed. The expansion in output was accomplished in part by increased employment and longer hours of work, and in part by greater productivity. Nonagricultural employment rose 4.5 percent, comparing the first half of 1950 with the second half. Average hours worked per week in manufacturing rose from

40.5 in June to 41.4 in December. Increased productivity has partly resulted from programs for modernizing and expanding productive facilities, which have been carried on since the end of World War II.

Industrial production expanded not only in the United States, but also in other countries. This expansion has contributed to the current shortage of raw materials. Output in other countries has been rising since World War II. New impetus was given by the rapid expansion of demand in the United States after Korea, and the consequent sharp increase in American imports. World industrial production outside the United States and the Soviet Union, which had been rising prior to the outbreak of hostilities in Korea, has since risen somewhat more rapidly, exceeding the corresponding level of the year before by 15 percent. Production in Western Europe averaged still higher during the first part of 1951.

In parts of Western Europe and even more in Japan, manpower and plant are available or could be provided to permit further gains. A limiting factor is raw materials. Although material supplies appear to be sufficient to permit production at current or slightly increased rates, a substantial further growth of output in Western Europe is being hampered by shortages of coal, sulphur, wool, high grade iron ore, steel scrap, and nonferrous metals. This results somewhat from the fact that in 1950, when the United States was building up inventories, some countries of Western Europe were running down their inventories of many important raw materials. But primarily, it reflects the failure of raw material producing capacity to grow sufficiently to meet the needs of the United States and other industrial countries, when their economies are all operating at high levels at the same time.

The inflationary rise in prices

Prices, which had risen moderately during the first half of 1950, began to climb rapidly with the expansion of business and consumer demand after the North Korean attack. The sharpest of the early advances occurred in markets for raw materials, which responded quickly to the flood of buying orders. Food prices, both wholesale and retail, reacted less violently but moved up rapidly and substantially. Prices of industrial products went up somewhat more slowly in the early weeks following the Korean outbreak, but had risen by about the same percentage as food by February 1951, when wholesale prices leveled off. The rise in consumers' prices, which had begun in March 1950, was accelerated after Korea, and, lagging as usual behind wholesale prices, continued somewhat after the latter had stabilized. (See appendix tables B–24 and B–25.)

The timing of price increases reflected the two great spurts in consumer buying. There were sharp increases during the summer of 1950, then a short period of relative stability during which some prices at wholesale declined, followed by a sharp upward movement between November and

February. During January, the price advance was rapidly accelerating, prompting issuance of the General Ceiling Price Regulation late that month. Wholesale prices continued to rise for a few weeks, but later declined somewhat, varying within a narrow range from the middle of February through the balance of the half year.

The spread of price increases throughout the economy was primarily due to very strong demand, but was also an adjustment of sales prices to rising costs, the imitative reaction of businessmen to other price increases, and an effort to anticipate and be in readiness for the later imposition of price ceilings. Most manufacturers and merchants had an active sellers' market, which gave promise of long duration. Believing that the increases in their costs would not be temporary, they quickly brought prices into line with costs. Expectations of direct control of prices encouraged this speedy adjustment. Many firms raised their prices in anticipation of the cost increases without waiting for them.

A price increase for one commodity brought higher prices for other commodities, with spiraling effect. Moreover, as the prices of consumers' goods rose and demand for workers increased, widespread upward wage adjustments followed. The number and speed of these reflected the number and strength of organized workers, and the presence of cost-of-living escalator clauses in many wage contracts. Business concerns were in a financial position to grant large wage increases, and employers wanted to lift their wage rates to a level favorable to the recruitment of workers before controls took effect. The higher production costs, which resulted from higher material prices and wage increases, led to still higher sales prices and thereby entered into the spiral.

The inflationary price pressures were not limited to the United States. The response of the free world to the Korean development created upward pressures upon prices in many countries. Particularly, there was increased demand for such materials as rubber, wool, tin, and woodpulp. The influence of developments in the United States was augmented by the actual and anticipated acceleration of defense expansion in Western Europe and some other countries.

The result has been to generate an inflation of worldwide scope. Although the slackening in price rises here has been followed by some recent slackening abroad, the rise of prices has gone to far greater lengths in most other countries than it has in the United States. Contrasted with the 15 percent increase in our wholesale prices since the outbreak of Korean hostilities, nearly half the countries in Western Europe have suffered increases in wholesale prices exceeding 30 percent since June of last year. In the case of Japan, where there are special factors associated with its role as a staging area for the Korean campaign, the increase through April exceeded 50 percent. The enormous price increases which have occurred constitute in some countries a danger to political and social stability, and to the security program of the free world.

The inflationary danger was recognized by the public and the Government immediately after the Korean outbreak, and a number of steps were taken to meet it. The Defense Production Act was passed. Priorities and export controls were placed on the flow of scarce materials essential to defense production. Measures to reduce civilian demand were designed. The public was repeatedly informed that there was a plentiful supply of most goods, and was urged not to buy more than necessary. All Federal Government programs were reviewed aiming at the curtailment, as far as possible, of nondefense spending. A tax-reducing and adjusting measure was turned into a major tax-increasing measure, an unprecedented achievement made possible by the close cooperation of all concerned. Later, the excess profits tax was passed. Selective credit controls were imposed on the purchases of new houses and consumer durable goods, and some general measures of credit restraint were adopted to make credit less available for nonessential purposes. Actions were also taken to achieve maximum expansion of domestic agricultural production.

"Indirect" measures are essential to counteract an excess of demand over supply, and are therefore fundamental. But to deal with waves of mass buying, financed by accumulated liquid savings, more direct and drastic measures are also at times required, such as price and wage controls. The legal powers to impose such controls were enacted in September 1950. By then, the situation in Korea seemed more favorable, the wave of consumer buying was dying down, and prices were leveling off. But the new wave of mass buying, which followed the entrance of the Chinese into the conflict, again altered the outlook. On December 15, 1950, in declaring a national emergency, the President announced the determination to impose mandatory price and wage controls.

During December and January, administrative preparations were made for this step. As a stopgap, the Government called for voluntary restraint, and promulgated in December a set of voluntary pricing standards. These measures undoubtedly had some usefulness, but public belief that mandatory controls were soon going to be applied probably accelerated the upward price and wage movement. Confronted with this critical situation, and despite the lack of an adequate administrative staff, the Office of Price Stabilization late in January issued the General Ceiling Price Regulation. In effect, this froze most prices at the highest levels at which deliveries had been made during the period from December 19, 1950, through January 25, 1951. At the same time, a parallel order was issued freezing all wages and salaries.

New and stronger measures of credit restraint were also brought to bear. Member bank reserve requirements were increased, further attempts were made to limit the amount of funds available for lending through a new

policy on open-market operations, regulations applying to loans for new construction were broadened, margin regulations on stock exchange loans were tightened, and the major classes of lending institutions were brought into a voluntary program to limit lending for purposes not related to mobilization objectives.

Meanwhile, the tremendous increase in general output, reviewed above, was building a curb against inflation from the supply side. These productive achievements tended to be overlooked in the general public concern with military difficulties on the battlefield and the evidence of inflation on the homefront.

The Lull in Inflationary Pressures

A feature of the first year of the security effort was that, just when defense production began really to expand, a lull in inflationary pressures developed. Beginning about mid-February 1951, buying slowed down and prices showed signs of stabilizing. Real consumption expenditures (first half 1951 prices) declined from an annual rate of 208.2 billion dollars in the first quarter of 1951 to 203.0 billion in the second quarter. In the second quarter, there was a softening of some markets, and many prices eased off from their peaks.

Paradoxical as this slowing down may appear at first glance, it should not have been surprising. The strong, sometimes even violent, spurts in buying during July and August 1950, and again early in 1951, had important emotional elements—the fear of early shortages and of rising prices. There was some factual basis for this reaction, in that a greatly expanded security program must add substantially to demand, and lead to a shift of resources from civilian to defense purposes. But general public expectations of the timing and degree of impact of the program proved to be incorrect. The rush to buy on the part of consumers and business created the very situation which had been feared. Prices did surge upward, and temporary shortages began to appear, thus accentuating the rush to buy.

Two factors deprived this phase of the inflationary movement of its momentum.

In the first place, the general freeze of prices late in January allayed the fear of rising prices. Suddenly, there was no need to buy to beat the price rise. With this pressure removed, other stabilization measures also began to exert continually increasing restraint.

Second, the fear of early shortages was reduced by several developments. There had been a large increase in the output of civilian goods since the Korean outbreak. The effect of this growing supply was temporarily obscured by the continuing rise in prices, and by fear that the war in Korea might spread to a wider area. As the military situation improved and stabilized, and as prices were brought under control, consumers realized that the fear of immediate shortages had been exaggerated. Moreover, by

this time consumers had greatly increased their stocks of durable goods, and many of them had spent a substantial part of their accumulated savings or had gone into debt. In this situation, consumer buying began to slacken.

Since civilian production during the first quarter of 1951 continued at or close to the peak rates achieved in 1950, the result was a continued high rate of inventory accumulation, particularly at the retail level and especially of consumer durable goods. Retailers who since Korea had placed larger orders than normal, to be sure of receiving an adequate supply, found themselves with a flood of deliveries. These caused no difficulties, so long as consumers continued to expand their purchases. But with the decline in retail sales after mid-February, retailers became concerned. This was enhanced by the failure of Easter sales to meet expectations. As a result of slower sales and quicker deliveries, a substantial volume of involuntary inventory accumulation took place. During the second quarter, retailers cut new orders sharply and attempted to reduce inventories through aggressive sales promotion. Particularly noteworthy was the temporary war on privately-price-fixed items in New York and several other cities.

The chief effect of the lull has been a softening in some prices, and a leveling off in some important business activity. Wholesale prices, which had risen sharply to an all-time peak of 184.0 (1926=100) in March, leveled off, and were down to 181.7 in June. A somewhat sharper drop was experienced by prices of farm products, and by prices of some industrial commodities, especially some textiles and some chemicals. Wholesale food prices were down less than 1 percent from their peak. The most pronounced drop was in the prices of basic commodities, which had begun to weaken in mid-February and fell by about 13 percent by the end of June. The cost of living, however, was about 1 percent higher in May than in February.

Just as the immediacy of the impact of the security program was exaggerated, there is now the danger that the significance of the present lull may be similarly overestimated. To the extent that the lull has restored buying to more normal proportions, its effect is all to the good. But to the extent that it leads to a state of complacency about the future risk of inflation, its effect is harmful. The current period of hesitation must be seen in the perspective of the basic, longer-range factors affecting demand.

The Lull in the Growth of Industrial Output

The lull in inflationary pressure has been accompanied by a slowing down in the rate of growth of industrial production. The gross national product in real terms has expanded about 5 percent from the fourth quarter of 1950 to the second quarter of 1951, while the Federal Reserve Board index of industrial production rose from an average of 216 to an average of 223, an increase of 3.2 percent. (See appendix tables B–3 and B–17.) Although the index has not increased in recent months, indus-

trial production has been running at very high levels. Consumption expenditures, however, declined about 5 billion dollars (annual rate) from the first quarter to the second quarter of this year. Associated with this decline in consumption expenditures has been an offsetting increase in the accumulation of inventories amounting to about 5 billion dollars (annual rate) during the same period.

The slackening in the vigor of industrial expansion during the past 6 months has been due to three sets of causes: first, some industries had reached capacity; second, some industries were forced to reduce output because of limitations on the nondefense use of metals or other raw materials; and, third, some industries faced a drop in demand.

Steel is one of the industries in which output has been limited by existing plant capacity. Steel capacity is being increased, but the expansion necessarily will be slow.

At present, about 8 percent of the gross national product is going into new nonfarm plant and equipment, so that industrial capacity is rising significantly. Expansion programs in bottleneck areas such as steel, aluminum, power, and transportation equipment are particularly effective in raising our productive potential.

The main raw materials bottlenecks have been metals, including steel, copper, lead, zinc, aluminum, and tin. It has been necessary to restrict the use of these materials. Such restrictions account in part for recent decreases in the output of automobiles, washing machines, refrigerators, and other durable goods.

However, some industries have been operating at less than capacity levels because of the market situation. Large inventories, and in some cases reduced demand, appear to explain recent drops in output in a number of industries, notably textiles, shoes, and liquor.

The Expansion of Defense Production

Primary defense production, which started slowly following the Korean outbreak, has been picking up speed, and is now rapidly moving ahead.

The increase in defense production involves conversion of many facilities being used in other ways. In addition, it requires substantial industrial expansion. The Government has employed a number of incentives for encouraging expansion in the desired industries. Accelerated tax amortization reduces some of the risks of investment. Defense loans are available where financing is needed. Long-term purchase contracts and standby purchase agreements help give assurance that the plant will have a market.

In the second half of 1950, there were large increases in the output of many goods and services which are necessary in a defense economy. The index of machinery production increased from 262 in June to 321 in December (1935–39=100). Chemical products jumped from 261 in June to 283 by the end of the year.

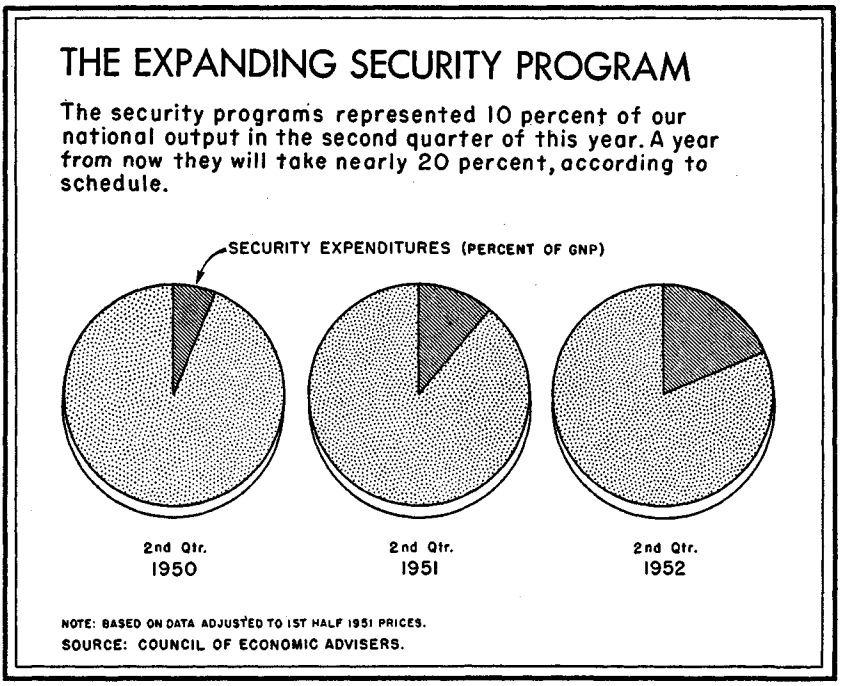
There was little increase in deliveries to the Government of finished defense products during the second half of 1950. In the first 6 months of 1951, however, deliveries of military goods and military construction have increased rapidly, and have now reached a level of 1.5 billion dollars a month, which is more than three times the monthly rate before the Korean outbreak. Large further increases are ahead. The Second Quarterly Report of the Director of Defense Mobilization indicates that the delivery rate is scheduled to rise to 4 billion dollars a month within a year.

The total security program took 6 percent of the gross national product in the second quarter of 1950, 8 percent in the fourth quarter of 1950, and 10 percent in the second quarter of 1951. According to the present schedule, it will increase further to about 15 percent in the last quarter of 1951. (See chart 6.) We have greatly enlarged the production of aircraft and combat vehicles, electronic equipment, and other military goods. Defense production of all kinds will mount rapidly in the future. It takes time to work out specifications, draw up contracts and subcontracts, and get production lines organized. Much of the tooling up and other preliminaries has now been accomplished.

The Underlying Forces at Midyear

As the Council seeks to appraise the economic outlook at midyear, the most important factors to be considered are the prospective levels and

CHART 6



trends in the security program, in business investment, and in consumer demand. The relationship between the total of these forms of demand and the available supplies of goods will mainly determine the nature and intensity of the stabilization problem to be met.

Powerful international tensions continue to dominate domestic economic developments. The President and the governmental agencies charged with responsibility for national security have made clear that the security program should continue as planned, regardless of the outcome of negotiations in Korea. The reason compelling this conclusion is clear. To stop the aggression of the Soviet Bloc in Korea is not to prevent aggression elsewhere. Since 1945, the Soviet aggressors have sought to create political and economic instability in nearly all non-Soviet countries. When conditions seemed right, the aggressors have used military threats and actions. Such tactics have been particularly successful in China, but were resisted in Iran, Greece, Turkey, Berlin, Indo-China, and Korea. If we falter or relax in our security build-up, it is reasonable to expect that this would prompt a renewal of pressures at other points. Only through strength can we succeed in proving that aggression does not pay.

The rate of defense production is rapidly increasing. During the second quarter of 1951, the output for security reached an annual rate of over 35 billion dollars. Under present schedules, we are to achieve an annual rate of almost 65 billion dollars a year hence. It is manifestly impossible to accomplish such an enlargement of the security program, without placing strains upon many parts of the economy. Our total output cannot be increased as rapidly, during the next year, as the security program. In the case of many vital commodities, the increased security requirements will greatly reduce the amounts available for other purposes.

A large increase in defense spending, to the extent that it is not offset by reduced spending in the private sector of the economy, will greatly increase the incomes of consumers and businessmen. With increasing defense expenditures, the Council would expect the number of people gainfully employed to rise, hours of work and overtime payments to increase, and wage rates to creep upward even under an effective wage stabilization program.

A rising level of defense production and consumer spending stimulates business demand for plant and equipment, which has been running at all-time peak rates. In fact, the most recent declarations and surveys of business intent reveal that affirmative policies must continue to be used to bring the total of private investment downward toward a less inflationary level. By weeding out nonessential investment, this can be done without impairing the high level of investment in plant and equipment required to keep our economy strong enough to support the defense burden.

Thus, with these fundamental forces at work, strong restraint on both business investment and consumer spending is required if a new inflationary movement is to be avoided.

There are, to be sure, some substantial uncertainties in the picture. Many people have interpreted the opening of negotiations for a cease-fire in Korea as evidence of a fundamental change in the economic outlook. This would be a correct interpretation only if the schedules for our basic defense build-up were to be substantially altered, and this is not the intent of national policy. Nonetheless, the cessation of hostilities in Korea could have important intermediate effects upon the climate of public sentiment which conditions the economy.

There might, for example, be important effects on consumer spending, which does not always follow a predictable pattern, particularly in the short run. Durable and semi-durable consumers' goods were purchased at an exceptionally high rate for a good many months in the second half of 1950 and early in 1951. The immediate necessity for consumers to buy such goods has accordingly been somewhat reduced. Although personal disposable income rose by more than 5 billion dollars (annual rate) from the first to the second quarter, personal consumption expenditures dropped by more than 5 billion, resulting in an increase of over 10 billion in personal saving. At the same time, there was an increase of 5 billion dollars (annual rate) in inventories, probably much of it involuntary. No one can forecast precisely how long the lull in consumer expenditures may continue.

If consumers should interpret the international developments to mean that there will be plenty of goods at lower prices, there might for a time be a substantial decline in purchases, despite rising personal income. It does not seem probable, however, that this would continue for long, even in the absence of any new alarming international developments which might start a new spurt in buying. The pressures to buy the necessities and comforts of everyday living are very strong in the case of most families. In the longer run, changes in prospective incomes are as good a measure as there is available of changes in prospective spending. In the second half of 1950, disposable personal income was at an annual rate about 14 billion dollars higher than in the first half of that year. In the first half of 1951, it was at an annual rate 9 billion dollars higher than in the second half of 1950. In the second half of this year and on into next year, this growth is likely to be very substantial.

Businessmen, likewise, are in a position to decide whether to continue with their plans for a very high level of business investment. They could, if they chose, substantially reduce their plans, even below the point where restrictions would have to be placed upon them. This is certainly a possibility to be reckoned with, but we believe that on balance it is not likely to occur. The interests of business lie in maintaining a high level of investment, to meet both the demands of the defense program and of the civilian economy. Even in the ultimate event of a general and more permanent improvement of international relations, the basic expansion programs which have been outlined by those in charge of the mobilization effort would

not result in any general overexpansion of facilities. There is hardly any important expansion program for basic industrial commodities which exceeds the sound needs of an expanding peacetime economy. If it should become possible at some later time to reduce our defense goals, the expanding output of steel and other commodities could find ample markets in the unsatisfied needs of our own people and in the expansion of world trade. The high level of saving which will be generated by an effective stabilization program, and the opportunity of reducing the very high level of taxation if and when defense needs dwindle, will help support markets during such a transition period.

Businessmen also recognize that they have a large responsibility to conform their investment plans to the level and composition which will fulfill the strategy of the defense program. This responsibility is particularly heavy, because private expansion is now being relied upon much more heavily and public investment in plant much less heavily than during World War II. To falter in this responsibility would jeopardize national security in the event of a more critical situation later.

The analysis we are advancing may be stated in this form: First, there is nothing in the international situation to justify a basic alteration of course, and the build-up of the security program will be continued. Second, while carrying out the security program will require that total business investment be cut substantially below the all-time peak rate of recent months, nonetheless such investment must be encouraged to remain at levels which will still be very high by past standards. Otherwise, we could not build the necessary industrial complement to our growing military strength. And third, the pursuit of these needed military and industrial objectives will in itself augment consumer incomes, which already are high enough to be potentially inflationary, even though there has been some lull in buying during recent months.

Although the Council recognizes the existence of some uncertainty in the immediate economic outlook, even with the continuation of the security program as planned, the uncertainty is mostly a question of short-range timing. The precise length and depth of the lull are difficult to forecast, and we do not attempt to do so. It seems highly probable that the underlying inflationary pressure developing from the defense program will expand to serious proportions, as production under that program increases.

With civilian incomes in the aggregate likely to rise much more rapidly than civilian production, the basic forces are inflationary even though the current erratic buying on the part of consumers or businesses may prevent these underlying forces from manifesting themselves in any particular month or even for a few months. Over a longer period, which is of greater significance for national policy, civilian incomes rising faster than civilian production will generate inflation, unless there is an effective containment program. For such a program, we cannot rely mainly upon the further increases in the

rate of voluntary saving which would be required to do the job alone. The rate of saving has already increased greatly in recent months, and this increase itself has been in large part the reaction of the public to the fact that other anti-inflationary measures were initiated and have been taking hold.

In any event, the implications for policy are clear. The only safe course is to be continually prepared to meet expanded inflationary pressures to the extent they arise. An ineffectual program, by removing assurances against new breaches in the price line, would bring danger of repetition of past spurts in consumers' buying, and resultant inflationary pressures even beyond expectations based on rising levels of incomes. It takes time to put measures into operation and to make them effective. For example, those who say that price and wage controls were established too slowly should be the last to reduce the power to impose those controls; it takes time to build up administrative organizations capable of effectively applying controls. All our equipment should be in good order to fight the fires of inflation. When they are burning vigorously, it is too late to start getting ready. It would be a most unwise gamble now to deprive the economy of reinforcements against inflation.

In the following sections of this Review, we undertake to fill in these general conclusions with more specific details, both as to the shape of the economic outlook and as to necessary measures.

II. The Shaping of the Defense Economy

Main Objectives

At the present time, our principal task is to make ourselves more secure and help to make the rest of the free world more secure. This involves a two-fold economic objective. First, we must speedily build up and equip armed strength. This includes, as a current objective, maintaining our own armed forces at 3.5 million military personnel, producing the increased quantities of armaments and military equipment needed for our expanded forces, and helping other free nations to build up their military strength. The second and equally important part of our two-fold task is to keep our economy strong by assuring an adequate flow of civilian goods, and to make it stronger for the great challenge now confronting us—and the even greater challenge which could arise—by expanding our total output and by adding even more to our productive capacity or industrial potential. In addition, we need to help other free nations in further developing their economic strength.

Each element in this effort is a necessary part of the whole program. By rebuilding our military power, we hope to deter aggression and prevent a major war. Since it would be imprudent to dismiss the possibility that actions of hostile powers might bring about such a conflict, it is necessary to lay the foundation for the rapid achievement of full mobilization should that become necessary. Helping other free nations build up their military and economic strength is also vital, because our security is bound up with the rest of the free world, just as its security is bound up with ours. This interdependence takes many forms—military, economic, political, and psychological. On the economic side, we are to a growing extent dependent on foreign countries for a large fraction of our supplies of certain important raw materials, while the industrial capacity of other countries is a vital element in the common capacity to produce military goods.

The economic significance of these security objectives in present planning is highlighted by the fact that the national security programs are scheduled to rise from an annual rate of about 35 billion dollars in the second quarter of 1951 to nearly 65 billion dollars in the corresponding period of next year.

It should be observed that this is not, in the Council's judgment, a maximum program. To be sure, the maximum practicable size of a

defense program cannot be determined completely by the primary purpose of achieving national security; it is necessarily limited by the size and strength of the economy, by the willingness of the people to incur sacrifices, and by the prospective duration of the emergency. In a short, intensive effort, the expansion and even the replacement of industrial equipment can be omitted, but if this were done in a long-continued effort, the productive machine would break down.

In this Review, however, the Council is not concerned with what could be the maximum size of a security program. We are confident that the program which has been adopted is readily sustainable, as will clearly appear in the pages which follow. The practical problem now confronting the country is what implications this defense program has for the Nation, and what steps need to be taken to achieve the defense program, while at the same time maintaining the strongest possible civilian economy.

To promote a strong civilian economy, while at the same time building up our defenses, requires both the expansion of productive power and the maintenance of economic stability. These objectives are often mutually supporting. For example, increasing production by increasing the number of people at work, and the hours worked, makes it possible to meet the needs of the defense program with more goods remaining for civilian use. However, increases in production through expanding industrial plant and equipment require the use of labor, materials, and existing plant, which otherwise would be largely available to make goods directly for consumers. Rapid industrial build-up is thus likely to make the task of maintaining economic stability immediately more difficult. But for the future, it makes that task easier, particularly if it results in greater productivity and the removal of production bottlenecks.

In determining the rate of industrial build-up to be encouraged, it is thus necessary to consider the feasibility of holding down or reducing consumer spending. Moreover, we must constantly appraise the use of resources, and take appropriate action to effect the necessary changes. Decisions concerning resource use made on a piecemeal basis are likely either to overshoot or undershoot feasible goals, and to cause great waste and loss of strength by unsound allocation of resources. Only by comprehensive programming of requirements and supplies is it possible to arrive at a rational balance among objectives, to determine whether in total they are feasible, and to shape carefully the individual components of our composite of military and economic strength.

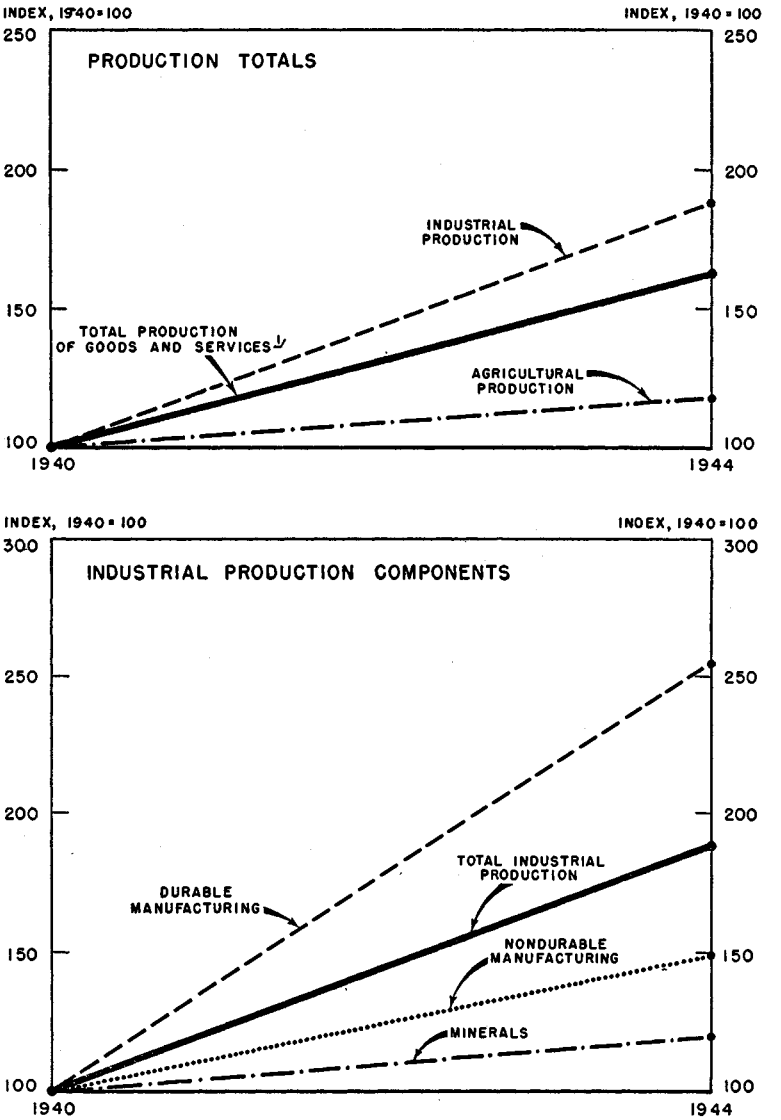
Our Economic Potential

To sustain a large defense effort, we must accelerate the expansion of our total output, and we must expand a few specific types of capacity to levels even beyond those likely to be used in the short run, except in case of war. A large increase in the output of basic industrial and agricultural

CHART 7

GROWTH IN PRODUCTION, 1940-44

The total production of goods and services in 1944 was about 60 percent higher than in 1940. The increase was much greater in industrial production which rose 90 percent, and especially in the durable goods industries, where output in 1944 was more than 150 percent above the 1940 level.



1/ INDEX BASED ON GROSS NATIONAL PRODUCT IN 1ST HALF OF 1951 PRICES.

SOURCES: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, DEPARTMENT OF AGRICULTURE, AND COUNCIL OF ECONOMIC ADVISERS.

commodities, both here and abroad, will make it possible to maintain a large security program with a progressively lighter strain upon our economy, and on that of the free world generally. It would also permit within several years, provided that the international situation does not worsen, the resumption of improvement in living standards in the United States and elsewhere in the free world. On the other hand, if output in the United States were to increase no faster than the 2½ percent average annual increment which was achieved between 1946 and the Korean outbreak, the impact of the defense program would be prolonged. By increasing our capacity to produce military items and certain key materials even more rapidly than we increase actual output, we can have a large reservoir of power to draw upon quickly if critical events should require fuller mobilization.

Both the World War II experience and the postwar experience have direct bearing on what we are able to do, and how we can best proceed to do it.

The World War II production achievement

From 1940 to 1944, the total national output (measured in real terms) increased about 60 percent, industrial production by nearly 90 percent, and the production of durable goods, including military goods, by more than 150 percent. (See chart 7.) While these figures need to be qualified because of the many difficulties of measuring wartime production, nonetheless the achievement exceeded all expectations. (See also appendix tables B–2, B–16, and B–17.)

A major factor in this growth was the much fuller utilization of our manpower resources. Between 1940 and 1944, the total labor force rose from 56 million to 66 million, and the proportion of the population of working age in the labor force rose from 56 percent to 63 percent. (See chart 8.) Civilian employment rose by 6½ millions, while the armed forces were increased by almost 11 million; of this 17½ million increase, 55 percent reflected growth in the labor force, and 45 percent reflected a reduction in unemployment from about 8 million to less than 1 million. During the same period, the workweek for factory workers was lengthened from about 38 hours to about 45, providing the equivalent of about 2½ million additional production workers. (See chart 9 and appendix table B–13.)

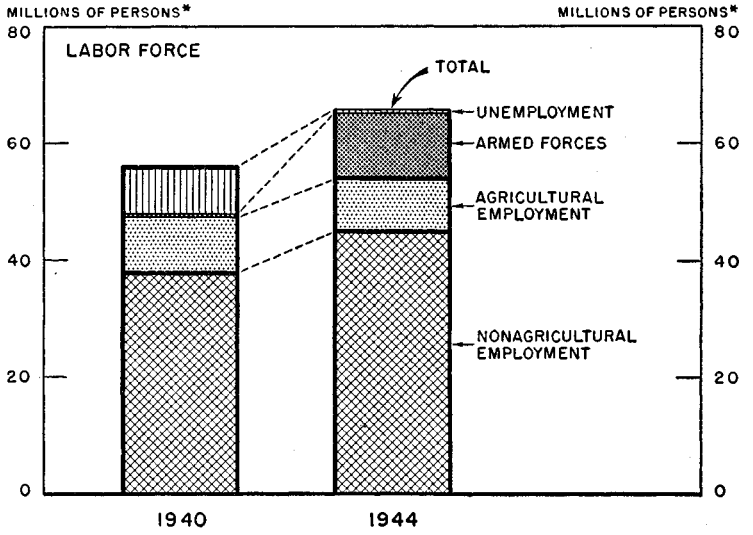
Although increases in labor productivity can be measured only roughly, output per man-hour is estimated to have increased about twice as fast between 1940 and 1944 as it did on the average over the previous 4 decades. This was partly a byproduct of bringing resources into intensive use, and partly a result of the changing composition of the national output.

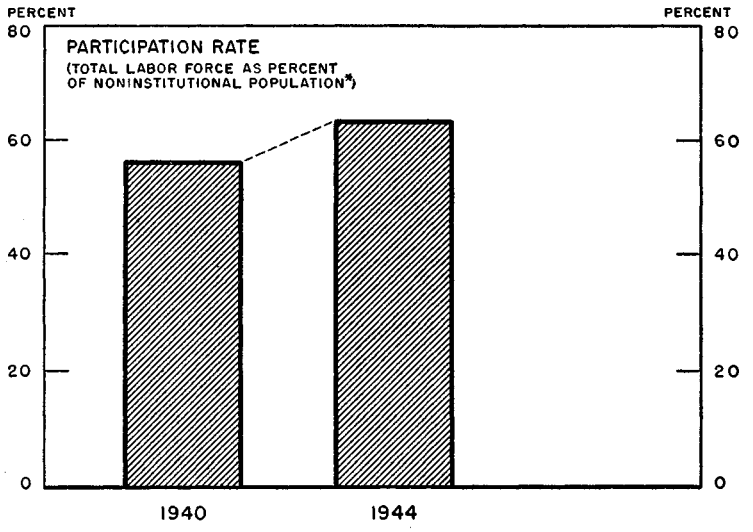
The wartime production achievement also required a large expansion of productive capacity. From 1939 through 1945, total manufacturing capacity increased by approximately 30 percent. (See chart 18, page 79.) The capacity increase in machinery producing industries was about 50

CHART 8

EXPANSION OF THE LABOR FORCE, 1940-44

An increase in the labor force of 10 million and a reduction in unemployment of over 7 million made it possible to increase the armed forces by almost 11 million and also increase nonagricultural employment by 7 million, contrasting 1940 with 1944.

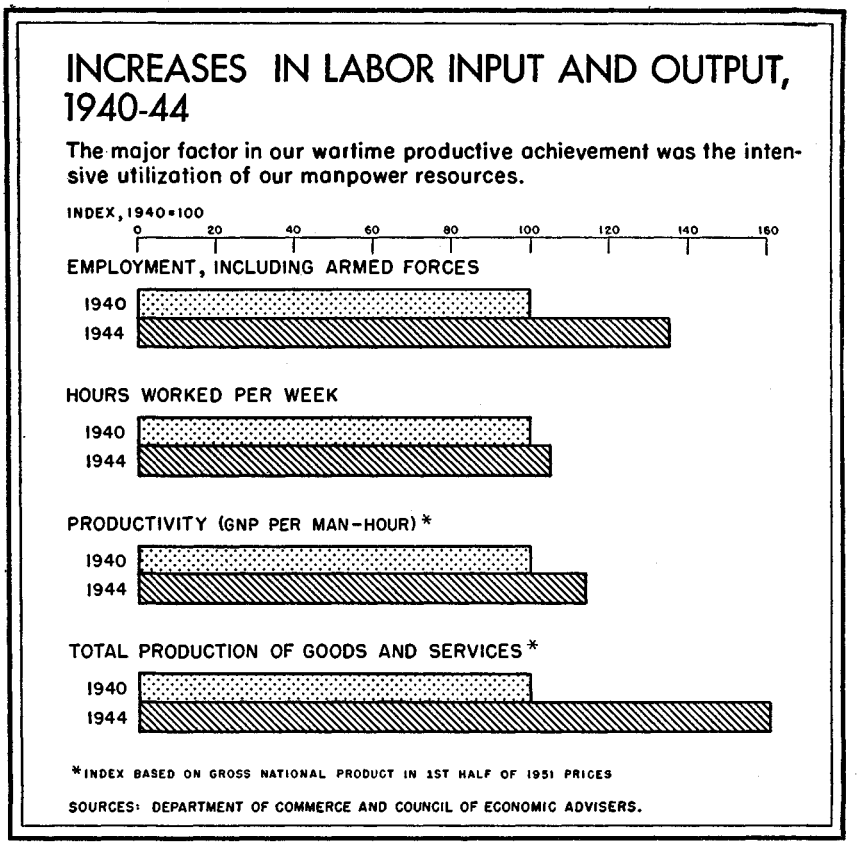




*14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF COMMERCE.

CHART 9



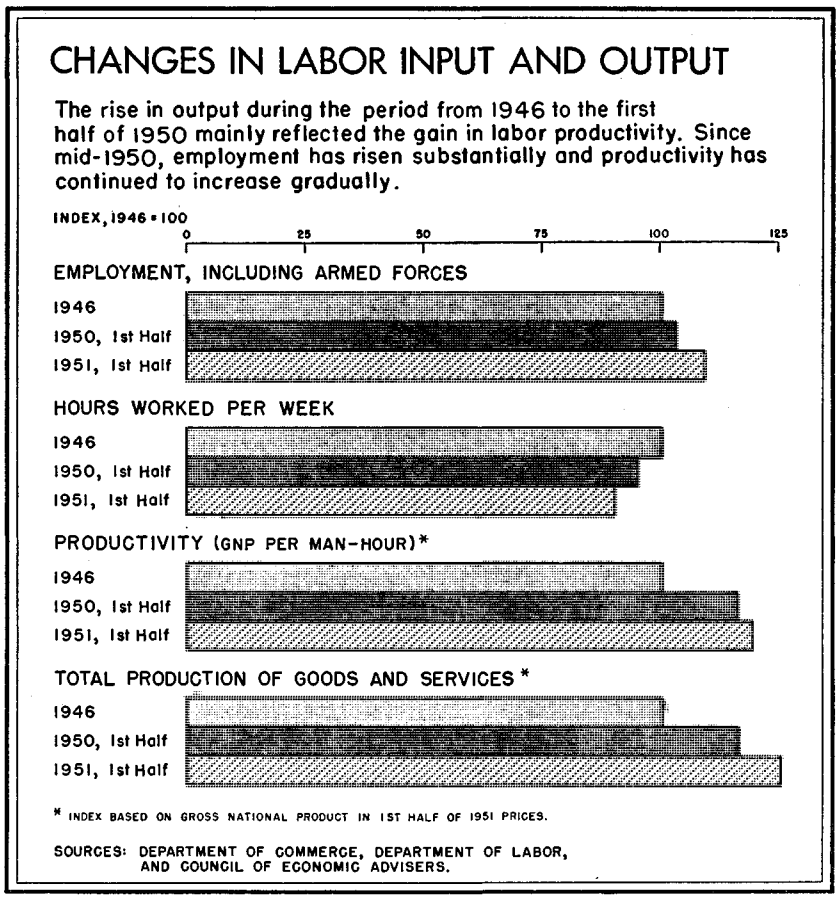
percent, in chemicals about 70 percent, and in electric power somewhat more than 30 percent.

Except in periods of full mobilization of resources, such as was reached during the latter part of World War II, the limits on the expansion of output are in practice seldom, if ever, reached. Within a surprisingly short time, seemingly impossible materials and facilities problems can be overcome. This was demonstrated not only by our own wartime experience, but by Britain's and Germany's as well.

The course of production from World War II to Korea

From the 1944 peak to 1946, the total national output in real terms dropped about 15 percent, and the index of industrial production fell nearly 30 percent. A large part of this decline reflected the change-over to peacetime products. At the same time, there was a shortening of the average workweek in all branches of employment by about 5 percent, and in manufacturing industries by more than 10 percent. Despite a large contraction in the total labor force, the return of military personnel to civilian life increased civilian employment.

CHART 10



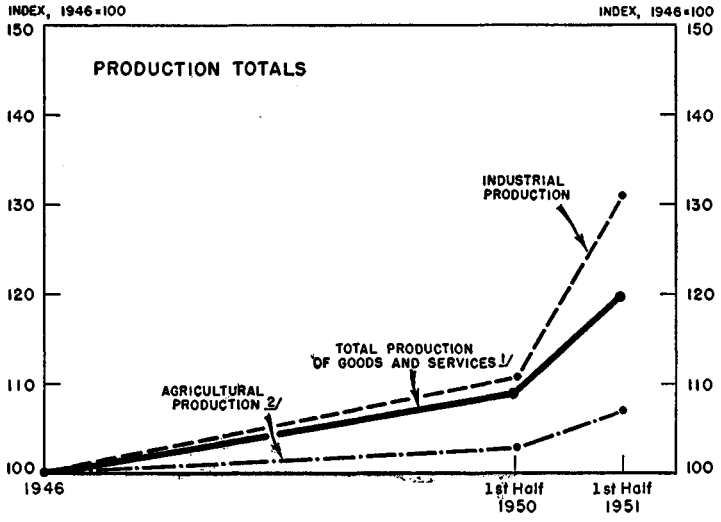
From 1946 to the first half of 1950, the gross national product (measured in terms of first half of 1951 prices) rose from an annual rate of 270 billion dollars to 294 billion, an increase of nearly 9 percent, while industrial production increased 11 percent. The rise in output occurred mainly from 1949 to 1950.

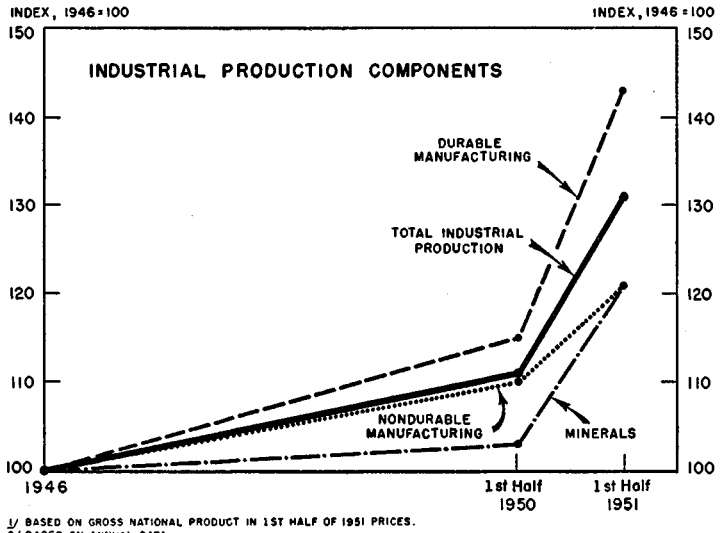
This postwar rise in output was the result of increases in productivity, since the increase in total employment was offset by the further shortening of the average workweek. (See appendix table B–11.) Output per man-hour appears to have risen about 2 to 2½ percent a year—a somewhat larger rate of increase than had occurred during earlier periods of peacetime prosperity. (See chart 10.) The equipping of workers with better productive facilities was mainly responsible for this gain in productivity. During the period, manufacturing capacity appears to have been increased a little more than 6 percent a year on the average. Electric power capacity rose somewhat faster, and much larger increases

CHART 11

CHANGES IN PRODUCTION

Compared with the first half of last year, all major sectors of production are much higher. Production in the durable manufacturing goods industries in the first half of 1951 averaged 25 percent higher than in the first half of 1950 and 43 percent higher than in 1946.





1/ BASED ON GROSS NATIONAL PRODUCT IN 1ST HALF OF 1951 PRICES.
2/ BASED ON ANNUAL DATA.

SOURCES: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, DEPARTMENT OF AGRICULTURE, AND COUNCIL OF ECONOMIC ADVISERS.

took place in the chemical, oil, machinery, and automobile industries. (See chart 18, page 79.) Despite these large increases, however, throughout most of the period a shortage of capacity restricted the growth of many types of output.

We thus found ourselves in mid-1950 with a productive plant so far superior to what we had at the peak of World War II that we were clearly in a position to exceed by far the 1944 production record, if we moved toward fuller utilization of our manpower and material resources.

Changes in output from mid-1950 to mid-1951

The decision last summer to undertake a greatly enlarged security program made it again necessary to step up the expansion of national production and productive capacity. Although we were at that time well on our way toward full employment, there was a remarkable expansion of output in the ensuing year. Short-term changes in total output cannot be precisely measured, but it appears that the total national product as well as industrial production increased considerably more in the 12 months following the Korean outbreak than they had in the entire period from 1946 through the first half of 1950. (See chart 11.)

Comparing the first half of 1950 with the first half of 1951, the gross national product expanded from 294 billion dollars to 324 billion dollars (annual rates, measured in first half of 1951 prices), an increase of about 10 percent. From June 1950 to the beginning of 1951, total industrial production rose 11 percent. This sharp rise in output was due to fuller utilization of the labor force, and continuing large increases in productive capacity. Since January, the index of industrial production has shown little increase, partly because a number of firms were changing over to defense production, partly because of shortages of some specific materials, and also because the defense program did not move up fast enough to more than offset a moderate slackening in some types of private demand which occurred during the first half of the year. The total national output of goods and services, however, continued to expand during the first half of this year. (See appendix tables B–3 and B–17.)

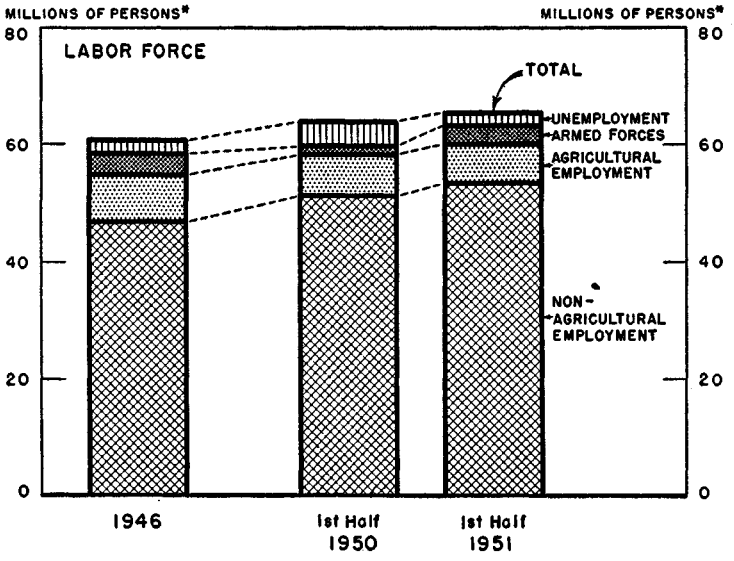
The expansion in the total labor force and reduction of unemployment during the past 12 months have permitted an expansion of 1.6 million in civilian employment, while at the same time the armed forces were built up nearly to the 3.5 million objective. The expansion in the total labor force has been much greater than the normal yearly increase. (See chart 12 and appendix table B–11.)

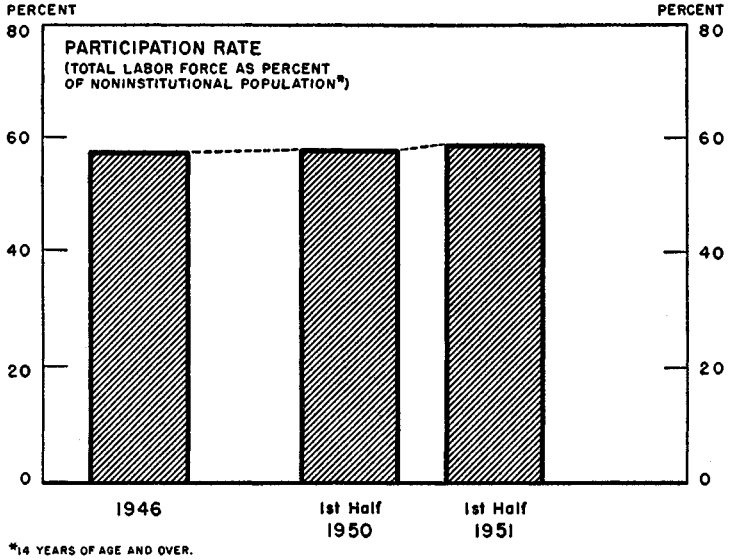
In manufacturing, the workweek was lengthened about an hour during the second half of 1950. In the first 6 months of this year, however, there appears to have been no further lengthening of hours in most sectors of the economy. In the nondurable goods manufacturing industries, there has been a larger than seasonal decline in average working hours, brought

CHART 12

CHANGES IN THE LABOR FORCE

The labor force continued to increase after 1946, with a particularly sharp rise following the Korean outbreak. The labor force growth and the reduction of unemployment since the first half of 1950 made it possible to approach the armed forces goal and to increase civilian employment at the same time.





*14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF COMMERCE.

about by a slackening in the demand for soft goods. (See appendix table B–13.)

At the time of the Korean outbreak, there was little idle capacity in the economy, measured by normal peacetime standards. Material shortages were an obstacle to further increases in total output both here and abroad. But under the impetus of the defense program, we have considerably expanded productive capacity, and have brought existing capacity into more intensive use. During the past 12 months, total private investment in industrial, transport, and utility plant and equipment amounted to 18 billion dollars (measured in terms of first half of 1951 prices). In terms of the same price level, such expenditures had averaged 16 billion dollars annually during the previous 3½ years. Manufacturing capacity has probably expanded 8 percent or more since June 1950. In the same interval, there have been considerably larger increases in the output of such basic essentials as electric power, petroleum, copper, aluminum, and synthetic rubber.

How much can we expand total output?

This appraisal of our economic growth during the war and postwar periods is important for evaluating our future opportunities for economic growth. In many respects, the problems involved in increasing output are now different from and more difficult than those we faced in 1940, when resources were much less intensively utilized than at the present time. On the other hand, our future opportunities for growth cannot be assessed simply by extrapolating the rate of economic expansion achieved between World War II and mid-1950. Expansion of output is now much more urgent; measures for accomplishing this can and should be much more fully exploited.

Before turning to a discussion of feasible output objectives, it should be emphasized that these objectives do not represent *predictions.* Actual changes in output can be influenced by a variety of unforeseeable circumstances. We are concerned, rather, with describing our output *potential,* as a means of supplying the necessary quantitative background for a more detailed analysis of major policy problems. The projections described here represent conservative estimates of what can be accomplished by the fuller utilization of our manpower and material resources.

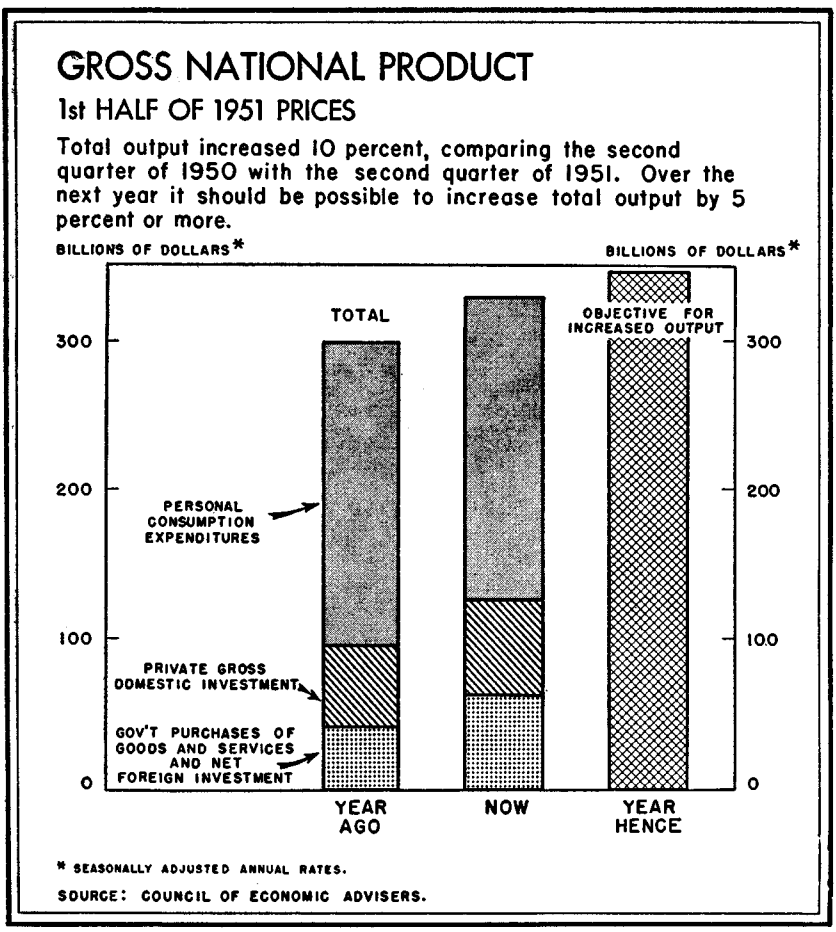
Over the whole first half of this year, the total gross national product was at an average annual rate of 324 billion dollars. In terms of first half of 1951 prices, the annual rate of gross national product at midyear 1951 was in the neighborhood of 330 billion dollars, or about 10 percent above the level of a year ago. Measured in terms of this same price level, it now appears that we should be able to increase total output by 5 percent or more during the coming 12 months, bringing the gross national product to an annual rate of over 345 billion dollars by the middle of 1952. (See chart 13.) Over the following year, the opportunities for further growth will probably diminish somewhat as resources are brought into still

fuller use. But it should be feasible also to realize during that period a further increase of at least 4 percent in total output. Thus, over the next 2 years, we should be able to increase total output at least twice as fast as we did during the period from 1946 through the first half of 1950.

Expansion of our economy at this rate will require that as a nation we work harder and longer, and devote considerable resources to economic expansion, necessarily at the expense of current consumption. But there is little doubt of our ability to do so. The actual course of production over the next several years will depend, more than on any other single factor, on whether our security program moves forward as now contemplated. If we were compelled to undertake a much larger security program, there is little doubt that, by harder exertion, output could be expanded faster.

In estimating the objectives for total output, it is assumed that industrial production will have to increase at a somewhat greater rate than the

CHART 13



nation's total output of goods and services, and that the largest increases will have to occur in industries producing military goods and basic materials. It is also essential that most types of agricultural output be expanded.

Expanding total output by 5 percent or better from the middle of 1951 to the middle of next year would involve substantial manpower requirements. As unemployment is already at a low level, these requirements would have to be met by further expansion of the labor force and lengthening of the workweek in some industries. In this respect, the manpower situation is now much tighter than at the beginning of World War II, when almost half of the additional labor requirements could be met by a reduction of unemployment. On the other hand, the strength of the armed forces is now near the 3.5 million objective, and nearly all of the further expansion in the labor force will be available to provide additional civilian workers.

Under present circumstances, it would be desirable to meet additional labor requirements primarily through expansion of the labor force. Training a large number of workers would place us in a better position to accelerate quickly the expansion of military output, should that become necessary. Over a mobilization period which might be long-lasting, an increase in the number of people at work is a more promising source of additional output than is the lengthening of working hours. There is little doubt that we still have large underutilized resources of manpower in the economy, including housewives without young children, older people, members of minority groups, and the handicapped—many of whom would welcome the opportunity to work. Some women with children can also be drawn into employment, if community care facilities are provided.

Placing major emphasis on labor recruitment would mean that the total labor force would average some 1½ to 2 million persons larger in the first half of 1952 than it did in the corresponding period of 1951. Of this increase, some 600,000 would come from the growth in the population of working age. The proportion of the total population of working age in the labor force would rise to about 60 percent. This compares with a labor participation rate of 63 percent in 1944, and slightly above 58 percent in the pre-Korean period.

Even if the labor force is substantially expanded, however, it still may be necessary to lengthen the workweek further in a number of industries. This will be the case if more serious shortages of some types of equipment develop, or if adequate numbers of skilled workers cannot be quickly trained. It is desirable that a longer than normal workweek not be accompanied by modification of protective legislation and practices with regard to overtime hours and pay. At the same time, a number of people who have held part-time jobs may seek and be able to find full-time employment, thus further lengthening the average of hours worked.

Over an extended period of 5 to 10 years, we should be able, through a sustained high level of investment in expansion and modernization of productive facilities, through worker-training programs, through the stimulation of industrial research, and through other means, to increase labor productivity at a faster rate than we realized during past peacetime periods. Even though the results may not be immediate, all of these means should be used as fully as possible. But in a period as short as a year or two, it is extremely conjectural to project productivity advances. Several factors may adversely affect productivity during the next few years. Substantial numbers of untrained workers will be taken into the labor force; frequent changes in the designs of military equipment will interrupt production; material shortages may hamper industrial efficiency. On the other hand, as defense production increases, there will be a shift in the composition of output towards higher productivity industries, and the bringing of our resources into fuller use may of itself encourage productivity. In projecting total output, the Council has assumed that over the next 2 years we cannot count on productivity gains of more than 2 percent annually.

The most important physical limitation on increasing output at the present time is not the availability of manpower, but rather shortages of basic materials and power. The major investment programs needed to permit the realization of the production objectives outlined above are discussed below in the section on "The Industrial Build-Up." Failure to overcome these basic capacity limitations would seriously restrict our opportunities for economic growth for a number of years, and thereby prolong the burden of a large security program. As the Western European nations are in a similar position, we cannot overcome the materials limitation simply by increasing our share of the total free world consumption. We need to place considerable reliance on increasing the output of scarce materials both in this country and abroad.

Major Required Adjustments in the Use of the Nation's Resources

During the intensification of our productive efforts in World War II, and again during the redirection of that effort after the war, there occurred major changes in the shares of our national output taken for public and consumer use and business investment. These changes reflect in broad outline the shifts which were accomplished in the use of our resources. The accomplishment of our current security objectives, including the expansion of our capacity to produce, is again requiring major shifts in resource use. These changes will not be nearly so severe as those which occurred during and immediately after World War II, but they will nevertheless be important in their impact upon the economy. A general description of these required adjustments will serve to indicate the major tasks of production and stabilization policy. This general description will be followed by a detailed analysis in later sections.

Major changes in the use of output, 1940 to 1944

In 1940, before the outbreak of war in Europe had a major effect upon our economy, total government purchases of goods and services and "net foreign investment" amounted to about 30 billion dollars (in terms of first half of 1951 prices), taking about 15 percent of the national output. The total of government purchases plus net foreign investment roughly measures the portion of the national output not available for private domestic use. During the following 4 years, the rise in output taken for war purposes increased the annual rate of these expenditures by 119 billion dollars (in first half of 1951 prices), bringing the total in 1944 to 149 billion, or about 45 percent of the national output.

As chart 14 and table 1 show, practically the entire increase in the Nation's output during this period was taken by the combined expansion in government purchases and net foreign investment. The moderate increase in personal consumption was nearly offset by the contraction of gross private domestic investment.

TABLE 1.—*Changes in the major components of the gross national product, 1940 to 1944*

[First half of 1951 prices]

Major component	Change, 1940 to 1944	
	Billions of dollars	Percentage
Gross national product	+121	+62
Government purchases of goods and services, and net foreign investment	+119	+393
Personal consumption expenditures	+18	+13
Gross private domestic investment	−17	−56

Source: Council of Economic Advisers. For further details, see appendix table B-3.

The expansion of war expenditures from 1940 to 1944—over 135 billion dollars, in terms of first half of 1951 prices—was greater than the 119 billion dollar increase shown in total government purchases and net foreign investment combined. Federal nonwar expenditures and the expenditures of State and local governments declined. A large part of the war expenditures went for the production of war matériel, shipbuilding, the building of war plants, and military construction—which took in 1944 more than half the Nation's steel output. As we were cut off from many important sources of imports, and as our economic assistance to Allied nations increased, the total export surplus rose to nearly 6 percent of the 1944 national product. From 1942 through 1944, more than one-half of our total exports in each year were made available through lend-lease.

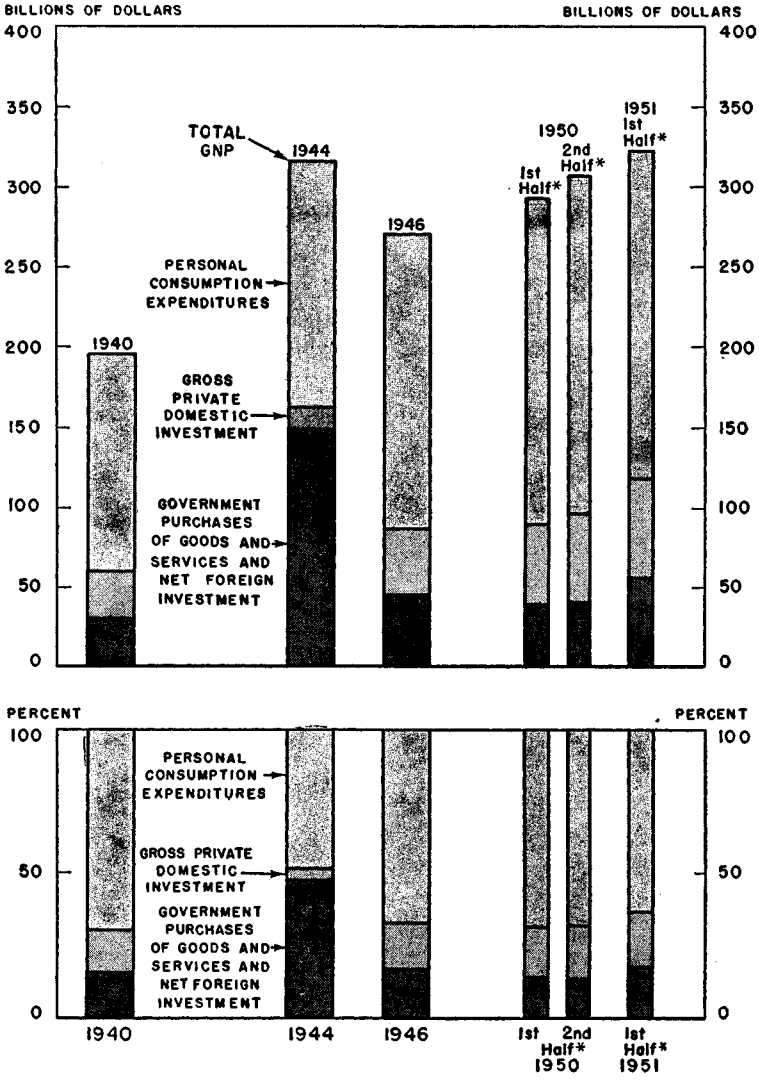
The rise in total output and the compression of investment—particularly inventory accumulation—were sufficient to permit an increase of more than 10 percent in the level of consumption. This increase was represented by

CHART 14

CHANGES IN COMPOSITION OF GROSS NATIONAL PRODUCT SINCE 1940

1st HALF OF 1951 PRICES

During World War II, Government expenditures increased greatly, personal consumption rose, and business investment declined markedly. Since mid-1950, both Government expenditures and business investment increased markedly, while consumption expenditures remained practically constant.



* SEASONALLY ADJUSTED ANNUAL RATES

SOURCE: COUNCIL OF ECONOMIC ADVISERS

types of consumer output which did not directly compete with war production for scarce materials. But as a proportion of the national output, consumption declined from about 70 percent in 1940 to 50 percent in 1944. As types of investment not needed for the war effort were practically eliminated, gross private domestic investment declined from 15 percent to less than 5 percent of total output. Government investment in industrial facilities was substantial, however, raising the total of such investment considerably above the prewar level. (See chart 17, page 76.)

The postwar period to mid-1950

From the 1944 war production peak to 1946, the annual rate of total government purchases and net foreign investment fell by more than 100 billion dollars. The proportion of total output taken for these uses declined from 47 to 17 percent. Despite this contraction, however, total output fell much more moderately than had been generally expected. The impact of the decline in war expenditures was cushioned by substantial increases in both business investment and personal consumption expenditures. From 1944 to 1946, total consumption expenditures and gross private domestic investment increased by 57 billion dollars (in terms of first half of 1951 prices). The combined proportion of the national output rose from a little over one-half to nearly five-sixths. (See chart 14 and appendix table B–3.)

From 1946 through the first half of 1950, there were no major changes in the relationship of the major components of the national output. (See chart 14.) Gross private domestic investment in equipment, construction, and additions to business inventories increased from 42 billion dollars to 50 billion (measured in first half of 1951 prices); personal consumption expenditures rose from 183 billion dollars to 203 billion. Their proportion of the national output increased moderately. Total government expenditures and net foreign investment declined both relatively and absolutely. This was brought about mainly by a reduction in the total export surplus. With the rapid progress of reconstruction and recovery abroad, the export surplus of goods and services had been falling steadily since 1947.

The total level of output reached in the first half of 1950 was about 50 percent greater than the Nation's output in 1940. The proportion taken for consumption was about the same as in 1940. Gross private domestic investment was a somewhat larger proportion of total output; government expenditures and net foreign investment combined took a smaller proportion of the national product. Despite the fact that we were maintaining a much larger military establishment and still continuing a large foreign assistance program, total Federal expenditures for goods and services took only 8 percent of the gross national product in the first half of 1950, compared with 7 percent in 1940. The relative increase in cash outlays was somewhat greater, as cash payments included interest payments on the national debt and veterans' benefits.

Changes in the composition of the Nation's output from the first half of 1950 to the first half of 1951

Comparing the 6-month period preceding the Korean outbreak with the first half of 1951, the total national output rose from 294 billion dollars to 324 billion. (All of these comparisons are at an annual rate in terms of first half of 1951 prices, as shown in appendix table B–3 and chart 14.) About half of the 30 billion dollar increase in total output was represented by expansion of government expenditures and net foreign investment. Of the 15½ billion dollar increase in these outlays, nearly 14 billion was represented by the expanding security program. The other half of the increase in total output went mainly into private investment, especially inventory accumulation. Consumer expenditures, in real terms, after the subsidence of the post-Korean buying waves, were only slightly higher in the first half of 1951 than during the first half of 1950.

During the past year, therefore, the security programs have not required a net diversion of resources from other uses. The portion of the increased total output taken for security purposes was not so great as to prevent a large expansion of output for other purposes.

Prospective changes in government outlays, private investment, and consumption

Realization of our security objectives will require that, during the next year, there must be a contraction in total output available for consumption and gross private domestic investment. The scheduled increase in security programs, as described earlier, would raise total government expenditures by about 28 billion dollars from the first half of 1951 to the first half of 1952. Even if we are successful in expanding total output by 5 percent or more, there still would have to occur a reduction in output available for nonsecurity purposes. If the increase were 5 percent, the contraction would have to be 10 to 15 billion dollars. In other words, even if we achieve a sizeable expansion of total output, almost half of the increase in output for security purposes would have to be met by a diversion of resources from other uses, including public nondefense activities.

The largest contraction may be expected in gross private domestic investment. During the first half of 1951, this total was at an annual rate of 62 billion dollars, and will probably be reduced by something in the neighborhood of 15 billion dollars by the first half of 1952. The major reasons for the projected decline are, first, that inventory accumulation is expected to decline markedly as business comes to expect greater price stability, and as inventory and credit controls become more effective; and second, that some types of investment in construction and equipment will be limited or postponed because of the nonavailability of materials either for construction or operation of new facilities. On the other hand, despite the projected

decline in total gross private domestic investment from recent levels, investment in productive facilities should be maintained at a rate as high as or higher than in most recent years, though not as high as in early 1951.

The effort to increase output will have to be undertaken without the impetus given workers by the large increase in consumption which ordinarily accompanies a more intensive labor effort. Even if we are successful in increasing total output by 5 percent or more over the next year, realization of our security objectives will prevent average family consumption from rising significantly. Consumption may decline as a proportion of the total national output from 69 percent in the first half of 1950 to about 64 percent in the first half of 1951, and about 62 percent in the first half of 1952. At the same time, there almost certainly will be a large rise in spendable income, mainly associated with the increase in employment and output. As will be elaborated in Part III, the inevitably disproportionate developments in incomes and consumer supplies are of major significance in assessing the magnitude of the inflation problem.

The Current National Security Program

The two preceding sections have set forth our general objectives for economic expansion, and the general nature of the economic adjustments which should be accomplished during the next year. We can expand total output by 5 percent or more, comparing the middle of this year with the middle of next year, if as a nation we work harder and longer, and concentrate the build-up of our industrial capacity in certain key sectors of the economy. Even if we expand total output by 5 percent, however, the build-up in our national security programs would require a sizeable diversion of resources from other uses.

This section describes in greater detail the nature of the security program, with respect both to its domestic and international economic implications. In the following two sections, the nature of the required industrial build-up will be elaborated, and the adjustments which will have to be made in less essential types of public and private investment, and in our consumption standards, will be described in further detail.

Size of the security program

During the second quarter of 1951, total security expenditures, measured in terms of deliveries of military goods for our forces and our Allies, military payrolls, and expenditures on other foreign aid and domestic security programs, reached an annual rate of over 35 billion dollars. In terms of constant prices, the total was nearly double the pre-Korean level, and 50 percent above the rate reached in the fourth quarter of 1950. As shown in table 2, these expenditures are scheduled to increase to an annual rate of over 50 billion dollars in the fourth quarter of this year and nearly 65 billion dollars in the second quarter of 1952. Detailed programs have not

as yet been worked out for the period beyond June 30, 1952, but it is now contemplated that the rate of expenditures will be even higher in the fiscal year 1953. The share of our total output used for security purposes would rise from about 11 percent during the second quarter of 1951 to more than 15 percent in the fourth quarter of this year, and to a take of almost 20 percent in the second quarter of 1952.

TABLE 2.—*National security program: deliveries of military goods and other expenditures* [1]

[First half of 1951 prices, seasonally adjusted annual rates]

Period	National security expenditures	
	Billions of dollars	Percentage of gross national product
1944	141.7	45
1950—Second quarter	18.1	6
Fourth quarter	23.6	8
1951—Second quarter [2]	35.7	11
Scheduled:		
1951—Fourth quarter	52.0	[3] 15
1952—Second quarter	64.0	[3] 19

[1] Includes certain work put in place and accumulation of inventories for the military account.
[2] Estimate based on incomplete data.
[3] Approximate.

Sources: Bureau of the Budget, Department of Defense, and Council of Economic Advisers.

It is important to note that these estimates of the timing of the program are based on the value of scheduled deliveries, rather than on expected Treasury expenditures. Neither deliveries nor payments furnish a wholly satisfactory measure of the economic impact of Government procurement, which begins to be felt as soon as—and even before—contracts are placed. Owing to the lag in expenditures behind deliveries, the total value of deliveries will be somewhat greater than actual Treasury disbursements during the period of program build-up. Thus, for the fiscal year 1952, it is estimated that the value of goods delivered to the military services, including certain work put in place and accumulation of inventories for military account, will be in the neighborhood of 4 billion dollars greater than expenditures.

Reaching these objectives will involve serious production problems. The types of equipment which we are now producing or preparing to produce are generally much more complicated than World War II military equipment. Moreover, in a mobilization which is defensive in purpose and therefore protracted, it is undesirable to stabilize weapon designs to the extent which would be appropriate in wartime. For this reason, we shall not be able to realize all the production economies which might accompany an all-out effort. The highly specialized nature of some of the

equipment will result in serious difficulties in obtaining adequate component supplies. A serious machine tool problem has already developed, just as it did during World War II. Because of these and other difficulties, military production has not moved up as fast as was earlier contemplated.

Nevertheless, there can be no doubt that these programs, measured by their rate of build-up and by the level which would finally be reached, are well within the capabilities of our economy. Compared with the rise of almost 30 billion dollars in security expenditures scheduled for the coming 12 months, we increased war expenditures by no less than 75 billion dollars (in terms of first half of 1951 prices) in the first year of our participation in World War II. The present program is expected to absorb not more than 20 percent of our national output at its peak, compared with 45 percent in 1944. A year from now the program is expected to require about 11 million men and women directly or indirectly engaged in defense activity (including those in the armed services). This figure compares with about 25 million at the peak of World War II.

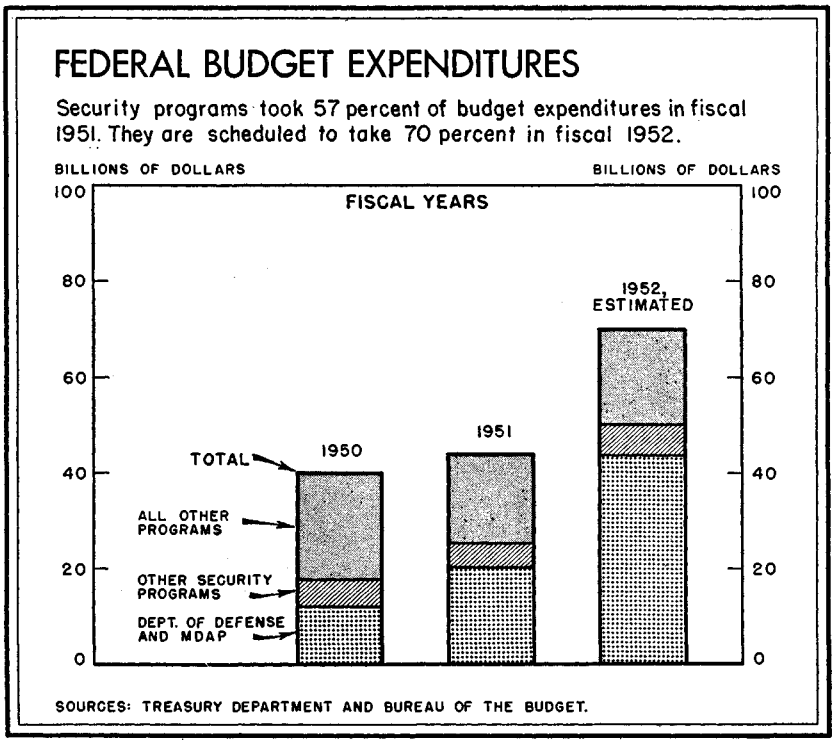
General character of the security program

More than 85 percent of the total security budget for fiscal 1952 is for building up the military establishment of this country, and providing our North Atlantic partners with military assistance. The foreign economic aid programs, as proposed by the President, will decline further in fiscal 1952, to about 5 percent of the security budget. The remainder will be divided among stockpiling, atomic energy, and other security-related programs. (See chart 15.)

The current major objectives for strengthening our military establishment are fivefold: First, to maintain our armed forces at a strength of 3.5 million men; second, to provide for equipping and maintaining the equivalent of 24 army divisions; third, to build the Air Force toward the objective of 95 air wings; fourth, to maintain an active naval fleet of over 1,100 ships with the necessary aircraft and supporting elements, and the Fleet Marine Force of 2⅓ divisions with essential aircraft and supporting units; and fifth, to establish a defense production base which could be expanded very rapidly in the event of full mobilization.

Though the foreign aid expenditures represent a relatively small part of the total program, they are of great importance to the realization of our policy objectives in the international field. The expenditures for foreign military and economic aid in fiscal 1952 represent a major part of our most essential export requirements, but do not include export of essential goods to countries which can pay us out of their own resources. Even though such exports do not involve financial aid, and may in fact be paid for by shipment of goods to us, they constitute a high-priority demand upon our total production and in some cases upon our supply of scarce goods.

CHART 15



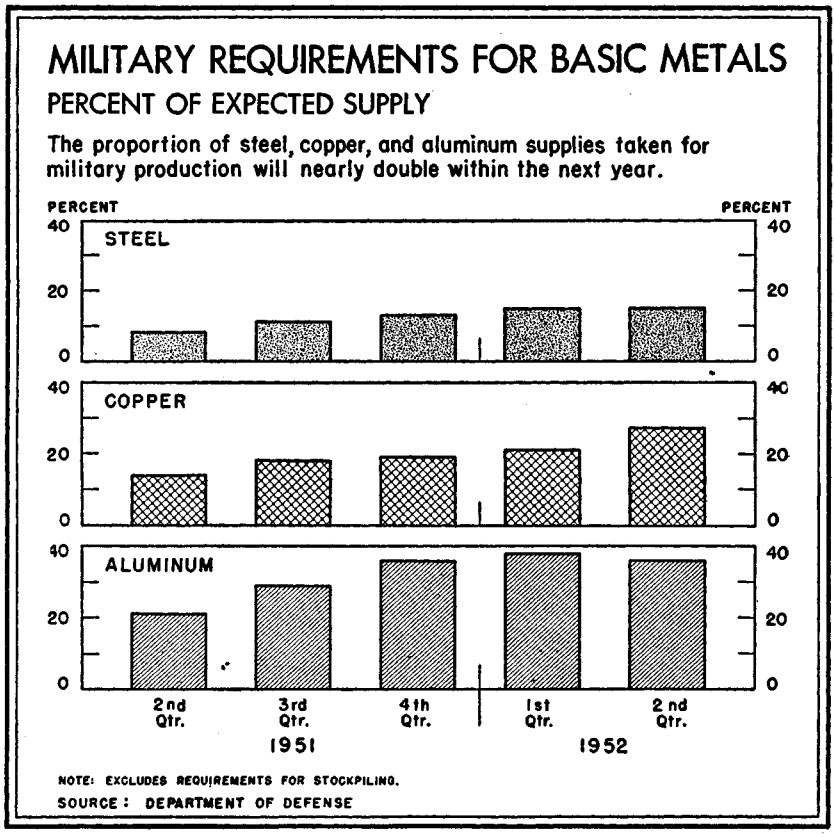
The impact of military production programs on materials

The impact of expanding security outlays on the economy is accentuated by the fact that a large part of the increase is represented by outlays for military equipment, defense production facilities, and military construction. At the end of June, about 32 billion dollars of military orders were outstanding. Military orders are currently being placed at the rate of about 4 billion dollars a month. Deliveries of military hard goods, which include items of major procurement such as aircraft, tanks, and ammunition, as well as some machine tools and equipment used in defense plants, are scheduled to rise from a rate of about 1 billion dollars in June of this year to about 3 times that level next June. Within the same period, aircraft deliveries are scheduled to be tripled, and deliveries of tanks and automotive vehicles increased to 4 times the level of this June. More than half of the increase in total hard goods deliveries is scheduled to take place by the end of this year. (A more detailed description of our military production targets appears in the Second Quarterly Report of the Director of Defense Mobilization.)

Military and public industrial construction is scheduled to increase to an annual rate of about 6 billion dollars by the summer of 1952, which is approximately equal to 20 percent of the present near-record volume of total public and private construction. A large part of this construction will be in the form of training facilities and airfields.

Peak material requirements for these programs will necessarily precede the peak of scheduled deliveries of equipment. Chart 16 shows the expected military requirements for copper, steel, and aluminum as percentages of total anticipated supply. Since a substantial increase in supply is planned in the case of steel, and an even larger percentage increase in the case of aluminum, the period of maximum stringency in these materials will have passed before the peak rate of deliveries is attained. If military production objectives are attained, the percentage of our steel, aluminum, and copper supplies going for military uses will have to increase very rapidly between the second quarter of this year and the first quarter of 1952. The estimates in chart 16 do not include stockpiling requirements, which are sizeable for copper and aluminum. Moreover, the impact of military requirements is

CHART 16



even greater in the case of some specific shapes and types of these metals than the over-all figures disclose.

For many of the materials required in the military production programs, we are largely—and in some cases almost wholly—dependent on imported supplies. No less than 70 of the strategic materials comprising the stockpiling program come wholly or partly from foreign sources. Other security programs and essential civilian needs add further to our requirements for these materials. Even with limitation of nonessential uses, major increases in imports are needed in commodities such as cobalt, copper, iron ore, nickel, manganese, crude petroleum, tungsten, and zinc.

The impact of the common security programs on materials

In addition to the increased requirements arising from our domestic security programs, and from our program of military aid to our Allies, there are other essential requirements of foreign countries which must be met as part of the effort to attain the free world's security objectives. A large part of the common security program consists of the expenditures which the other North Atlantic Treaty countries are making out of their own resources for their military establishments. They must buy capital equipment and raw materials to support this expansion of military production. Foreign countries must buy equipment to maintain and expand capacity to produce raw materials which are in short supply, and to provide power, transport, and other facilities to support the operation of such productive capacity. Goods are also needed to maintain the civilian economies and political stability of friendly foreign countries, to reduce the dependence of some of them on unfriendly countries, and to support development projects in some areas where development of resources will strengthen social cohesion and the will and ability to resist aggression.

These requirements, like our own, must be met from the total production of the free world. They include not only United States goods financed with our foreign economic aid, but also goods purchased from the United States which the importing countries finance themselves, as well as goods they produce themselves or purchase from other foreign countries which help supply the United States economy. Where they involve scarce goods, the problem is to increase production; and, if that is not sufficient, to limit nonessential uses throughout the free world.

The estimating of free world supplies and requirements for major raw materials is now in process, through the International Materials Conference and other channels. On the basis of present estimates, it appears that in the coming 12 months there will be shortages of aluminum, cobalt, copper, zinc, nitrogen, sulfur, tungsten, molybdenum, nickel, iron ore, petroleum, steel, tin, wood pulp, and perhaps a number of other materials. Despite increased production of many scarce commodities, it will be necessary to control nonessential consumption. Agreement has recently been reached

on interim plans for international allocation of sulfur, tungsten, and molybdenum.

The United States consumes very large proportions of the free world's total production of many basic commodities. As a result, relatively small percentage cuts in our consumption may alleviate appreciably the pressure upon supplies available for other countries. Our share of free world consumption has in most cases increased considerably since before the war, although in many cases our contribution to the total production of the free world has also increased. This is shown in table 3 below and in appendix table B–18.

TABLE 3.—*United States consumption and production of selected commodities as percentages of free world production*

[Percent]

Commodity	1939 [1]		1950 [1]		1951/52 projected production
	Consumption [2]	Production	Consumption [2]	Production	
Items not largely imported:					
Bread grains	19	21	18	24	24
Coarse grains	48	50	54	54	54
Cotton	30	55	51	46	55
Fats and oils [3]	26	21	32	33	35
Fertilizer (nitrogenous)	18	11	31	28	30
Lumber	40	41	72	66	66
Meat	31	31	36	39	38
Sulfur:					
Native	53	77	66	93	89
All forms	[4]	[4]	43	56	54
Items imported in substantial quantities:					
Aluminum	22	27	63	51	50
Cobalt [5]	27	----	63	4	[4]
Coffee (green)	33	----	55	----	----
Copper [5]	30	31	61	38	38
Iron ore	32	31	54	51	49
Lead [5]	25	24	64	29	29
Manganese ore	31	1	56	4	4
Newsprint	43	12	65	11	11
Nickel [5]	51	----	68	----	----
Petroleum	62	70	62	57	55
Rubber (natural and synthetic)	59	----	53	20	[4]
Sugar (raw equivalent)	28	17	27	16	15
Tin [5]	45	----	65	----	----
Tungsten [5]	23	13	65	23	[4]
Wood pulp (mechanical and chemical)	40	33	52	43	46
Wool	20	11	32	6	6
Zinc [5]	38	34	55	33	32

[1] Other years used for some commodities. For further details, see appendix table B–18.
[2] Apparent consumption (production plus imports minus exports), except for some commodities, noted in appendix table B–18, for which estimates of actual consumption are used. Additions to domestic stocks are included in apparent consumption.
[3] Includes butter and peanuts.
[4] Not available.
[5] Production represents metal content of mine production.

Source: Compiled by the Department of State.

From the point of view of the United States, the limitation of nonessential uses of some commodities will be necessary to make goods available for export and for essential domestic use, and to limit the need for imports. In general, it appears that the exports of commodities in short supply in the United States will be small in relation to total United States production of those commodities. The highest proportions exported are

likely to occur in the cases of cotton and sulfur. In the case of sulfur, our production will fall substantially short of export requirements and normal domestic demand.

In foods, export requirements are not expected to be a major determinant of domestic supplies. The level of civilian food consumption in the United States during the next 12 months will be determined largely by this year's crop production. The major imported foods, such as coffee and cocoa, are likely to be plentiful.

The Industrial Build-up

Over-all investment objectives

The special needs of the present emergency impose certain objectives for domestic investment. For the immediate future, the objectives are to assure adequate and sufficiently maintained capacity for direct military production, exports essential to our security, and essential domestic civilian needs; and in addition, to build up reserve capacity for items which will be needed in greatly increased quantity if international conditions become more critical. Over a somewhat longer period, it is likewise important to provide the investment in facilities essential to the rapid over-all growth of the national economy, and thus make it possible to remove direct restrictive controls on civilian consumption, while continuing to support the military establishment in a high state of readiness and making our contribution to the security and progress of the free world.

A primary basis for this continued growth is a high level of investment in more and better capital goods. It is evident, however, that the current level of business demand for equipment and construction materials could not be met without delaying the build-up of military power or disrupting the civilian economy. While the maintenance of a high level of investment is imperative, the composition of investment must shift to reflect the urgency of some types and the postponability of others.

Both the level and the composition of investment have changed strikingly since 1940. (See chart 17.) During World War II, the physical volume of gross private domestic investment dropped to less than 40 percent of the 1940 level. Nonindustrial construction was severely curtailed, to save materials and labor. Private investment in industrial facilities was likewise at a fairly low level after 1941, but this reflected the fact that a substantial part of the industrial expansion of the period took the form of Government-owned plants and equipment. The total rate of investment in industrial facilities, both private and public, rose to an all-time record in 1942, and then fell off rapidly.

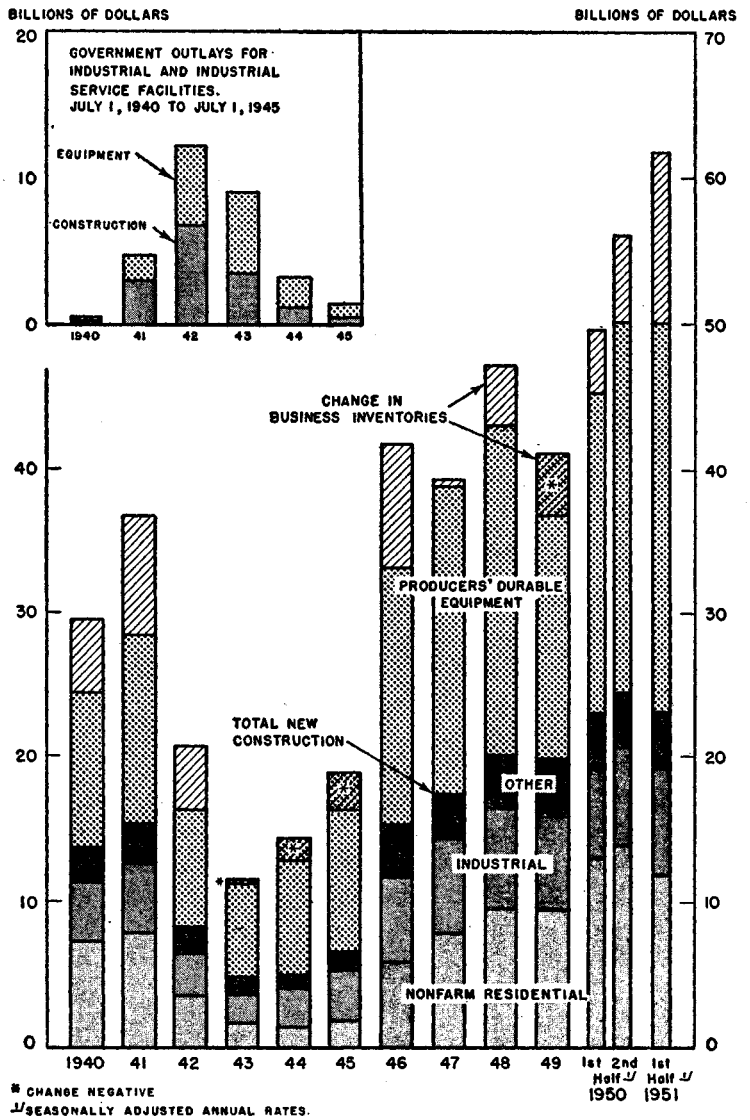
In comparison, the period from 1946 to the middle of 1950 showed a much larger share of resources going into private investment than was the case during World War II. This reflected both Government with-

CHART 17

GROSS PRIVATE DOMESTIC INVESTMENT

1st HALF OF 1951 PRICES

Business investment has risen rapidly during the past year. Increases in equipment purchases and in the rate of inventory accumulation account for the entire growth in total business investment from the first half of 1950 to the first half of 1951.



* CHANGE NEGATIVE

1/ SEASONALLY ADJUSTED ANNUAL RATES.

NOTE: INDUSTRIAL CONSTRUCTION INCLUDES MANUFACTURING, MINING, AND PUBLIC UTILITIES.

SOURCE: COUNCIL OF ECONOMIC ADVISERS.

drawal from the industrial facilities field, and the availability of materials and equipment for nonwar types of expansion and modernization.

Nonfarm housing construction outlays, adjusted to first half 1951 prices, rose rapidly from the 1946 level of 6 billion dollars to well over double that annual rate in the first half of 1950. Nonresidential private construction, on the same price basis, jumped quickly in 1946 to a level exceeding anything since 1929, and held that level with only moderate changes throughout the succeeding years. Producers' durable equipment purchases, already at an all-time high in 1946, increased 28 percent further by 1948; and after a moderate let-down in 1949, were again approaching a new record in the months before Korea. Accumulation of business inventories was more rapid than usual in 1946 and again in 1948, but gave way to temporary liquidation in the 1949 recession.

During the 12 months which have elapsed since Korea, gross private domestic investment has claimed a record share of total national output: nearly 19 percent, compared with less than 9 percent in the period from 1940 to 1944, and about 15 percent in the period from 1946 to the middle of 1950. Comparing the first half of 1951 with the first half of 1950, the physical volume of total gross private domestic investment increased 25 percent; that of inventory accumulation 181 percent; producers' durable equipment purchases 21 percent; and construction other than residential and farm 16 percent. The volume of residential and farm construction, after reaching an all-time high in the second half of 1950, was 9 percent lower in the first half of 1951 than in the corresponding period of 1950. (See appendix table B–5.)

This unprecedented level of all-round private investment, made possible by the ample financial resources available, was induced by the upsurge in consumer demand following the Korean outbreak; by the widespread desire to hasten construction and equipment projects and to accumulate inventories in anticipation of increasing shortages and higher prices; and, in the more recent part of the 12 months' period, by the actual impact of defense orders and the stimulus of Government aids to expansion. Restrictions through credit terms, materials control, and direct licensing of some types of construction, have been reflected in actual reductions of some forms of investment only during the past few months.

During the next few years, fulfillment of our objectives will entail a further curtailment of those types of investment which contribute least to our productive strength. This includes residential, commercial, recreational, and also some kinds of industrial construction. Inventory accumulation likewise should be kept at a minimum, and should represent a considerably smaller drain as the military production program levels off. Total outlays for industrial, utility and transport expansion, however, should be encouraged to continue at levels somewhat higher than in 1950.

The pattern of investment for 1951 and 1952 is likely to be intermediate between that of full peacetime prosperity and that of peak full-war mobilization effort, such as in 1942 and 1943, when Government investment was very great.

Plant and equipment

Expansion and modernization of productive facilities is, for the next few years, the crucial sector of investment. Such investment provides the capacity needed to meet our security and growth objectives. But this type of investment calls for much more steel and other scarce items, dollar for dollar, than do other types such as housing or commercial building. Moreover, related types of capacity expansion must be kept in balance, and we must avoid waste of resources in setting up facilities for which adequate materials will not be available to support their operation.

It is especially important, therefore, that programs of facilities expansion be evaluated as carefully as possible with regard for their contribution to needed production, their properly balanced relationship, and the magnitude of their short-term drain on resources.

Our manufacturing capacity was being expanded during the five years following World War II at an average rate of 6 percent a year. (See chart 18.) A roughly similar rate of expansion prevailed in the electric power industry. The total capital outlays involved, for expansion plus modernization and replacement of manufacturing facilities, averaged about 7½ billion dollars a year, which at first half of 1951 prices would be the equivalent of about 9 billion dollars. Nearly four-fifths of the total nonfarm plant and equipment outlays were spent in the mining, manufacturing, transport, and utilities fields. (See appendix table B–20.) Despite the impressive increase in capacity during this period, our productive capacity appeared to be, in mid-1950, close to full utilization by normal peacetime standards.

The growth of total national product, set forth as a realizable objective in a previous section of this Review, is estimated to call for a continued growth of industrial capacity at a rate at least equal to the 6 percent annual average of the postwar period, and a level of total outlays for plant and equipment roughly comparable to that of 1950. Considerably larger outlays would be involved, if business went ahead with investment plans on the scale suggested by surveys made at the end of 1950 and early this year.

Priorities in expansion

Within this total amount of investment in facilities expansion, a greatly increased share should be devoted to the kinds of expansion most urgently needed.

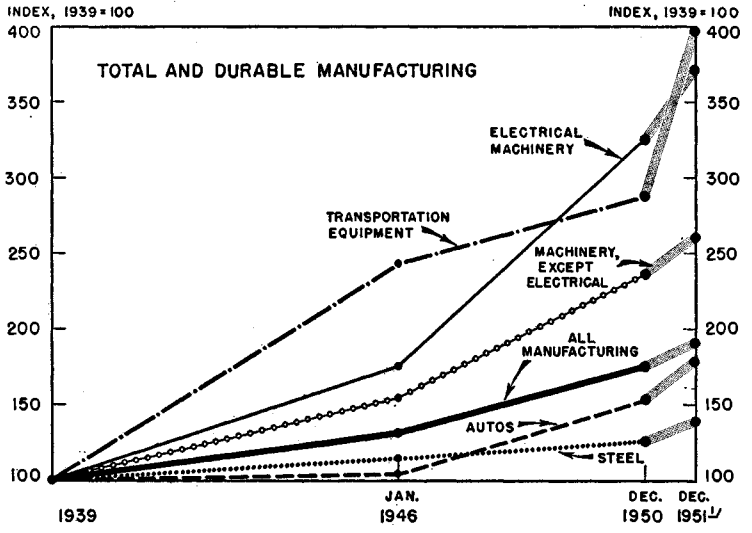
First in priority is the capacity expansion needed to produce the military supplies for existing security programs, with a margin for a possible

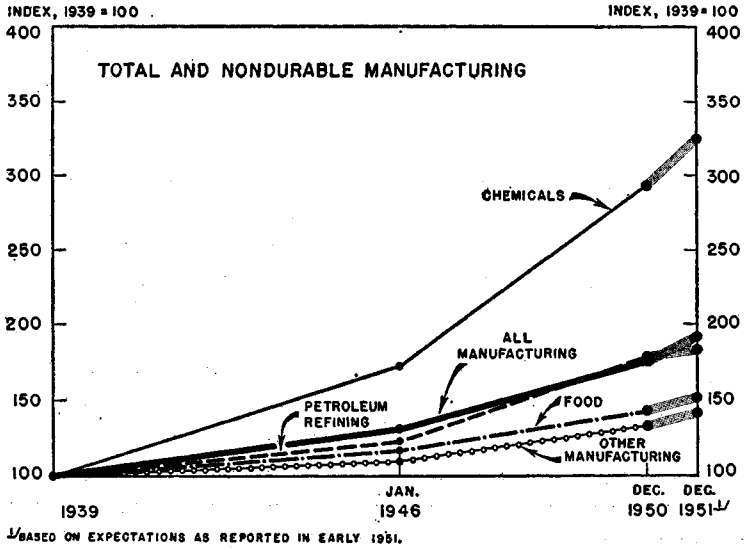
CHART 18

EXPANSION IN INDUSTRIAL CAPACITY

1939 TO END OF 1951

Capacity in most major industries increased faster in the postwar period than during World War II. Business plans for 1951, as reported early this year, reflected a further acceleration of expansion.





1/ BASED ON EXPECTATIONS AS REPORTED IN EARLY 1951.

SOURCE: McGRAW-HILL PUBLISHING COMPANY.

quick step-up to full war production schedules, should the need be imposed on us. In the period from 1940 to 1945, this type of capacity expansion absorbed a large share of the Nation's investment of both private and public funds. About five-eighths of the total outlays for expansion of manufacturing facilities was in the field of aircraft, ships, ordnance, combat and other motorized vehicles, and chemicals (including aviation gasoline and synthetic rubber) amounting to more than 25 billion dollars at first half of 1951 prices. In those areas, the bulk of the investment was Federally financed.

The present program for expansion of capacity for direct military items is considerably less extensive. This reflects not merely the lower level of military procurement now contemplated, but also the fact that we have a substantial reserve of suitable plants used in World War II. Reequipment and reactivation of a large share of these reserve facilities was started in 1950, and the further program now envisaged runs mainly in terms of such action rather than the building of new plants. The major Government industrial plant construction program is that of the Atomic Energy Commission.

The Department of Defense plans to spend approximately 6 billion dollars, from fiscal 1951 and 1952 funds, for expansion of facilities for production of specialized military items, components, and materials. Three-fourths of this represents purchase of equipment, a major part of which will be installed in privately-owned structures. Expansion of aircraft production facilities will absorb nearly half the total sum.

In addition, a much smaller though substantial private investment in equipment and structures for war matériel production is under way. Its magnitude is roughly indicated by the fact that tax amortization certificates have been requested for nearly a billion dollars of private investment in aircraft and other munitions production facilities, and already issued on nearly 400 million dollars. In addition, a substantial part of the contemplated private investment in facilities for electrical, electronic, and other equipment, and in other basically civilian-type industries, is designed to provide capacity to serve military needs.

Outside the sphere of facilities expansions directly needed for military production, there are some other types of investment also deserving of high priority because they are designed to augment the supply of materials, products, and services on which our all-around productive strength and its growth depend. Our general objectives will also require expansion of some of our basic industries to sustain the economy in readiness for full mobilization. This will include expansion of capacity for producing aluminum and other light metals, requiring substantial additions to electric power capacity in some areas; provisions for increasing our supplies of steel, copper, ferro-alloys, and several other metals and minerals; and enlargement of our transportation capacity. Expansion of supplies available

from foreign sources is an important aspect of several of these programs. Goals are taking shape for the principal expansion programs, and substantial progress has been made toward their realization. The status of some of these programs will be outlined below.

In cases such as aluminum and certain alloy metals and chemicals, the production of war matériel itself will absorb a large part of the supply. This is true also of certain steel mill products, and even of electric power in a few specific areas. In the case of such basic types of capacity as transport equipment, petroleum production and refining, and power and steel in the aggregate, the case for expansion at this time rests on the desirability of maintaining the strength of our productive system in general, and not allowing the immediate demands of civilian consumers to inhibit the longer-range growth on which both our military security and our economic welfare ultimately depend.

But in a period when resources are scarce, we cannot afford to promote or even permit all types of investment which make some contribution to total output of any sort. Some kinds of output will be more important than others during the next few years, and some kinds of investment will make a more effective and useful contribution to output than do others.

In judging what kinds of capacity expansion—in addition to those kinds closely related to short-run security needs—may deserve special consideration in this situation, relevant considerations include these:

(*a*) Expansion at bottlenecks is more quickly productive than expansion of facilities which cannot be fully utilized for some time to come. For example, expansion of retail store capacity in a community already fairly adequately served in this respect merely lowers the degree of utilization of that type of capacity and contributes little to total output. As another example, expansion of any type of final processing capacity, over and above what can be supplied with materials, is relatively unproductive. On the other hand, increased supplies of certain machine tools will remove an important production bottleneck.

(*b*) In general, expansion of domestic productive capacity should not be pushed when there is a safe and economical alternative of utilizing similar idle facilities in friendly countries abroad. Such utilization can avoid unnecessary drains on scarce resources to build facilities here, while at the same time helping to strengthen the economies of those countries.

(*c*) One purpose of the increase of general civilian supplies is to make possible the relaxation of irksome and costly controls, and to help in curbing inflation. Easing of shortages of cost-of-living items, which give rise to cumulative inflationary pressure, should presumably be rated high in this category. The need, however, is primarily for

larger capacity to produce the basic materials going into such items rather than for larger final processing capacity.

(*d*) Easing of materials shortages which severely restrict opportunities for small business is desirable, wherever feasible.

Expansion objectives in specific industries

Progress has been made in recent months toward resolving the broad picture of prospective production requirements into objectives and programs for the expansion of capacity for specific products. A brief examination of some of the most important of these objectives and programs will indicate the pattern of expansion which is taking shape, its impact on current shortages and subsequent contribution to supplies, and some of the necessary interrelations among programs.

Although a substantial part of the contemplated expansion represents definite business plans and projects, with various types of Government assistance already approved or pending, the goals are still not finally established in most cases, and much remains to be done in firming-up and scheduling individual expansion projects.

Apart from the expansion of capacity for making finished munitions—discussed at an earlier point—the expansion programs which have been formulated and set in motion are mainly designed to meet the urgent need for larger supplies of metals and other basic materials, energy sources, and transportation.

Steel, copper, and aluminum occupy a special role in the programming of production expansion. All are in short supply, particularly the last two, and all have such pervasive and important uses throughout the economy that now, as in World War II, their allocation through the Controlled Materials Plan is the main basis for production controls. These three metals, however, by no means represent the only areas of major shortage where accelerated expansion is needed. Important expansion programs are being formulated and put into effect in such fields as petroleum production and refining, electric power, transportation, chemicals, and metalworking.

In the light of these programs, it is evident that the pattern of plant and equipment expenditures will show quite a sharp break with the past. The impact of Government programs in aid of facilities expansion will fall primarily in certain industries where there is a clear need for accelerated expansion. Investment in iron and steel, petroleum products, chemicals, transportation, and electric and gas utility facilities accounts for roughly two-thirds of the outlays for which tax amortization certificates of necessity have been requested, and about the same proportion of the amount of certificates thus far granted. (See table 7, page 102.) The magnitude of expansion goals suggests investment in these industries, over the next 2 or 3 years, running considerably above the 1950 rate of 8 to 8½ billion dollars. Capacity expansion in machinery, nonferrous metals, ordnance, pulp and

paper, and a number of other important industries also is being actively stimulated, and is absorbing an increasing share of resources.

With a large step-up in the rate of expansion and investment in these major fields, and with the supply of materials inadequate for any great increase in over-all plant and equipment outlays, investment in fields of lower priority must clearly fall considerably short of the 1950 level, and still farther below the levels originally contemplated in business plans for 1951 as reported in surveys made earlier this year. To make the higher-priority expansions possible, it is necessary to restrain the investment outlays of other lines of business, notably trade and recreational services, food processing, apparel, and a variety of manufacturing industries where capacity is already reasonably in line with the supplies of material which can be made available to those industries under shortage conditions.

Iron and steel. The programs in this area involve ore mining and transportation facilities, coke ovens, blast furnaces and steel furnaces, and still other related types of investment such as refractories plants. There are difficult problems of keeping the various interrelated programs in step so that capacity at all stages can be utilized as fully as possible.

The expansion under way in the steel industry is expected to increase total ingot capacity to nearly 120 million tons by the end of 1952, compared with 107 million tons at present. This program will require 2 to 3 percent of the supply of steel and about the same proportion of the copper supply over this period. It will involve private investment outlays of about 4 billion dollars, which represent not only a large increase over the pre-Korean rate of investment in this industry, but also a sizeable part of total prospective outlays for industrial facilities.

To accomplish this expansion in the time proposed will tax the ability of producers of specialized heavy equipment and components. Full utilization of the expanded steelmaking capacity will also mean increased demand for metallic materials and fuel. It is hoped to meet this demand by taking advantage of recent technical improvements which increase the effective capacity of blast furnaces, by expanded direct use of high-grade imported ores in open-hearth steel furnaces, by increasing ore production and imports, and by collecting more scrap.

Increased scrap collections, and increased use of Lake Superior high-grade ores, are both only temporary contributions to the supply of materials. By 1953, an estimated 150 million short tons a year of iron ore will be required, compared with 123 million in 1951. To meet this requirement, it will be necessary to step up the rate of production at the Lake Superior mines, which will hasten the depletion of that source. Increased dependence on imported ores over the longer run appears inevitable. New mines in Venezuela and Liberia will furnish substantial amounts of ore before 1953, and Labrador is expected to become an important source by about 1956. Beneficiation of low-grade taconite ores is not expected to contribute sub-

stantially to total supply for some years. To provide for efficient use of new ore sources in supplying our major inland steel production areas in the face of a decline in Lake Superior ore supply, initiation of the St. Lawrence Seaway project is an urgent need.

With a sufficient supply of materials to support full utilization of the planned steelmaking capacity, the output of finished steel mill products, which rose from 74 million tons in 1950 to an annual rate of about 82 million in the first half of 1951, could rise by 4 or 5 million tons in each of the next 2 years.

Military and atomic energy requirements for finished steel under present programs are expected to reach by about mid-1952 a peak annual rate at least 12 million tons higher than in 1950, and 5 to 6 million tons higher than in the first half of 1951. Since the supply of steel can grow by only about the same amounts, total nonmilitary uses of steel must be held down to about the 1950 level through most of 1952 at least. In some specific shapes of steel, such as structural shapes and plates, there are much more serious stringencies than the over-all figures disclose.

The use of steel in machinery and equipment for expansion, conversion, and upkeep of productive facilities has increased considerably above 1950 levels, and cannot be reduced much during the next year or two if our industrial build-up objectives are to be met. Even after allowance for an expected reduction in the amount of steel going into inventories, it appears that substantially less steel will be available than in 1950 and early 1951 for consumer durable goods and the less essential types of construction. Substantial cuts have already been made in most of these uses.

With adjustments of this character, the shortage of steel need not significantly impair the maintenance and build-up of our national security during the next few years. If national defense programs continue in subsequent years at levels now contemplated, the squeeze on consumer durable goods and nondefense construction should begin to relax by 1953; and continuation of steel capacity expansion at a more moderate rate thereafter should make possible a fairly rapid return to free use of steel. Expansion of finished steel output to about 90 million tons in the next few years—which would require full utilization of about 120 million tons of ingot-producing capacity—would support continued economic growth, residential and public contruction on at least as large a scale as in 1950, and the satisfaction of normal demands for consumer durable goods.

Aluminum. The expansion program proposed by the Defense Minerals Administration calls for increasing primary aluminum production by 775,000 ingot tons, or 108 percent, from the 1950 level of 719,000 tons. This would mean a total output objective of 1,494,000 tons by the end of 1953, to be achieved mainly by construction of new capacity. Reactivation of existing stand-by plants will provide 79,000 tons of the increase, and 62,000 tons will come from improvements increasing

output at facilities now in operation. The capital outlays involved are estimated at over 750 million dollars, compared with very small investments in such facilities in the postwar period. Approximately half of this expansion program is already assigned to aluminum companies, with tax amortization approved.

The expansion of aluminum capacity is given further support by Government contracts guaranteeing a 5-year market for the output of specified new facilities.

More than two-thirds of the aluminum capacity expansion is planned for the Gulf Southwest states, and will use electricity generated from natural gas. Because of the need to bring this production in speedily, these locations near the gas fields have been desirable. However, for longer-range additions to capacity, cheaper aluminum can be produced by means of hydroelectric power, which may be developed in large quantities and at low cost on the Columbia and St. Lawrence Rivers and at Canadian and Alaskan sites.

Imports of aluminum from Canada are expected to furnish 15 to 20 percent of the supply of primary metal this year; but any enlargement of imports must await the further expansion of production facilities.

Our direct national security needs for aluminum accounted for less than one-tenth of requirements in 1950, but will take about half the supply in 1952. With the contemplated expansion program and the requirements entailed in the present defense program, including the strategic stockpile, civilian use of aluminum will have to be restricted until 1953, but can expand thereafter along a growth trend rising at the rate of 5 percent a year from 1950. This trend projection appears conservative in the light of the past rate of increase in aluminum use. Any over-supply appears unlikely in view of the known opportunities for extensive and economical substitution of aluminum for copper, a metal which seems likely to remain in short supply for an indefinite period. Substitution for steel is also important, especially in military uses.

Under full mobilization at any time in the near future, military requirements for aluminum would increase greatly, and would force a much more drastic cutback in civilian use.

Copper. In contrast to steel and aluminum, the possibilities for increasing our supplies of copper are severely limited. It is estimated that by 1953 the total supply available to this country, including imports, can be increased by only 15 percent over 1950, and then only by carrying forward investment programs both in this country and abroad, and by purchases above present ceiling prices. The contemplated investment in domestic copper mines, amounting to about 250 million dollars, will hardly more than stave off an actual decline of production arising from depletion. By 1953, it is hoped to increase imports, which in 1950 accounted for about 40 percent of our supply of new copper, by at least one-fourth above the 1950 level.

On the basis of the current partial mobilization program, and a curtailment of copper use in consumer durable goods by 40 percent from the high level of the first half of 1950, supplies of copper might be balanced with requirements for the next few years. However, the need for additional supplies is acute if any allowance is to be made for growth in civilian use, and much more acute should full mobilization become necessary. The latter eventuality would require extremely severe restriction of civilian demand.

Over the longer run, the most promising solution of our copper problem lies in the development of adequate substitutes in both civilian and military uses. Aluminum is the most promising substitute; but no relief from that source is in sight until after 1953, even under presently planned defense programs.

Petroleum and refined products. The program formulated by the Petroleum Administration for Defense calls for a 15 percent increase in domestic producing and refining capacity in the 3-year period 1951 to 1953. This is designed to leave modest margins of spare capacity by 1953, assuming no curtailment of imports, and allowing for a roughly doubled military demand plus a continued increase in civilian demand.

The program is aimed at achieving a larger margin of capacity in crude production than in refining, because of our present partial dependence on crude imports, and because it is difficult to gauge accurately in advance the success of exploratory drilling operations in actually developing new production. A much larger margin is to be provided in the case of facilities for special components needed for aircraft fuel, to provide for needs during the first year of a possible war while still further expansion of such facilities would be in progress.

To achieve the projected capacity increases, it would appear that the investment outlays of the petroleum industry would run moderately higher during the next three years than in either 1949 or 1950, even in the absence of further cost increases. The difficulty and expense of exploratory drilling are gradually increasing, which implies a rising cost of maintaining the growth of oil production capacity and proven reserves.

The petroleum expansion program involves a large drain on critical materials, especially steel. Including oil and gas production, refining, transportation, storage, and marketing facilities, the expansion programs will require nearly 10 percent of the entire prospective supply of steel over the next 3 years.

A full-scale war, or continued political difficulties in the Middle East, might result indirectly in a sharp reduction of our imports, now furnishing about an eighth of our supply. Even with present imports, war requirements would be so substantial that civilian rationing would immediately become necessary. Between 1941 and 1944, civilian consumption was reduced by about 12 percent under rationing. Since any great reduction

in civilian use of petroleum products would interfere with maintenance of transportation services, heating, and industrial production, the capacity expansion now planned appears to be an essential precaution.

Electric power. Power demand, as measured by the seasonal peak load, increased 60 percent between December 1945 and December 1950. Despite a large building program during these years, the reserve margin is now less than 10 percent. The presently proposed expansion would provide for meeting the expected December 1953 peak load with the 15 percent reserve margin which is considered adequate. The reserve position in certain regions of the country, especially the Pacific Northwest and parts of the Southeast, is much more critical than nationwide estimates show.

The proposed program calls for a 40 percent increase of electric utility generating capacity—from 70 to 97 million kilowatts—during the 3-year period 1951 to 1953. A significant part of this expansion is needed for expanded production of light metals and radioactive materials for national security purposes. The total outlays for generating plants and associated transmission and other facilities are estimated at 11 to 12 billion dollars. Most of this will be spent by private utility companies, whose outlays are expected to run roughly a third higher, on an average yearly basis, than in 1949 and 1950.

This electric utility expansion program would take, during the 3 years 1951 to 1953, about 2½ percent of the total supply of steel, 6 percent of the supply of aluminum, and 17 percent of the supply of copper. The relatively heavy demands which the power expansion program places on basic and scarce materials and critical equipment items indicate the need for periodic re-evaluation of the various segments of the program, to make certain that the more essential projects get the right of way. However, the fundamental and indispensable role of electric power in the economy, especially the wide variety of its uses, means that a deficiency of electric power would pose a serious threat to the whole production expansion program.

Although power requirements would not be very much greater under full mobilization than under the presently planned defense programs, wartime experience here and abroad has demonstrated the extreme practical difficulties of curtailing less essential uses.

Other programs. In addition to these large and basic programs, there are numerous others which, though of less general importance in American industry, are vital at specific points.

One of the needed materials is manganese, necessary in the steel industry. At present, nine-tenths of our supply of metallurgical manganese is imported. The expected increases in domestic production and imports during the next 2 or 3 years will satisfy our metallurgical requirements but will not permit stockpile objectives to be met in full. Substantial additional supplies might be made available after 1953 from low-grade ore deposits and small mines, and particularly from the wide application of technological

improvements in the recovery of manganese from slags. These processes, now in the experimental pilot-project stage, appear very promising.

Sulfur, in the form of sulfuric acid, is essential in a wide range of industries, including fertilizers, petroleum, chemicals, paints, and iron and steel. In other forms, it is used in pulp manufacture and other processes. The proposed expansion program is designed to increase sulfur supply by about 700,000 long tons, or 12 percent over the 1950 domestic output, by the end of 1953. The cost of this program may run in the neighborhood of 20 million dollars, on a portion of which application has been made for tax amortization assistance. Domestic demand alone, at present prices, would probably increase considerably more than the proposed expansion of output. A balancing of supply with domestic and essential export needs will call for wider use of conservation and recovery methods, and the expansion of production of sulfur from pyrites, both here and abroad.

A plan to cope with the shortage of sulfur throughout the free world by voluntary international allocations has just been worked out by the International Materials Conference, which recently announced such allocation plans for molybdenum and tungsten as well.

Nitrogen is essential for fertilizers, industrial explosives, and other industrial uses, and—especially in full-scale war—for military explosives. The expansion program proposed by the National Production Authority calls for increasing domestic production capacity for synthetic ammonia from 1.6 million tons of nitrogen content at present to about 2.3 million by the end of 1953. Of this increase, 0.2 million could be achieved by reactivation of a relatively high-cost Army reserve plant. The proposed expansion would involve capital outlays of about 130 million dollars.

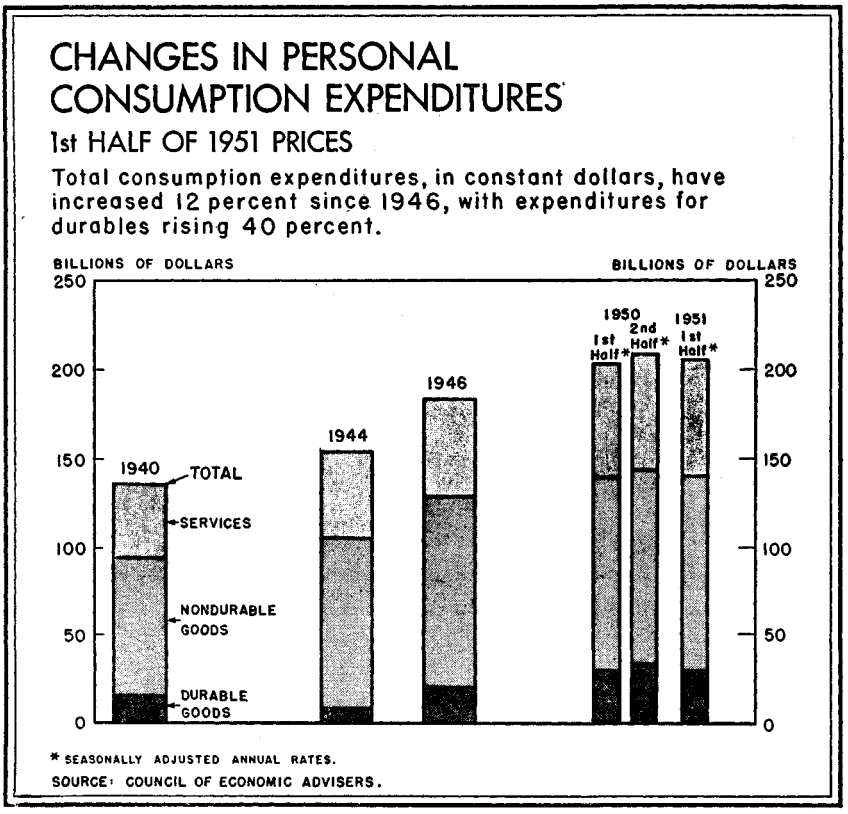
With this program, the requirements as estimated by the National Production Authority could be met during the period 1951 to 1953 under the presently planned mobilization program. Further expansion of supply, to about 2.5 million tons by the end of 1953, would be needed, however, if enough nitrate fertilizer were to be made available to produce feed to keep meat production at present levels without further drawing upon grain reserves. An all-out war would give rise to a heavy additional demand for nitrogen for the manufacture of explosives.

Impact of the Security Program on Consumption Standards

While the defense effort is being pushed to peak levels, important changes in composition of consumer goods production will take place, although total consumption will probably be relatively stable near the present level, which is about 12 percent above that of 1946.

In this respect, the period will be considerably different from the early phases of the World War II mobilization period. Consumption rose 8 percent between 1940 and 1941, and increased in all subsequent years except 1942. A brief review of the war and postwar period will reveal notable

CHART 19



progress in raising standards of consumption throughout the population over the last 10 years, and indicates that a period of slower progress, or even curtailments in consumer goods in the next year or two, would still leave us well off as a nation. (See chart 19.)

The growth of consumption, 1940 to 1944

By 1940, the output of consumption goods had risen by 40 percent from the depth of the depression, although there were still substantial numbers unemployed. Relatively large additions were made in stocks of automobiles and durable household goods in consumers' hands; in 1940, 3.7 million automobiles, 2.7 million electric refrigerators, and 1.6 million washing machines were purchased. As shown in chart 20, per capita consumption of nondurable goods and services in 1940 was about 20 percent below present levels. As the war progressed, per capita consumption of nondurable goods and services rose in every successive year, though due to difficulties of measurement the estimates may overstate the actual increase. Despite large shipments of food to our Allies abroad, the diet of the American family improved a great deal. While the production of metal-using consumer

appliances was virtually eliminated after 1941, purchases of furniture and other types of consumer durable goods increased.

Not only did per capita consumption of most goods and services rise during the war, but the output of the American economy was more broadly distributed among all segments of the population. Depressed areas practically disappeared, and migration from regions of lower productivity and lower employment helped to raise the living standards of the neediest groups. Economic opportunities for the underprivileged were enlarged. Vastly expanded employment opportunities allowed the number of persons contributing to family income to increase, thus helping to raise the income of many families at the lower end of the income scale.

Between 1941 and 1944, there was a marked improvement in the relative status of the lower income segments of the population, particularly families of two or more. As shown in table 4, the average income of the two fifths of families (excluding single person households) at the bottom of the income scale increased by nearly 50 percent from 1941 to 1944, after allowance for price changes. This compares with a 28 percent increase for all income groups, and an increase of 19 percent for the top fifth of families. Rationing was a further factor improving the ability of the lower income groups to compete for consumption goods during the war period.

TABLE 4.—*Changes in the distribution of family income, before taxes, 1941 to 1944*[1]

Families ranked from lowest to highest income	Families and single persons		Families of two or more				
	Percentage of total money income		Percentage of total money income		Average money income (first half of 1951 prices)		Percentage increase in income, 1941 to 1944
	1941	1944	1941	1944	1941	1944	
All families	100.0	100.0	100.0	100.0	$4,085	$5,227	28
Lowest fifth	3.5	3.6	3.9	4.5	796	1,177	48
Second fifth	9.1	10.1	9.6	11.0	1,960	2,874	47
Third fifth	15.3	16.3	15.6	16.6	3,187	4,338	36
Fourth fifth	22.5	23.0	22.1	22.5	4,514	5,882	30
Top fifth	49.6	47.0	48.8	45.4	9,968	11,867	19

[1] Includes family allowances and pay of armed forces living at home.

Sources: Council of Economic Advisers (1941) and National Bureau of Economic Research (1944).

Consumption in the postwar period

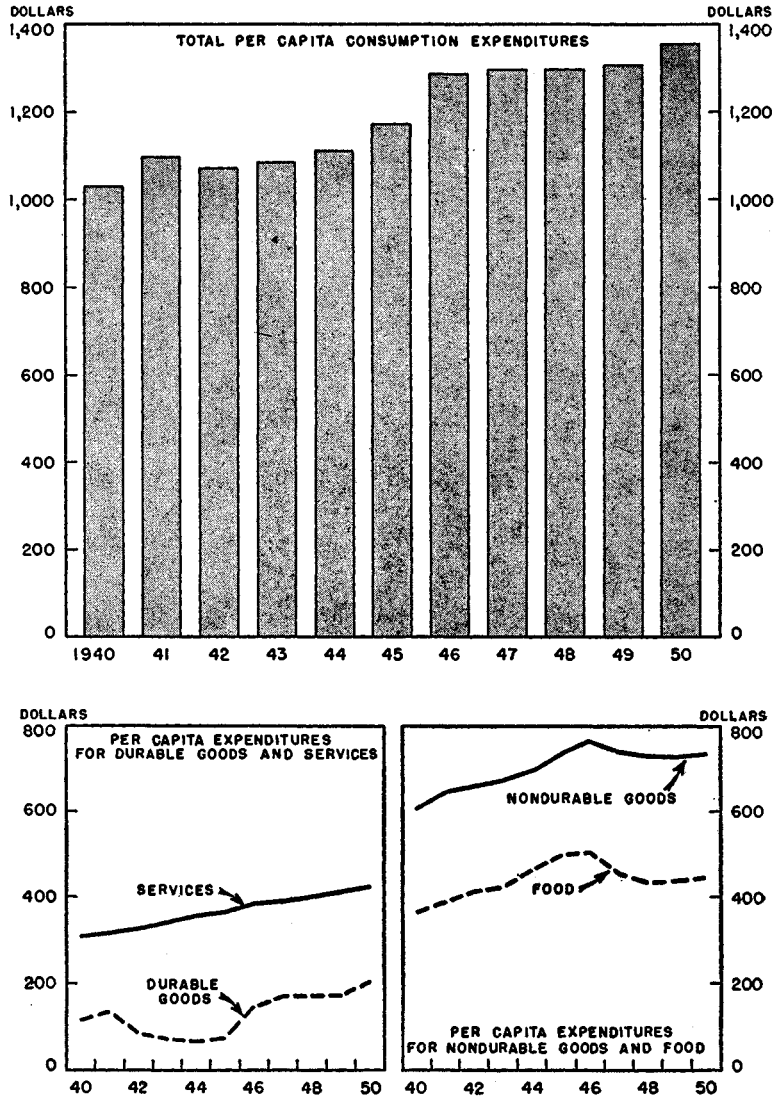
The standard of living is largely determined by the current flow of nondurable goods and services, and the stock of housing and durable equipment. In the postwar period, it has been raised largely through an increased flow of services and large additions to the supply of homes, automobiles, and household appliances. (See chart 21.) The per capita consumption of nondurable goods apparently reached a peak in 1946,

CHART 20

PER CAPITA CONSUMPTION EXPENDITURES

1st HALF OF 1951 PRICES

Real per capita consumption rose throughout most of the war and postwar period. In 1950, it was nearly one-third higher than in 1940.



SOURCE: COUNCIL OF ECONOMIC ADVISERS.

and has since declined somewhat, although it is doubtful whether the estimates fully reflect the degree of product improvement which has occurred since the war. On the other hand, the per capita consumption of services has moved steadily upward since 1946, as it did during World War II. (See chart 20.)

The average rate of construction of new nonfarm dwelling units was only about 300,000 units annually during the period 1942 to 1945, including many of temporary types, and the production of automobiles and other major appliances was severely restricted. Thus, at the end of the war, there was an urgent need for new housing and improvement of existing housing; a high percentage of automobiles on the road were near the end of their useful life; and stocks of other appliances were being depleted. Notable progress has since been made in remedying these deficiencies. In 1950, only 5.6 percent of families were living doubled up with other families, compared with 6.8 percent in 1940 and 8.6 percent in 1946. Automobile ownership has significantly expanded. In 1940, there was a car for every 4.8 persons; by the end of the war, there was only one car for every 5.4 persons; at present there are about 3.7 persons per car. Twenty-eight million homes had washing machines at the beginning of this year, compared with only 13½ million in 1939; and the number of homes with electric refrigerators has almost tripled. Most homes now have a radio, and almost one in four has television.

The more nearly equal distribution of income which was attained during the war has been largely preserved during the postwar period. Although statistics on the distribution of income are not entirely comparable for the prewar, war and postwar periods, the evidence is fairly clear that the postwar distribution is less concentrated than the prewar distribution. Approximate stability in the distribution of income since 1946 is indicated by both of the main bodies of available data—the Census Bureau's Current Population Reports on Consumer Income and the Federal Reserve Board's Surveys of Consumer Finances. The distribution of income for postwar years is shown in table 5.

TABLE 5.—*Distribution of income in the postwar period*

Families, ranked from lowest to highest income [1]	Percentage of total money income		
	1946	1948	1950 [2]
All family units	100	100	100
Lowest fifth	4	4	4
Second fifth	11	11	11
Third fifth	16	16	16
Fourth fifth	22	22	23
Top fifth	47	47	46

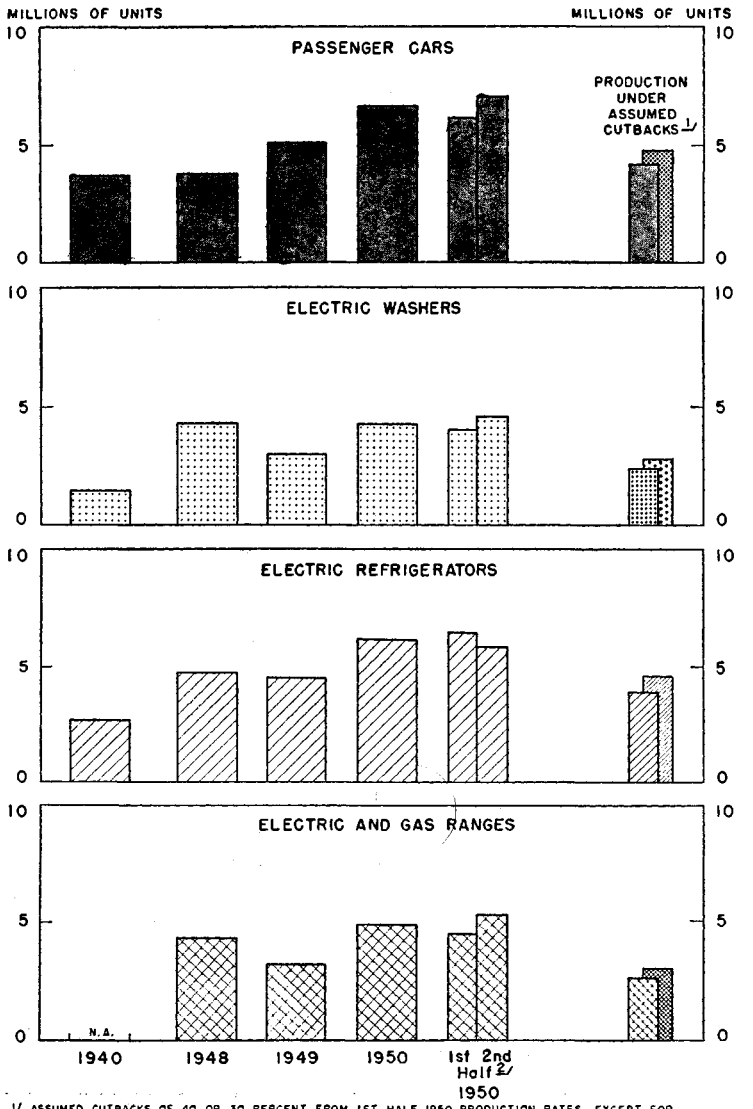
[1] Includes single-person families.
[2] Preliminary.

Sources: Survey of Consumer Finances, Board of Governors of the Federal Reserve System (1946, 1950) and Council of Economic Advisers, based on data from Bureau of the Census (1948).

CHART 21

PRODUCTION OF SELECTED CONSUMER DURABLE GOODS

Cutbacks in civilian production of 30 percent from first half of 1950 rates would permit passenger car output of almost 5 million units per year, and household appliance production near 1949 levels.



1/ ASSUMED CUTBACKS OF 40 OR 30 PERCENT FROM 1ST HALF 1950 PRODUCTION RATES, EXCEPT FOR AUTOMOBILES, WHICH HAVE BEEN ADJUSTED UPWARD TO TAKE ACCOUNT OF THE LOW PRODUCTION BASE.
2/ ANNUAL RATES.

SOURCES: AUTOMOBILE MANUFACTURERS' ASSOCIATION, MC GRAW-HILL PUBLISHING COMPANY, AND DEPARTMENT OF COMMERCE.

Consumption during the period of the new defense build-up

If the production goals outlined in previous sections are realized, there will still be opportunity for further increases in some types of output for consumers during the next year or two. The output of many types of nondurable consumer goods and services can be expanded, while the production of housing and of durable goods is expected to be sufficient to take care of the population growth and some replacement. Exact estimates of the degree of expansion which will take place in the output of nondurable goods, or of curtailments in durable goods, are of course impossible. In the first place, projections included here assume that targets for defense production will be met, although many factors may accelerate or retard progress toward these targets. Secondly, the extent to which total output can be increased depends on the willingness of more people to enter the labor force; on willingness to work longer hours; and on some unforeseeable factors, such as the influence of weather conditions on crops and the availability of imported raw materials. Further, it is impossible to anticipate in detail the policy decisions which will distribute the burden of necessary cuts among consumption, private investment, exports, and public programs.

Making such assumptions as seem reasonable for all these factors, it appears that per capita consumption of food can be maintained at levels as high or higher than in 1950, as can consumption of clothing, shoes, and other nondurable goods. The output of many types of services can be substantially increased, as during World War II. On the whole, it seems likely that increased demands for nondurable goods and services will draw forth moderate increases in output, despite the diversion of material and manpower to defense industries. Those types of consumer output which will be adversely affected by the resource needs of the security programs are housing and consumer durable goods, including automobiles, household appliances, and television and radio sets.

Credit restrictions on new housing have been established with the object of reducing construction to an annual rate of 850,000 nonfarm dwelling units (a level which may be substantially exceeded in 1951, because of the backlog of commitments existing at the beginning of the year). The 850,000 new units would provide dwellings for the expected 400,000 to 500,000 increase in new families each year, with a substantial margin for retirement of substandard units, abnormal demands in defense areas, and other needs. Thus, while additions to housing may not always be of the most desirable types from the standpoint of meeting the needs of a defense economy, the quantity of new housing, together with improvement of existing structures, insures that housing accommodations will not deteriorate during the period of defense build-up.

However, more attention needs to be concentrated, not only upon proper location, but also upon proper pricing relative to the need. Much more

of the housing should be built to sell or rent within the means of defense workers. This involves, among other things, a larger volume of low-rent publicly financed housing.

The outlook for metal supplies indicates that the needs of defense procurement and essential investment will not require, by the end of this year, a greater reduction in the use of scarce metals in consumer durable goods than 30 to 40 percent, measured against the first half of 1950. After adjustment for the effects of the Chrysler strike in early 1950, a cut of this order would permit the production of passenger cars at an annual rate of 4½ to 5 million units, compared with an estimated 5½ million this year, 6.7 million in 1950, and 5.1 million in 1949.

The effect of cuts in the supply of metals for major items of household equipment, ranging from 30 to 40 percent of the first half of 1950 rate, is shown in chart 21. The estimates are largely illustrative, since numerous factors could influence actual production levels in addition to the current allocation of materials. However, it can be seen that a 30 percent cutback would permit output near the levels of 1949 for electric refrigerators, electric and gas ranges, and electric washers. In terms of experience prior to 1950, this is a very high level of production. Maintenance of supplies at these levels would be more than adequate to equip new dwellings and to permit normal retirements of over-age units.

In summary, the output of consumer goods will be adequate to maintain high consumption levels in the United States under present defense programs, but at the cost of a greater labor effort, and some sacrifice of leisure time. Consumers will not, however, be able to translate all of their increases in money income into additional consumption. Some goods will be produced in quantities inadequate to meet demand, and some degree of quality deterioration may take place. The variety and attractiveness of some goods will suffer, as substitutes are used and skilled labor becomes more scarce.

For most families, only some inconvenience is involved in meeting our national objectives. For others, however, there will be real hardship. Even in normal times, many groups of the population hardly participate in what we like to regard as the American standard of living. In 1950, as shown in table 6, 28 percent of the families had incomes below $2,000, after taxes, and an additional 18 percent had incomes between $2,000 and $3,000, after taxes. While these income groups contain relatively large proportions of single-person families and of farm families with non-money income, it is obvious that very large groups still live in relative poverty.

TABLE 6.—*Distribution of families by income level, before and after Federal income tax,*[1] *1950*

Money income	Before tax		After tax	
	Percentage of families	Percentage of money income	Percentage of families	Percentage of money income
All families	100.0	100.0	100.0	100.0
Under $1,000	11.5	1.2	11.6	1.4
$1,000 to $1,999	15.2	5.7	16.4	6.8
$2,000 to $2,999	15.6	9.7	17.7	12.3
$3,000 to $3,999	17.9	15.6	19.7	18.8
$4,000 to $4,999	12.7	14.2	13.6	16.6
$5,000 to $7,499	17.7	26.3	14.3	23.4
$7,500 to $9,999	4.8	10.4	4.0	9.5
$10,000 and over	4.4	16.9	2.7	11.2

[1] Families include single-person families. Income tax liabilities have been estimated from data on family income and composition.

NOTE.—Detail may not add to totals due to rounding. Figures in this table are not comparable with those shown in table 10, page 132, which are based on a distribution by spending units rather than family units.

Source: 1951 Survey of Consumer Finances, Board of Governors of the Federal Reserve System.

Some of the poorer groups of the population have already benefited by the defense effort. The competition for labor will create better employment opportunities, and in some families, working wives will augment the family income in the coming period. The defense effort properly gives relatively more income to those who can work longer hours or take jobs in higher-paying defense industries. Changes in income distribution are inevitable in a time of economic readjustment.

On the other hand, a spiraling process of general price and wage increases entails a general redistribution of earning power, which cannot be justified by the need to get out more production or to change its composition. This process leaves behind those groups who are not in a position to take jobs or to obtain wage increases, such as retired persons, annuitants, disabled veterans depending on pensions, and all other fixed income groups. This is particularly unfortunate because fixed income recipients are disproportionately concentrated in the lower income brackets. Between early 1950 and early 1951, when personal income rose by about 13 percent, half the population did not obtain any increase in income. In fact, 18 percent had decreases in income.

These considerations point to the need for a firm policy of price and wage stabilization. But the fact that there are difficult problems involved in distributing the burdens of a defense program does not by any means imply that much greater cuts could not be made in civilian output than are now contemplated. Durable consumer goods production could be cut to a minor fraction of its present rate, and the output of nondurable goods and services reduced substantially without damage to health or morale, if the international situation required. By contrast, the degree of sacrifice associated with our present objectives appears relatively minor.

III. Economic Policies for Defense

Prime Importance of Economic Programming

In the Council's December 1950 Annual Report to the President, entitled "The Economics of National Defense", and in its January 1951 Annual Economic Review, the need for programming of requirements and supplies was emphasized. Although substantial progress has since been made by the defense agencies toward this programming operation, the Council feels called upon once again to emphasize its vital importance.

"Programming", as we use the term, does not mean the central planning characteristic of the economic operations of some other countries. It means simply that, in a defense emergency, the Government is necessarily affecting the whole economy in so many important ways that it has the high responsibility to see to it that these various operations are harmonious and guided by a vigilant logic.

Such a programming operation involves four main tasks.

First of all, it involves the application of an economic strategy, which fits together insofar as feasible the various major parts of the national effort. The military build-up, the stockpiling effort, the measures for international aid, the actions to build up our own industrial facilities, and the steps designed to limit civilian consumption, do not exist in separate worlds. They must all be conducted at the same time within the American economy, and in the aggregate they are limited and conditioned by our economic resources. Thus, there must be a continuing effort to keep these various major parts of the effort in balance, although the relative size of these different parts may vary from time to time, depending upon the working hypothesis as to whether we are engaged in a long drawn out struggle or moving quickly toward an ultimate crisis. This first phase of the programming operation might be called the clear defining of major goals, and the testing of their feasibility one against the other.

Second, the programming operation involves a continuing determination of how these major goals are to be reached. What part can be accomplished through expanding supplies? What part needs to be accomplished through reducing demand? In this aspect, programming involves the constant testing of various economic policies and detailed actions in terms of the basic objectives which they are designed to achieve.

This aspect of programing involves both production and stabilization. The two are interconnected, and success in both is essential for success

in either. In one sense, the ultimate aim is production. The products of industry, not their price tags, fill the armories and commissaries of our Armed Forces. Yet in large measure the stability of the price and income structures conditions the will and capacity to produce. Without stability, production is disrupted and serious incentive-sapping inequities crop up. It is just as true, particularly for a protracted effort, that genuine stabilization requires expanding production. Stabilization means holding demand as closely as feasible to the supply of available goods, and this can be done more easily if the supply increases.

While production and stabilization efforts are complementary, there can be some points of conflict between them. If production were the only objective, we might make extensive use of price and wage increases as incentives, but this would destroy stabilization. Conversely, rigid and single-minded price and wage stabilization, or tax and credit programs directed exclusively to a narrow anti-inflation objective, might cripple essential defense and civilian production. The harmonizing of production and stabilization is part of the programming task.

Third, programming involves scheduling and timing. Not only must the major goals be defined with such clarity as is attainable, but in addition the relative speed at which these various major goals are to be attained must be borne in mind. Otherwise, vast and unnecessary dislocations in production and employment could be caused by cutting back on some things faster than others are increased; or damage to the defense effort could result from not cutting back on some things fast enough to satisfy military and related requirements.

Fourth, programming involves a reasonably complete and continuous synthesis or inventory at one central point of all the important facts about the progress of the whole effort, so that those concerned with policy may have immediate access to what is happening as a guide to what needs to be done. Without this opportunity to look at the whole picture as it evolves, great disparities or deficiencies could arise without being detected in advance.

Programming, in short, is nothing more nor less than the application of sound and tested business methods to the business of national defense, which is the biggest business that we are now undertaking, and by far the most vital. The progress thus far made in programming, while encouraging, should be carried further. And because it is at the core of the whole effort, energy and determination should be concentrated upon it even more than upon important segmental operations of production or stabilization. For, in the final analysis, production and stabilization actions must be guided by this kind of programming.

While the Government must lead in this programming effort, its success depends very heavily, as the Council has frequently said, upon voluntary cooperation. The detailed measures to increase production, to control

prices and wages, to restrain credit, and to stimulate saving, can be greatly facilitated through the constructive cooperation of unions, farm organizations, business and consumer groups, and local governments. Such cooperation may best be achieved if each group has an opportunity to participate in the programming action which gives meaning and direction to all of these other efforts.

The Production Effort

A year ago, the nation's security program was absorbing about 6 percent of the economy's total production. Under present plans, the figure is expected to approach 20 percent a year hence. This assumes that total production, which has increased 10 percent during the past year, can be increased at least another 5 percent during the coming year. The increase in total production from the first half of 1950 to the first half of 1951 has made it possible to increase outlays for national security, for facilities expansion, and for civilian consumption all at the same time. Without such an increase in total production, it would have been necessary to curtail business investment and consumption by about one-tenth from the present level. A further curtailment of one-tenth would be necessary if the scheduled increases in national security programs during the next year had to be met without a further increase in production. A rise of 5 percent in total output over the next year should make it possible, not only to meet the scheduled 30 billion dollars increase in national security expenditures during the next year, but also to add to capacity in at least some of the most essential industries, and to avoid a reduction in consumption.

To meet the national security objectives, it is essential that the goals outlined in Part II of this Report be attained, and that economic programs and policies be shaped to this purpose. These goals may be summarized as follows:

1. An increase in total output of 5 percent, or better, from the middle of 1951 to the middle of 1952.

2. An increase of something like 4 percent in total man-hours of work over this period. Most of this increase should result from expansion of the labor force by 1½ to 2 million. Some lengthening of the workweek will be necessary in some industries. Increased labor productivity should make an additional contribution of some 2 percent to expansion of total output.

3. Expansion of productive capacity in such basic industries as iron and steel, aluminum, chemicals, fuels, energy, and transportation facilities, requiring outlays of 20 to 30 billion dollars during the next 2 years. In addition, expansion of specialized facilities for military production will come to about 7 billion dollars.

4. Effective development and utilization of foreign as well as domestic resources of basic raw materials, and their allocation in line with comparative urgency of demand.

5. Restrictions on many types of consumption, business investment, and Government spending.

Industrial production aids

To promote the acceleration and redirection of production, the Government has in the past year, under the authority of the Defense Production Act and related legislation, taken action to guide the flow of materials; to aid some producers in financing their expansions of both working capital and fixed investment; to reduce the risks and enhance the prospective level and stability of earnings of some producers; to promote the wider and prompter adoption of new technology; and to broaden the participation in defense-related production by business enterprises both large and small. Some of the production aids are being applied abroad as well as at home, to enable friendly nations to increase their contribution to the common cause.

Materials controls. The most common limiting obstacle to production has been the relatively scarce supply of certain materials, mainly metals. This will continue, and control of materials flow is increasingly the key to the redirection of production.

In the initial year of the defense effort, while the drain on materials for national security was still small, a series of partial controls over key materials was instituted. They began with a limitation on accumulation of inventories. This was quickly followed by the granting of a general priority for defense production orders, later supplemented by grants of specific limited priority assistance to certain defense-supporting production and capacity-expansion programs. At the same time, the use of certain scarce materials, such as aluminum, in less essential products was curtailed by restriction orders. Conservation of scarce materials and the use of substitutes were promoted by controls over product specifications (e. g., for containers). Some uses of scarce materials were prohibited outright, and a few materials in shortest supply were placed under complete allocation.

The National Production Authority has been able to stave off a repetition of the breakdown of the priority system which occurred during World War II. To meet the increasing stringency of materials supplies, it is now achieving a transition to the comprehensive allocation and scheduling of key metals use through the Controlled Materials Plan.

Department of Defense programs for facilities expansion. A basic problem in this area of production is expansion of capacity, since the aim is to provide a wide enough margin to permit a quick step-up in the event of all-out war. A core policy underlying defense procurement is to balance

deliveries of end items with needs for equipping the active forces for the initial phases of mobilization. Preparation for possible full mobilization requirements is to take the form of quickly expansible production, rather than large reserve stocks of military end items. The Department of Defense is now carrying out a facilities expansion program involving primarily the purchase, conversion, and modernization of production equipment in both privately-operated and Government-operated industrial plants. Funds are generally authorized only when privately-financed expansion cannot be obtained, even with one or more of the Federal aids provided in the Defense Production Act and the Revenue Act of 1950.

Steps have been taken to meet the particular administrative issues and subsequent settlements posed by this program. Problems arise particularly where Government-owned and privately-owned equipment and structures are locally integrated in such a way as to make severance impracticable. During World War II, numerous additions to privately-owned facilities, which were financed by the services, proved to be relatively useless in the postwar period. The inevitable result was that, when the supply contracts were terminated, the Government faced the problem of disposal with no bargaining position. The only feasible prospective purchaser was the owner of the facility, and the cost of dismantling exceeded the best obtainable offer to purchase.

These problems will not be as serious under the present defense program as during and after World War II. Nevertheless, to protect the Government's interest and bargaining power more adequately, the Department of Defense has adopted a new policy on facilities contracts. Nonseverable facilities of such a nature as not to be disposable to third parties must in general be located on Government-owned or Government-controlled land, except where (1) the contractor agrees to purchase the facilities on expiration of the contract at actual depreciated cost, or (2) the estimated useful life of the facilities will not extend beyond the expiration of the contract.

Financial assistance through loan guarantees and direct loans. The program for loan guarantees by Government procurement agencies, administered through the Federal Reserve System under authority of the Defense Production Act, is designed primarily to aid producers otherwise hampered by lack of working capital. Where aid is required for the financing of fixed investment or developmental work, the Defense Production Act also authorizes direct Government loans (including participation in and guarantee of private bank loans).

The amount of financial assistance extended under these programs is shown in table 7. About three-fourths of the total direct loan assistance, including participation by the Reconstruction Finance Corporation, has gone to expansion of the production and initial processing of basic materials.

TABLE 7.—*Summary of tax amortization necessity certificates, and direct loans and loan guarantees under Defense Production Act, by type of production, through June 1951*

[Millions of dollars]

Type of production	Certificates of necessity for tax amortization			Direct loans (including supplemental RFC participation)	Loan guarantees
	Proposed investment	Tax amortization allowed	Percentage ratio of tax amortization allowed to proposed investment		
Total	7,562	5,199	69	116	656
Basic materials production and fabrication, total	5,057	3,521	70	87	(1)
Iron and steel	2,391	1,699	71	84	(1)
Chemicals	658	367	56	1	(1)
Petroleum products	537	416	77	3	(1)
Pulp and paper	372	221	60	----	(1)
Nonferrous metals	372	292	78	----	(1)
Nonferrous ore mining	245	164	67	----	(1)
Iron ore mining	146	114	78	----	(1)
Coal and coke	117	96	82	----	(1)
Refractories	68	57	84	----	(1)
Textiles	53	28	52	(2)	(1)
Cement and concrete products	48	33	69	(2)	(1)
Other	49	33	67	----	(1)
Finished products, total	796	569	71	24	(1)
Aircraft	301	212	71	8	(1)
Machinery and components	265	182	69	10	(1)
Electric and electronic equipment	104	78	75	4	(1)
Ordnance, tanks, guns, and ammunition	63	48	77	1	(1)
Automotive and tractor equipment and components	55	41	74	2	(1)
Other	9	7	82	----	(1)
Transportation and storage	1,036	752	72	2	(1)
Public utilities	523	256	49	----	(1)
Miscellaneous	150	101	68	2	(1)

[1] Not available.
[2] Less than $500,000.

NOTE.—Detail will not necessarily add to totals because of rounding.
Data for necessity certificates and direct loans are cumulative through June 25; the loan guarantee figure is cumulative through June 30.

Source: Defense Production Administration and Board of Governors of the Federal Reserve System.

The Reconstruction Finance Corporation, under its own authority, has also made additional loans of about 95 million dollars during the 12 months ending June 30, 1951, to aid the expansion of defense production facilities. These are not included in table 7.

Encouragement of supply through purchase contracts. Government procurement contracts are being used to promote the expansion of production in three different ways.

First, the negotiation of a long-term contract providing some protection against the risk of market collapse is an important aid to expanded production, applicable primarily in the case of staple raw materials which can be stored. Such contracts have been used in procurement for the strategic stockpile here and abroad, and under the Defense Production Act have also been extended to the purchase of materials for direct use in production. A somewhat similar principle underlies the Government program of pool

orders for machine tools, which is designed to secure the fullest utilization of tool-making capacity by encouraging subcontracting and more efficient scheduling of output.

Second, procurement contracts may, under the Defense Production Act, properly make provision for Government payment of part or all of the costs of developmental or research work or facilities expansion necessary for the fulfillment of the contract.

Third, the placing of procurement contracts can be an important aid to the expansion of production by enlisting the resources of small or new producers, who otherwise might be left idle and unproductive. In this way, the necessity of devoting scarce resources to costly and time-consuming facilities expansion can be reduced. This is discussed more fully in a later section on small-business aspects of production aids.

Tax amortization. The most important and most broadly applied aid to facilities expansion in the current mobilization effort is the granting of certificates of necessity, under the Revenue Act of 1950, which permit a producer to charge off for tax purposes part or all of the cost of certified new production facilities over a 5-year period. Table 7 gives a summary of the operations of this program.

At the outset of the mobilization program, speed was of the essence, and certificates of necessity were granted with the objective of getting the expansion of needed facilities under way as rapidly as possible. At the present time, a careful review and reappraisal of the program is being undertaken in the light of expansion progress and goals.

The tax amortization program is designed to provide, where necessary, an incentive to proceed rapidly with facilities expansion and conversion required in our industrial build-up. It offers the producer earlier recovery of his investment, thus providing some protection against unusual uncertainty regarding the economic life of the new facilities. The certificate holder gets a substantial reduction in income and excess-profits tax liabilities during the initial 5 years. This helps him not only because some tax liabilities are deferred, thus improving his short-term financial position and credit-worthiness, but also because some of the deferred taxes may never have to be paid at all, in the event that tax rates are lower after the initial 5 years, or in the event that the taxpayer's earnings position puts him in a lower tax bracket in that later period.

Wear and tear and obsolescence of facilities represent, of course, a genuine element of capital cost, which is properly recognized in determining fair prices in the negotiation and renegotiation of procurement contracts. Under present circumstances, such costs may be abnormally high in the case of special-purpose facilities needed for peak military output. These price determinations should be made separately from the granting of amortization for tax purposes.

In view of the varying degrees of necessity for assistance, a wide latitude for administrative discretion in operating this program is essential. The 5-year write-off privilege has in nearly all cases been allowed on only a part of the new investment, varying according to type of facilities, as shown in table 7. The issue of a certificate of necessity, in itself, has not been recognized by the Economic Stabilization Agency as establishing an allowable amortization cost factor in the adjustment of price ceilings.

The direct cost of the program to the Government, including tax revenue foregone and, in some cases, higher prices paid on procurement items, is only a fraction of the amount of the certificates issued. A possible offset to these direct costs arises to the extent that total investment and taxable incomes are increased by the tax amortization program.

Regardless of the ultimate effect of the program on tax collections, the important thing is to assure that it will play its proper role in relation to alternative devices, and that it be so administered as to make the Government's contribution as effective and economical as possible.

No one is in a position to say how much of the investment receiving this type of aid would have taken place in the absence of the necessity-certificate program. It seems reasonably evident, however, that the use of certificates has been of important assistance in expediting investment in the desired lines. This conclusion is based partly on scattered statements of producers to the effect that their expansion projects have been contingent on this assistance. In part, it is based on the rate of plant and equipment investment since the program was authorized.

Choice of alternative production aids. Proper use of the various available devices for stimulating high-priority investment calls for expert and objective judgment. The best means of assistance to use in a given case is not necessarily the one preferred by the applicant, nor the one found administratively most convenient. It is important to minimize the ultimate public cost involved, and to tailor the assistance given in individual cases insofar as feasible to the factors actually limiting the ability and willingness of business to expand. Although it may be appropriate, in some cases, to grant both tax amortization and additional assistance in other forms, such as direct loans, the tax amortization privilege is not properly to be regarded as a badge of preferred status to be given on a blanket basis or as a prerequisite to other assistance. In many cases, the promotion of expansion is more properly left to alternative devices. In the case of long-lived facilities of normal peacetime types, where presumptive usefulness does not depend directly on the operation of a high-gear defense program, long-term Government loans or loan guarantees often provide sufficient aid and incentive. These devices provide financial aid, where necessary, while also providing for ultimate full recovery of principal and interest. In another category of cases, the chief deterrent to adequate expansion is uncertainty as to long-run prices and markets, although the product is a staple and durable mate-

rial. Many cases in this category involve production of commodities bought by the Government for stockpile and other defense purposes, and this introduces an important factor of uncertainty into market prospects. In such cases, long-term purchase commitments are an appropriate device for the stimulation of the necessary investment.

The alternative to private investment, with Government aid, is construction of industrial facilities by the Government. While this plan was extensively used in World War II, it is less extensively needed now, because the emergency is less acute, and because business is now in far better position to do the preponderance of the necessary expansion job. Nonetheless, public authority to construct certain industrial facilities, subject to appropriate safeguards, is a highly desirable reserve power. When uncertainty as to the ultilization of the expanded facilities after the emergency is extreme, the cost of inducing private construction may be too great. In some other instances, private assent to undertake the job may not be attainable with sufficient speed no matter what the available inducement. There may also be some cases where the inducement to private construction may cost the Government far less if the reserve power to proceed by other methods is available.

Technological assistance and conservation of materials. Coupled with assistance on the market and financial side, there is need for increasingly active pursuit of technological development and materials conservation. The search is being intensified for new industrial techniques, which will save scarce materials vital to defense by utilizing them more carefully or by substituting more plentiful materials for them, or which will develop new sources of supply. In other instances, new processes or products will have similar beneficial results. For example, the minerals development program is being carried forward vigorously in the hope of discovering new ore sources and new metallurgical processes, which would enable lower grade ores to be utilized.

Research and experimental programs, for instance in synthetic liquid fuels, in the use of lower grade woods, or in more efficient processes in the steel industry, whether carried on under public or private auspices, should not be slackened, for they may result in large savings of relatively scarce materials. All such Government programs, to the degree feasible, are being redirected toward defense needs, particularly for the long pull, in which increasing shortages of many critical minerals, metals, and other items, including some agricultural items, threaten to limit our security and economic growth. This is true of such programs as those of the Bureau of Mines, the Bureau of Standards, and the Agricultural Research Administration. Certain programs intimately connected with defense may properly be financed by defense appropriations.

Perhaps more significant for the short run, and also of great importance for the longer period ahead, is the further application of direct materials

conservation measures. Specific limitations have already been placed on the use of such scarce items as tin for containers. Percentage cutbacks in the permitted use of various scarce metals have stimulated substitution and other forms of conservation.

The interagency Conservation Coordinating Committee has taken steps to encourage conservation of critical materials, and to relieve pressure on inadequate plant facilities through standardization, simplification, and substitution. The program for conservation in construction, which includes dimensional coordination, standardization of structural elements, and gradual unification of building codes, can result in substantial savings of materials and labor now going into construction. Projects to provide substitutes and conserve the use of scarce materials are well advanced. Promising community-wide conservation activities in industrial plants are being sponsored, and individual companies are furthering this kind of work in their own plants.

Similar conservation activities in World War II brought substantial savings in scarce materials, equipment, and inventories. After the war, however, many practices involving standardization and other forms of materials conservation were dropped. The chance for recapturing and extending these gains now exists, and can be accomplished by means of energetic cooperation between industry and Government.

During World War II the Office of Production Research and Development helped greatly by directing and coordinating scientific and engineering research to strengthen war production, making fullest use of existing research facilities. The solution of numerous critical technical production problems, including those involving substitute materials or new processes or products, was hastened by this service.

Preoccupation with immediate defense requirements should not cause us to overlook longer range requirements. This is especially true of natural resources development policies and programs necessary for maintenance and expansion of a strong, enduring resource base. The Materials Policy Commission, appointed by the President last January, is giving careful study to the national and international aspects of these problems. In particular, basic data, investigation, and survey programs should be sustained as a basis for future resources development.

Small business participation in production. The many thousands of smaller producing enterprises furnish a substantial part of total output, and have an even more than commensurate importance in terms of the preservation of competitive opportunity and individual initiative. In a situation which calls for the fullest practicable utilization of our resources, it is essential that the small business sector of the economy be encouraged to make its full contribution.

The firm policy underlying military procurement is that qualified small business concerns must be given an opportunity to participate in military procurement and to find a proper place either at the prime contract level, or at the subcontract level, whichever enables them to make their best contribution to the defense effort.

Many of the major items of military equipment, such as aircraft, tanks, heavy guns, and aircraft carriers, cannot possibly be supplied directly by small manufacturers, although small business concerns can and do make many of the parts going into such equipment. While small business firms have received only about 22 percent of military prime contracts, they have received about 40 percent of the contracts for those items which small business can produce. The extent of subcontracting to small firms is indicated by a recent study of Air Force prime contracts which showed that 75 percent of the resulting subcontracts went to such concerns.

At best, however, the shift to a defense economy tends to make the competitive position of small firms more difficult. Items of military procurement are generally required quickly and in large quantities, which gives an advantage to the larger and better known suppliers. Small firms generally are also less well equipped to finance expanded production, and to formulate and present applications for Government assistance in such expansion. Moreover, when materials become scarce, the small firm is often at a disadvantage in retaining its sources of supply or finding others.

Another important factor, often overlooked, is that the types of industry which expand most in a mobilization phase are characterized by relatively large business units. The present pattern of expansion consequently offers less opportunity to small business than would arise from a uniform across-the-board expansion of all types of output. This point is evidenced by table 8, which brings out the lesser relative importance of smaller firms in those types of manufacturing which predominate in the defense build-up.

TABLE 8.—*Importance of small business in selected defense-related industries*

Industry	Percentage of total employees working in firms with fewer than 500 employees, March 1948 [1]
All manufacturing industries	41
Machinery (except electrical)	36
Chemicals and allied products	29
Primary metal industries	19
Electrical machinery, equipment and supplies	17
Products of petroleum and coal	14
Ordnance and accessories	13
Transportation equipment	10

[1] Employees include those with taxable wages under the old-age and survivors' insurance program for January–March 1948.

Source: Federal Security Agency.

It should be noted that the figures in table 8 measure the relative importance of smaller firms in terms of employment. In terms of amounts of capital invested, these same smaller firms represented considerably lower percentages of the respective industry totals.

The above considerations partly explain why, even with legislation and policies directed to promotion of small business participation, larger firms have received the preponderance of the direct Government orders and assistance. For example, the manufacturing firms with fewer than 500 employees had received only about one-fifth of the amount of prime military procurement contracts, as noted above, and about one-ninth of the amount of certified tax amortization. Allowance should be made for the fact that much of the defense work of small business is done on subcontracts.

Government policy in assisting small business involves administrative action on many fronts—procurement placement, materials allocation, financing, and technical and informational services.

Definite steps have been taken by the Defense Production Administration to insure greater participation by small business in the prime contract and subcontract awards. An Executive Committee for Small Business has been organized to develop procurement policies which will form the basis of instructions to the contracting officers in the field. The development of regional offices in the National Production Authority, for the purpose of working with contracting officers in the field, is expected to aid small business in obtaining both prime contracts and subcontracts. The procurement agencies have also taken definite steps to bring qualified small business producers into the defense effort. These steps include: placing small business specialists in procurement offices to find and put into use small firms' facilities; development of procurement procedures to encourage prime contractors to subcontract to small firms as much as possible; and dissemination of information to small firms, as well as others, concerning Government needs and the manner in which both prime and subcontract business can be obtained.

In the administration of materials controls, a special effort is being made to counteract the handicaps facing small firms. In general, small-quantity requests for controlled materials are processed earlier, and approved for a larger percentage of the amounts requested, than the large-quantity applications. Priorities and allocations to warehouse distributors have also helped to maintain a flow of materials to the small producers who depend on such distributors.

Probably the most important help to small business in the present situation is the activity of business itself, and of local and regional development groups, in mobilizing information on small business resources and opportunities. In many areas this type of private initiative is showing notable results, in aiding Government agencies to broaden the base of the defense production effort and to avoid unnecessary dislocations of employment.

Defense production aids and regional development

The requirements of speed and long range security in the defense mobilization mean that customary economic factors governing the location of productive facilities have to be modified in certain cases. As was pointed out in the Council's Review of 6 months ago, two general types of dispersion appear desirable: the avoidance of over-concentration of industrial facilities within individual industrial and labor market areas, and the regional decentralization which looks toward the further development of cores of economic strength in the less developed regions.

Federal aids for the expansion of industrial facilities, and also the awarding of defense contracts and subcontracts, are important instruments for guiding the location of new facilities as well as related manpower and services. Table 9 compares for the major regions of the country the impact of the defense program, as indicated by approved tax amortization certificates and military prime contracts, with the regional distribution of industrial activities in 1947.

TABLE 9.—*Regional impact of the defense program, compared to regional economic activities in 1947*

[Percentages of United States totals]

Region	Tax amortization certificates approved as of May 7, 1951	Expenditures for new plant and equipment in 1947	Military prime contracts July 1950–March 1951[1]	Value added by manufacture in 1947
United States	100.0	100.0	100.0	100.0
New England	7.8	7.6	10.4	10.6
Middle Atlantic	24.8	22.3	26.9	26.0
East North Central	21.6	32.7	26.3	34.6
West North Central	2.0	4.4	6.1	4.2
South Atlantic	8.4	11.5	6.3	9.2
East South Central	7.0	4.0	1.5	3.7
West South Central	18.1	8.0	2.8	3.9
Mountain	5.8	1.3	.7	.9
Pacific	4.5	8.2	19.0	6.9

[1] Excludes small and certain other kinds of contracts. Contracts usually cite address of contractor's main office, which may not be located in the same region in which the work will actually be done. Moreover, a considerable, but unknown, portion of prime contracts are subcontracted out to firms which may be located in other regions. Therefore, the above data should be used with greatest care.

Sources: Department of Commerce and Defense Production Administration.

To date, no satisfactory means has been found for screening defense plant expansion and defense contracts for their locational desirability. To do this would require that workable standards or criteria be developed, against which to judge each particular defense plant or contract decision. Because of the enormous variety of economic and security factors having locational significance, any such standards would have to be flexible and at the same time be administratively feasible.

A checklist of points to be taken into account would include: planned dispersal of industrial facilities and activities for security reasons as determined by the National Security Resources Board, the Office of Defense

Mobilization, the Department of Defense, the Federal Civil Defense Administration, and other appropriate agencies; fullest possible utilization of manpower, particularly in those areas and categories of skill, industry, sex, or age where under-utilization is prevalent; maximum utilization of existing and potential natural resources, plant, and equipment; extent of disruption to established patterns of living and of housing and community facilities and services; to the extent possible, the solution or amelioration of underlying economic and social problems such as chronic underemployment, lack of industrial diversification, overcrowding of population, and substandard housing; and, of course most important, speed and efficiency in getting the needed defense work done. Many defense production facilities and activities do not admit of much choice in location. Those which do, however, should be located in the light of criteria worked out along the lines suggested above.

Certain large public developments, having both regional and national significance, are greatly needed for their contribution to national security and economic growth several years from now. Notable among these is the St. Lawrence seaway and power project which, when finished, will furnish 1,880,000 kilowatts of electric power capacity, to be divided equally between Canada and this country, and will provide a major water route to Great Lakes ports for the shipment of Labrador iron ore and other items. Although this project will not help until it is completed several years from now, the decision has to be taken soon if we are to have the power and the iron ore even then, when both will be more urgently needed than at the present time.

The outlook for severe shortage of electric power continues in several parts of the country, most seriously in the Pacific Northwest. Beginning of new projects planned and budgeted for this year, and now being considered by Congress, cannot be put off without delaying the time at which ever-increasing demands for power in that region may be met under conditions of adequate reserves.

It will be necessary also to assure that the construction of necessary power transmission lines be carried on in step with the construction of new generating capacity. In line with traditional public power policy, the Federal Government should be in a position to deliver power from its dams to publicly and cooperatively owned utilities, to insure that users get electricity at low developmental rates. This means essentially the authority to build transmission lines to load centers, and to negotiate suitable contracts for transmission over privately owned lines.

Aids to agricultural production

As Part II of this Review indicated, our national security program requires a continuing expansion of total agricultural production, with much

larger increases for some crops than for others. This expansion must be accomplished with a smaller labor force on farms, and with shortages of some materials which are essential to farm production and to food processing.

The farm labor force dropped from 9.6 million persons in 1939 to 7.5 million in 1950. Further decreases are in prospect, as farm workers take higher paid jobs in defense industries. With a declining labor force on farms, output of agricultural products has been maintained only by the greatly increased use of fertilizers, insecticides and pesticides, farm machinery, electricity, and other labor-saving materials and supplies. Still further use of these will be required for additional increases in output. Specifically, it is essential to increase nitrogen production capacity substantially and quickly; to give high priorities to agricultural needs for machinery and spare parts; to increase substantially the output of insecticides and pesticides; and to assist farmers to obtain essential labor during peak seasonal needs.

Rural electrification has helped to increase farm output. The present shortage of copper and power prevents the full development of the rural electrification program. Nevertheless, it will be prudent to supply necessary material and power to those projects which are of the greatest importance in increasing farm output.

We must continue to emphasize conservation and development measures, designed to maintain the productivity of our farm land and to increase the yield of crops. Land reclamation projects, now nearing completion, will add to our farm output. With a heavy demand for lumber and wood pulp, we should proceed with the rapid construction of forest access roads, especially in the West.

These efforts are needed to assure a sustained expansion of farm output over a period of several years. The immediate supplies of farm products are adequate. Per capita food supplies in 1951–52 are expected to be slightly larger than those of last year. The current wheat harvest is running better than had been previously expected and according to the July 10 crop report, crop prospects are generally good. Meat and other livestock products are in strong demand, and some production increases would be desirable. But this would require more feed. Thus, the principal immediate problem is that of increasing our supplies of corn and other feeds. With good weather, a start may be made toward replenishing reserves during the coming year.

Studies are under way to determine guides for agricultural production in 1952. National, State, and county Agricultural Mobilization Committees are cooperating in this work, and will carry on an intensive educational program to inform farmers of these guides, and to help them make needed adjustments to keep output and requirements in balance.

Manpower build-up

Comparing the first half of 1950 with the first half of 1951, the total labor force expanded by about 1¼ million. We have nearly reached our armed forces goal and have maintained our civilian labor force near the pre-Korea level. Employment in civilian industry is about 1.6 million above the pre-Korea average. Unemployment was drawn down from an average of 3.9 million to 2.1 million during the first half of 1951. To date, there has been no evidence of a general manpower shortage. Neither employment nor hours of work have shown significant increases during the past half year.

During the next half year, we should add about 2 million additional workers to our defense production. About 1 million of these would have to be drawn from persons not now in the labor force. Others must become a part of the defense effort through the conversion of civilian goods industries to defense production; still others must change from their present jobs to industries working on defense orders. Securing these additions and shifts may prove difficult.

Shortages in scientific and health professions, and of workers trained in skills required by some of the defense industries, exist and will increase. Thus, although it would be inappropriate to recommend now manpower policies for a general manpower shortage, it is important to take such actions as are feasible to meet the specialized problems of skill shortages and shortages within particular labor market areas. The situation is particularly critical where both types coincide.

While we cannot afford to be complacent about our manpower resources, we should not go to the other extreme of being unduly alarmed about possible future difficulties. We should time our efforts to encourage the entrance of workers into the labor force, so that the new entrants will find that jobs are available for them. We should not increase hours indiscriminately, without considering whether this would interfere with the very necessary training of additional workers to help in the long-run job of defense production. The Interagency Manpower Committee, which advises the Director of Defense Mobilization, has issued a statement dealing with problems involved in lengthening the workweek. We must plan our manpower program in such a way that we provide for the needs of the next year, and at the same time lay the foundation to meet the contingency of full mobilization if that should become necessary.

The Council concurs in the view that the manpower program should be voluntary. Compulsion, particularly for a long drawn out effort, is undesirable.

Various agencies of the Government are taking action to deal with different aspects of the manpower problem under their usual powers. The Department of Labor has been using its clearance machinery for out-of-area recruitment with increased frequency. The Department is also en-

couraging employers to relax unnecessary hiring specifications on age limits, sex, experience, and physical requirements.

The Wage Stabilization Board has adopted a policy which recognizes that some wage increases may be necessary in rare and unusual cases, to enable employers in essential industries to recruit and maintain an adequate labor force.

Regional and area labor-management committees, established by the Secretary of Labor, are expected to play an extremely important role in the labor market areas in which significant defense manpower problems exist or impend, advising and assisting community action. The committees offer advice principally on three categories of problems—elimination of wasteful turnover; bringing about the fullest use of local labor supply in a given geographic area in order to minimize immigration of labor, and thus reduce the strain on community facilities; and identifying unused plant capacity and local pools of labor, which might be utilized in defense production.

While these devices have been established to develop manpower policy and to coordinate activities, we are still in the "tooling-up" stage. It is necessary now to move forward with a manpower program involving four main measures.

One important step is the improvement of the present program designed to prevent area labor shortages, and to relieve those that have already developed or may develop. On the preventive side, the availability of labor supply and of related housing and community facilities and services should be given greater weight in the locating of new defense plants, and in the channeling of defense contracts and subcontracts. This should be part of an improved system for taking economic and security locational factors into account. Where the shortages cannot be relieved sufficiently by such measures, and where additional workers have to be brought in, causing overcrowding, high turnover, and inefficiency generally, a program of aid for housing and community facilities and services will prove helpful. Recommendations for additional forms of indirect and, if necessary, direct Federal aid for facilities and services as well as housing have been presented to Congress in the Defense Housing and Community Facilities and Services bill.

A second step in the manpower program today should be toward further conservation and development of essential professions and skills. Since we are faced with an emergency which may last for many years, it obviously is necessary to begin now the education and training of professional and scientific personnel in those physical and social sciences in which the supply will be most seriously short two or more years from now. These include virtually all of the major health professions, such as doctors, dentists, and nurses; many types of scientists and engineers; and a growing number of skilled trades, particularly in the metalworking and

electrical trades. There are also serious shortages of farm labor and elementary school teachers. To meet these problems requires, among other things, joint action of military and civilian authorities to share the existing supply of key personnel to assure optimum distribution. It requires additional advisory services to employers, to help increase the productivity of their workers. It requires also the expansion of the long-term supply of scarce professions and skills, through expanded education and training. A program of Federal aid to medical education and nursing training is particularly needed. Efforts to redirect on-the-job training programs and public school vocational education toward defense needs should be intensified. The apprentice training program should also be enlarged.

The third step should be the development of better statistics, to show more clearly the manpower situation, both from the demand and the supply sides. This requires more definite and detailed manpower requirements data, derived from specific production programs. These data should not only show total needs, but also should indicate the type of workers needed, the skills which will be required, and the location of the need. There is room also for more specific information concerning the number of workers in our economy who are trained in particular skills, and the number of persons not presently in the labor force who could become available for work.

The fourth step is the development of manpower data for the total free world effort, and of programs to improve the use of manpower by the cooperating countries. A major contribution could be made to total free world production if greater effort were devoted, especially in Western Europe, to improving the utilization and productivity of manpower through facilitating the mobility of labor, work training, and similar measures, although the major scope for increasing productivity in many countries lies in improving capital equipment and productive techniques.

International production and resources policies

The problems of production, conservation, and distribution of goods are not merely problems of the United States economy. They involve the whole free world. The need for an integrated use of free world resources should be a major factor in determining the best course to pursue in many matters which we customarily think of as "domestic."

The raw materials problem. Because the shortage of raw materials is a main factor limiting the growth in output of finished goods in the world today, these shortages are one of the most important economic problems facing the free world. The solution of this problem along international lines requires cooperation among the countries of the free world, to increase production and availability of materials in short supply, and to assure their most effective use. To meet this problem, an International Materials

Conference was set up early this year, consisting of a central group and seven commodity committees concerned with sulfur, cotton and cotton linters, tungsten and molybdenum, manganese, nickel, and cobalt, pulp and paper, wool, and copper, lead, and zinc. The countries participating in the Conference account for 80 to 90 percent of the producing and consuming interests of the free world in the commodities concerned. Outside the International Materials Conference, the United States has met with other countries to consider problems of the international distribution of tin and rubber.

These committees have obtained information on past and near-term future production and requirements. They have studied, and in some cases already recommended to governments, measures for increasing production and conserving supplies. In most cases, these measures alone will not suffice to close the gap in supplies. The committees have therefore also undertaken to work out acceptable procedures for equitable distribution of current supplies. Agreement has been reached among the governments concerned on specific third quarter allocations of sulfur, tungsten, and molybdenum. An emergency allocation of newsprint has also been recommended, to meet certain specially urgent needs. With respect to the other commodities, allocation measures are still under study. Many problems remain to be solved. There is a tendency for each country to press for allocation of commodities over the supply of which it has no control, and to resist allocation of commodities which it does control. The problems of increasing supply, limiting consumption, and securing equitable international distribution are complex. They involve questions of the treatment of stockpile requirements, definition of defense requirements, and the impacts upon prices, normal trading arrangements, and future market positions.

One of the major factors hindering international agreement is the background of surpluses and relatively low prices of primary materials between the two world wars, and a consequent uncertainty on the part of producing countries as to the duration of high demand for these materials. Because of this uncertainty, there is some reluctance to accept measures which would reduce the demand for, or the prices of, these commodities. Similarly, there is reluctance to increase production. Some producing countries fear that the expanded output may become surplus after the period of rapid build-up in free world defenses has ended.

While this lack of confidence in the future demand for raw materials is quite natural, in view of the depressed raw materials prices during the interwar decades, shortages were appearing in several of the major raw materials even before the current defense program. The period shortly before the Korean outbreak was the first time in a long period that there was any test of the adequacy of the free world's raw material supplies to support simultaneous high levels of production in all the industrial countries. It should be borne in mind that, during the war and early postwar years, Europe's

demand for raw materials had been below the levels corresponding to full production, and that in 1949, after a considerable recovery in Western European and Japanese production, there was a temporary slump in United States raw material purchases. With the resumption of the upward trend during the first half of 1950 in the United States as well as in Western Europe and Japan, there was some evidence that the long term demand-supply situation for some of these commodities is favorable to producers. Expanded production appears necessary to support long-term growth, as well as current emergency demands.

In cases where fear of the future makes producers reluctant to expand production, and makes their governments reluctant to take price-restraining action, the Council believes that serious consideration should be given to providing producers of selected materials both here and abroad with some form of assurance limiting market declines for restricted periods in the future. During the past two decades, our farm price support policies have demonstrated that assurance as to minimum prices can be effective in stimulating increased production. In the present emergency, the Government has offered to purchase at a price below the present market all domestically produced tungsten concentrates which cannot be sold elsewhere, until a specified quantity is obtained or until July 1, 1956, whichever occurs first. Besides providing for the needs of future growth, the assurance given by devices of this general character may favorably influence the attitudes of other countries in present negotiations.

We could probably get better price terms during the present defense period if the market risk factor could be taken out of the producers' price. Minimum prices and long-term contracts at reasonable prices stand an excellent chance of providing a good investment for the United States, since the goods involved are storable.

Other measures to further the expansion of world production have been discussed in the Second Quarterly Report of the Director of Defense Mobilization.

It is clearly not enough to secure increased production of essential imports. It is also necessary to maintain our access to them. During the past half year, there have been difficulties in obtaining a number of essential imported commodities, owing to the fact that their prices in world markets have risen above domestic price ceilings. In some cases, where the material is not an important part of the cost of the goods in which it is used, it will be possible to meet the problem by exempting the commodity from price control. In other cases, it would be desirable for the Government to purchase imported articles and resell them at domestic ceiling prices. Such purchase and resale operations, however, require legislative authority and provision of the necessary funds.

Export control and allocations policy. It was pointed out in Part II of this Review that our security requires that goods be made available to meet

certain important foreign as well as domestic uses. In a situation where many goods will be in short supply, this requires a mechanism for making goods available for essential exports. At the same time, a mechanism is required for restraining less essential exports of scarce goods. The control instruments for restraining and for assisting exports are now available. Export controls are exercised under the authority of the Export Control Act of 1949. This Act was recently renewed until June 30, 1953. The means for providing positive assistance to exports are priorities and allocations, exercised under the Defense Production Act of 1950.

To provide policy guidance for the mechanisms for restraining or assisting exports, the Director of Defense Mobilization has recently set forth the general principles which should govern the export or retention of scarce supplies. His statement lays down specific guides, without attempting to rate the separate priorities, as objectives to be pursued by regulatory agencies in the United States Government. Allocations should be made in such a manner that supplies contribute most to military production and other aspects of mobilization, essential civilian requirements in the free world, lessened dependence of the free nations upon supplies from the Soviet bloc, and prevention of political deterioration in areas essential to the combined strength of the free world.

After requirements of high essentiality have been met, the allocation of remaining supplies should take into account the effects upon the respective civilian economies of the broad contribution which each area or country makes toward common defense, including direct military production, increased political and economic strength, and control of inflation of world prices. Individual countries differ widely in their ability to make such contributions; the objective should be an equitable distribution of the burdens. These principles help carry out the recommendations adopted last winter by the Economic and Social Council of the United Nations, and the more detailed agreements reached subsequently by the Foreign Ministers of the American Republics.

To carry out these principles effectively, estimates of essential foreign as well as domestic requirements are needed. Without such estimates, production needs cannot be properly gauged, and the need for curtailing nonessential uses cannot be properly evaluated. At present, fairly firm estimates of Western European requirements are available, largely because of knowledge obtained in the three years of operation of the European Recovery Program. But greater progress is needed in evaluating the specific requirements of other countries, to which three-quarters of our exports go. This evaluation is in some respects more difficult than in the cases of the Western European countries, owing to the fact that less information is available. But this fact increases the need to study such requirements more closely.

Foreign aid. The ability of the Western European nations to undertake large and rapid expansion of their defense establishments is partly a political question, but it has important economic aspects. These arise from the fact that expansion of their defense production, besides requiring enlargement of total production, will severely limit the goods available for domestic consumption and investment and to some extent their exports. These countries cannot build up their stock of military equipment unaided, within the time required by their planned increases in troop strength. This is partly because of technical factors relating to the kinds of goods they are equipped to produce, but also because the required curtailment of consumption and investment would be too great. The populations of most of these countries have been under constant economic and psychological pressure for more than a decade. Rapid and steady progress had brought recovery within their grasp, just at the time when the need for a rapid rebuilding of defenses became clear. In all of these countries the narrow margin of reserve economic strength, and in some of them political and social tensions, limit the degree to which they can subject themselves to renewed strains without undermining their economic strength or even their political stability.

In the economically underdeveloped countries, there is a serious and chronic deficiency in total production. Their living standards are far lower than those of the industrial countries of the world, and in most cases there had been little if any improvement between World War II and the Korean outbreak. Some countries had even suffered a further deterioration of living standards. This situation, combined with intensified nationalism, and in some cases with problems arising from newly won independence, has led to increased tension and political as well as economic instability.

Our policy regarding aid to other countries should be considered against this background, modified by the effects of recent world economic developments.

In this connection, the sharp rise in world prices and demand following the Korean outbreak has had effects of major significance. The rise of raw material prices has been much greater than that of finished goods prices. Broadly speaking, there has been some redistribution of income from countries which are substantial net importers of raw materials to countries which are substantial net exporters of such materials. In many of the raw material producing countries, a great expansion of income has occurred in the export industries. These countries are undergoing an expansion not only of money incomes, but also in most cases of real national incomes. The effect of world economic developments in the past year has been to reduce the need for external financial assistance of many of these countries, although there are important exceptions, notably India. The prospect is that their main concern will be the availability of essential imports, rather than the means of paying for them. It should be realized, however, that a portion of

their increased earnings will accrue to foreign owners rather than to the exporting countries themselves; that the distribution of the remaining benefits as between the underdeveloped countries bears little relation to the relative intensity of their economic needs; and that the internal inflations which in some cases are accompanying the large increases in export income may have disruptive and dangerous economic and social effects.

In countries dependent on imports for a major portion of their raw materials, such as most of the Western European countries and Japan, the rapid rise of import prices has meant a pushing up of costs. Where export prices have risen less, as is typical in these countries, it has also substantially offset the effects of increased production on the volume of goods available for domestic use. It will be recalled that, when hostilities broke out in Korea, production in Western Europe had largely recovered and was increasing in Japan as well, although a need for adequate foreign markets still persisted and there continued to be some competitive weakness. The first economic effect of the Korean outbreak and the boom in the United States economic activity was to increase the dollar earnings of many foreign countries, including many industrial countries. In some quarters, this was taken as an indication that their dollar problems were ended. So far as some of the rearming industrial countries are concerned, however, the initial improvement in their balance of payments positions is somewhat deceptive as an indication of the fundamental effect of rearmament, and the increase in their holdings of gold and dollar assets may be even more so. As was indicated by the Council last January, there were reasons for thinking that the improvement in the balance of payments positions of the countries building up their defenses might be temporary. The prices they had to pay for necessary imports were rising more rapidly than their export prices. Moreover, it seemed clear that when the expansion of their defense production got under way on a large scale, it would press hard upon their resources, making necessary an increase in the quantity of their imports and limiting their ability to export, while at the same time subjecting them to inflationary pressure.

In the past half year, these difficulties have been materializing. The more rapid rise of import than of export prices has been a major factor in widening Western Europe's trade deficit, which had previously been declining steadily, from an annual rate of 3 billion dollars in the last quarter of 1950 to more than 5 billion in the first quarter of 1951. At the same time, various European countries in the North Atlantic Treaty Organization have increased their planned rate of defense expenditures from approximately 4.5 billion dollars a year prior to Korea to almost 8 billion in 1951, and higher spending rates are projected for subsequent periods. Thus, the rapid expansion of free world defenses is increasing the demands upon the resources of Western European countries, and is again making it difficult

for them to meet their essential requirements without outside aid. This is true despite the continuing growth in Western European production.

Because of the strains of increased defense needs, and the political and economic problems they create, the President has requested the Congress to authorize and appropriate 8.5 billion dollars for foreign aid for the fiscal year 1952, a much larger sum than would otherwise have been required. Of this total, 6.3 billion dollars is intended to finance the procurement of military end-items for shipment abroad, and 2.2 billion is for economic aid in the form of grants. The major portion of both military and economic aid is for Western Europe. A build-up of Western Europe's defensive strength to the necessary size and with the necessary speed cannot be achieved solely through military production in the Western European countries. It requires the shipment of large amounts of military production from the United States. Economic aid is equally necessary. Without it Western Europe would either be unable to build up its own defense production on the scale and in the time required to deter and to resist aggression, or would be under severe internal economic pressure which would threaten its stability or its power to sustain a long-run defensive effort. Technical assistance and aid for specific projects to economically underdeveloped countries are necessary to assist in increasing their economic strength. This aid will also have the effect of helping to expand the production of scarce materials needed by the free world. Such aid will be financed partly by grants and partly by Export-Import Bank loans. To permit the Export-Import Bank to perform its role, the President has recommended an expansion of its lending authority by 1 billion dollars.

The Stabilization Effort

The nature of inflation

Stated most simply, inflation develops when there is a general excess of demand over supply at current prices. But this statement does not penetrate very deeply into the manner in which inflation is generated or how it affects the economic and social structure. A fundamental feature of the inflationary process is its uneven impact upon prices and incomes. While prices and incomes rise on the average, they do not rise uniformly. Many incomes do not rise at all. Those whose incomes outrun the price rise may even benefit from the inflation. But the many millions who are unable to advance their money incomes, or who are holding fixed dollar assets, are injured. Under some circumstances, a moderate rise in the general level of prices and wages stimulates production; but when resources are being intensively used, this stimulus is not likely to be needed. And in a period when a rapid shift toward defense production is required, those activities which may be stimulated by such a rise may well be nonessential. Moreover, one price or wage increase which may provide a desirable incen-

tive often leads to other price and wage increases, and initiates an inflationary spiral. Spiraling inflation does not create wealth but only changes its distribution, not on the basis of one's contribution to output, but on the basis of one's strength and bargaining position in the complex of market forces.

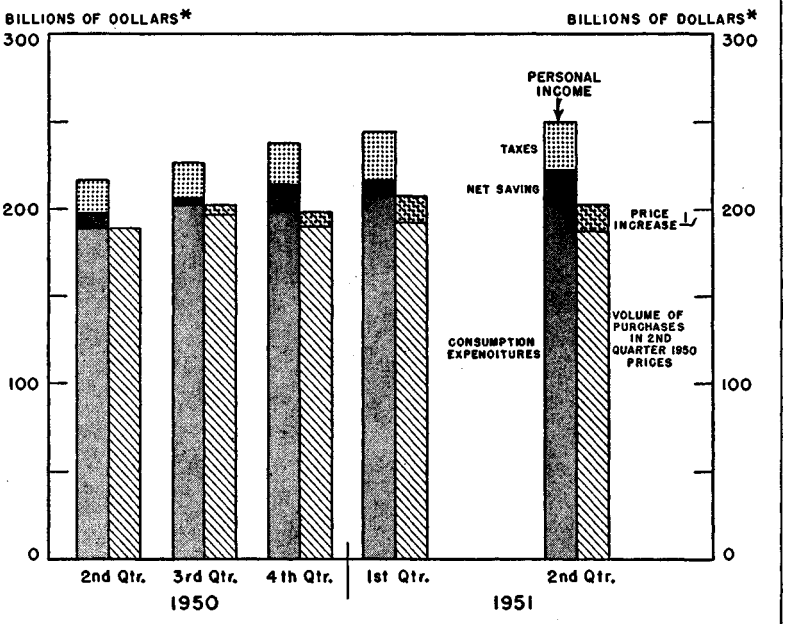
Thus inflation destroys the existing balance among the various groups in our economy. It generates a hectic inter-group scramble to maintain or improve one's position, in which speculation thrives, hoarding is encouraged, and social strife is stimulated. It creates inequities, disorganizes markets, disrupts production, raises the costs of the security program, and impairs the motive to save. Such a process is bad at all times. It is intolerable when the need is to concentrate all energies on national security.

Since a rise in prices reflects the gap between supply and demand, it has been said that price rises are only the result and not a cause of

CHART 22

CONSUMER INCOME AND DEMAND, AND PRICE INCREASES

Consumption in real terms is almost the same as a year ago, but because of higher prices the cost of goods and services consumed has increased about 7.5 percent.



*SEASONALLY ADJUSTED ANNUAL RATES.

⊥EXPENDITURE DUE TO PRICE INCREASE SINCE 2ND QUARTER 1950.

SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

inflation, and that it is futile to "suppress" inflation by controlling prices. This is a misleading oversimplification. For through the dynamic interaction of prices, incomes, and spending, price increases are not only end results of the inflationary process, they are integral moving parts of the inflationary mechanism. A price rise creating the expectation of further price rises stimulates the demand of buyers, and thus helps to bring about anticipated price rises. This raises the income of sellers, leads to demands for higher wages, and thus further stimulates inflationary pressure.

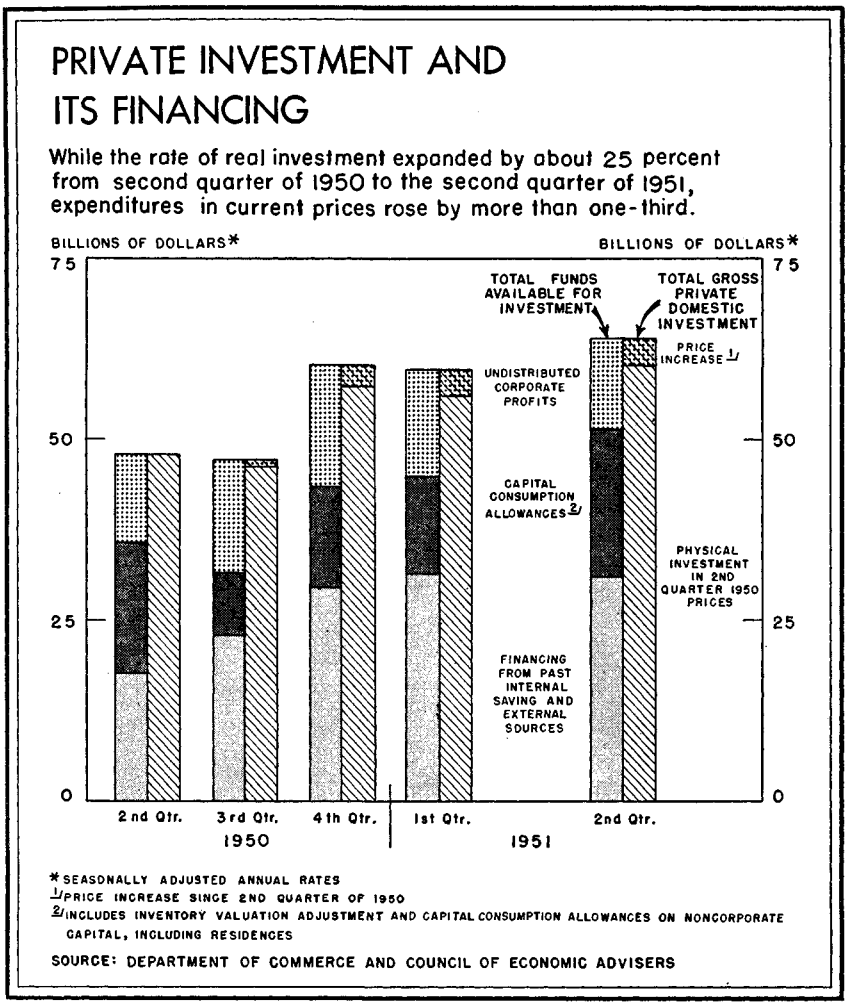
Properly stated, the problem of stabilization policy is to seek out and contain the sources of inflationary pressure wherever they exist. The sources of such pressure usually are diverse. A rise in the ratio of private spending to production available for private buying may result from a diversion of production into national security programs without a commensurate diversion of incomes into higher taxes or savings. Private spending, even without an increase in incomes, may also result from a reduction of savings out of current income, from the spending of past savings, or from credit expansion. A rise in incomes in turn may be the consequence of rising prices, and then, in a secondary movement of the spiral, cause further price rises. In shaping and adjusting the stabilization program, it is essential that these sources of inflationary pressure be comprehensively identified, and their relative importance properly assessed. Only by this means can we find the take-hold points for policies adequate and effective in a particular situation.

Appraisal of prospective inflationary pressures

Previously in this Review, the Council traced the trends within the economy during the 12 months following the Korean outbreak. It pointed out that, while there were two buying waves set off by events in Korea, the inflationary trend resulted from demand, backed by ability to buy, expanding more rapidly than production. As more spendable dollars became available in ratio to the available volume of goods, prices rose; and, in turn, price increases were among the factors producing further increases in other incomes.

Comparing the second quarter of 1950 with the same quarter of 1951, the total wage and salary bill increased by 26.7 billion dollars. Farm prices and noncorporate business income also rose, contributing to an expansion of total personal income of about 33 billion dollars (all annual rates). Some of this increase in income was absorbed by taxes, partly in consequence of the increase in personal tax rates on October 1, 1950; but despite these higher rates, spendable income after taxes advanced 25 billion dollars or almost 13 percent. (See appendix table B–9.) During the same period, prices increased, partly because of demand in general rising faster than supplies, partly because of cost and price raising in anticipation of expected shortages and controls. It is estimated that consumers in the second quarter

CHART 23



of 1951 were spending (at an annual rate) 15 to 20 billion dollars more on account of the increase in prices since Korea. Allowing for price changes, the net effect of the expansion of incomes was to raise consumers' real buying power by less than 5 percent above the level before Korea. (See chart 22 and appendix table B–10.)

During the same period, as chart 23 shows, the increase in business demand for capital goods and for inventory accumulation was a very important factor in the rise in aggregate demand. This business demand also outran supplies and drove up prices. In consequence, while the rate of real investment was expanded by about 25 percent, the expenditures in current prices rose by one-third.

At the same time, while the national security program expanded rather slowly during its first months, the rate of deliveries for the defense program was almost twice as high in the second quarter of 1951 as in the first few weeks after Korea. Total public outlays for goods and services were 40 percent higher in real terms, but due to price increases were about 53 percent higher in current dollars.

In appraising the prospect for further inflationary pressures, main consideration must be given to likely trends in spending, in funds available for spending, and in lines of supply.

(1) The national security program, as now scheduled, calls for an increase of defense outlays (even assuming no further rise in prices) which would bring the annual rate of spending by the middle of 1952 to about 30 billion dollars higher than the present annual rate. In contrast, total output is expected to increase by about 15 billion during the same period. The Council's analysis of prospective inflationary pressures is based on the carrying out of this program at presently planned levels.

(2) During the second quarter of this year, total gross private domestic investment was at an annual rate of 64 billion dollars. Even subtracting the 14 billion dollars which went for inventory accumulation, about 37 billion dollars at an annual rate was applied to business and farm construction and equipment, and almost 11 billion to residential construction. Despite recent and prospective increases in taxes, the current and prospective earnings and financial position of most business concerns could support a still higher level of plant and equipment investment, and businessmen report plans for such an increase.

(3) The expansion of output shown to be desirable and feasible in Part II of this Review will entail increased employment and longer hours. Even under an effective wage and price stabilization program, which is assumed in this analysis, there will have to be some increases in wage rates to correct inequities, to draw workers into defense work, and to provide reasonable incentives. The incomes of unincorporated businesses and of self-employed professional people may fluctuate for some time, but the level by the middle of 1952 is likely to be higher than it is now. Preliminary crop reports indicate that farm production goals envisaging a 5 percent rise in output will be met. Farm income will rise substantially in 1951, and is expected to remain at higher levels in 1952. Taking all of these components together, it is a reasonable though very rough estimate that, if defense schedules and essential business investment needs are met, the total of personal incomes may expand by 15 to 20 billion dollars (annual rate) between now and the middle of next year. Over a sweep of time as long as a year, regardless of variations from quarter to quarter, it seems extremely likely that such an increase in personal incomes distributed broadly among almost all income groups would translate itself into a desire in the aggregate to spend more money. Even if one-third of the additional

income went into taxes and savings and only two-thirds were translated into efforts to spend it, there would be an increase in consumers' ability and desire to spend by about 10 to 15 billion dollars.

The three main factors of demand which have just been listed must now be measured against the realistic estimate of a possible increase in total production of 5 percent or better during the next 12 months. Such an increase in total production, which would amount to about 15 billion dollars, compares with a projected increase in security programs of 30 billion dollars. This indicates the need to curtail civilian demand, whether for investment or consumption, by a considerable amount. Investment could be substantially reduced by a sharp decline in the rate of inventory accumulation. Curtailment of residential construction as well as of nonessential business construction and equipment purchases needs to be continued. With such reductions in investment, it should become possible to maintain consumer supply in the aggregate approximately at present levels. Thus, it becomes clear that under the impact of the security program there will be a swelling of personal incomes and demand without a commensurate increase in consumer goods supply. This discrepancy will be sufficient to generate, and in all probability will generate, a renewal of strong inflationary pressures which will require a rounded containment program.

There may be a wide margin of error in these estimates. While they are based on fundamental aspects of an economy in a state of partial mobilization, other circumstances could alter the timing of intermediate events. For example, the rate of saving is very volatile. If people believe that there will be no serious scarcities and that prices will be held, they are likely to refrain from extraordinary buying. Under such circumstances, business may wish to liquidate accumulated inventories. In that event, the expansion of the security program may be offset or more than offset for a while by a temporary contraction in private demand. If, on the other hand, some new evidence of international tension should develop, another wave of scare buying by consumers and business could put additional pressures on prices.

No one can appraise all of these variables, which might accent a short-range movement in either direction. But national economic policy should be geared fundamentally to the strong undercurrent of basic factors. These basic factors underscore so heavily the prospect for more inflationary pressures, at some time well within the next year, that national economic policy should be on guard against this paramount danger.

The strategy of stabilization

The essence of sound stabilization policy in the present period is the integration of a combination of policy instruments. No single line of defense against inflation will do the job. Instead we must have a defense in

depth. As a matter of fact, at least five major lines of defense against inflation already have been erected and now must be maintained. Given the size of the inflation problem in prospect, the battle will not be won at any one of these lines alone. Moreover, strong support of stabilization at any one of them assumes an effective combination of policy instruments.

1. The most fundamental cause of inflation we are facing is that a rising defense effort leads to the creation of additional incomes, without a corresponding increase in the supply of civilian goods. Therefore, the most fundamental approach to economic stabilization consists in an effort to offset some of the rise in incomes by additional taxes. This brings disposable income into closer correspondence with available civilian supply.

Taxation of corporate profits also is important, not only because it is prerequisite for effective wage stabilization, but also because it reduces funds for business spending.

There is, however, no workable tax program which in itself could qualify as a sufficient anti-inflation policy at the present time. Exclusive reliance on tax increases as a means of checking inflation might call for such drastic increases when Government expenditures were near their peak that work and management incentives might be seriously damaged. Without simultaneous price and wage controls, moreover, drastic tax increases might be shifted forward to prices, or might lead to demands for compensating wage and other income rises. In this case, the tax measures would be largely self-defeating.

2. Another source of inflationary pressures is additions to purchasing power through the use of credit. The effect of higher taxes in reducing business and consumer spending out of income can be offset in part or more than offset by spending financed with credit. Therefore, a policy of credit restraint is a necessary complement of proper tax policy. One approach to credit restraint is by general measures, such as open market operations, discount rates and reserve requirements, designed to restrict the over-all supply and availability of credit, and by voluntary credit restraint programs. The effects of such measures, however, do not discriminate sufficiently between essential and less essential activities. General credit restraint must therefore be supplemented by selective credit regulations, applicable to fields where credit practices are standardized, such as the financing of consumer goods, especially durables, residential and commercial construction, securities listed on the stock exchanges, and commodities traded on futures markets.

3. In the case of business spending, an effective method of enforcing restraint is the direct control of production of goods available for purchase. Limitation orders and allocations of such basic materials are designed primarily to assure that scarce resources are made available to highest priority use. In addition, these measures limit business investment for less essential purposes, and thereby contribute to economic stabilization.

4. In the case of the consumer, if tax increases cannot be expected to bear the whole burden of closing the income gap, then obviously there is an urgent need for doing everything possible to limit the increase in spending out of rising disposable incomes. The fourth line of defense which we must reinforce is that of saving. We seek two things: first, to encourage positive saving out of current income; second, to discourage and restrict so-called consumer "dissaving," whether the latter takes the form of expenditures out of past savings or of consumer credit expansion.

5. Our final line of defense against inflation consists of price and wage controls. Such controls reinforce the other phases of stabilization strategy already outlined. In the first place, both wage and price controls restrain the growth of incomes before taxes, thus reducing the job of income absorption through taxation. The continuance of price and wage controls as income-restraining devices was one of the basic assumptions of the foregoing analysis of prospective inflationary pressures. If business prices, farm prices, and wages were allowed to spiral upward, each would add to incomes, and each would provide additional impetus for the others. It is not possible to estimate the magnitude which such dynamic income generation might attain in any given period, since this would depend upon the speed with which the changes interacted. But it is a process which, with the present volume of liquid assets in the economy, could easily reach dangerous proportions. Only an effective, simultaneous policy of price and wage stabilization can give assurance against the creation of such an inflationary spiral, arising either from the price or the wage side.

Thus price and wage controls support the other elements of stabilization strategy. Conversely, price and wage controls would be doomed unless taxation, credit controls, and savings programs, hold the inflationary pressure down to manageable proportions. Only if we use a variety of policies in complementary fashion can we hope to do the job which should be done, with justice to all of our interrelated objectives.

Tax policy

In a period of defense mobilization, taxation is more than a means of financing the necessary expansion of governmental outlays. It is also a positive instrument of Government economic policy. In fact, it is one of the most serviceable policy instruments to be used at the present time.

On the basis of the previous analysis of the short-range and long-range objectives of the defense mobilization effort, we may conclude that the primary requisites for an adequate tax program for the period ahead are as follows: (1) it should at least provide sufficient revenue to cover the cost of the national security programs, so that a further growth in the public debt will not be necessary; (2) it should make a substantial contribution to economic stabilization; and (3) it should conform to the general principle that the tax burden should at all times be imposed in accordance with the

ability of individual taxpayers to bear it, and in a manner which will preserve work and production incentives.

The January 1951 Economic Report was emphatic in stating that the existing legislation is far from adequate in terms of the financial requirements of the mobilization effort, notwithstanding the enactment by the last Congress of two revenue-raising measures with a combined yield of 9 to 10 billion dollars a year at present income levels. New tax legislation has been under active consideration by the present Congress since February, when the President, in a special tax message, called for early enactment of higher tax rates to yield at least 10 billion dollars annually, and for the enactment later of the additional amounts needed to keep the defense program on a pay-as-we-go basis. As passed by the House of Representatives, the tax bill falls about 3 billion dollars short of the amount called for by the President; and the increases will become effective at later dates than recommended. Unless the bill is revised upward and passed within the immediate future, it will probably fail to cover the fiscal year 1952 budget deficit, and will not adequately support the stabilization program.

The tax increases proposed by the President, together with those enacted by the last Congress, are in conformity with the tax policy requisites set forth above. They will satisfy immediate revenue requirements, while preserving adequate work and production incentives. They will operate to limit spending in those income ranges where the bulk of spending is done, while distributing the burden in reasonable accord with ability to pay.

The budgetary outlook and the need for heavier taxes. Difficulties arise in a period such as the present in deciding how large a revenue program is warranted on the basis of the budgetary outlook. There are more uncertainties than usual in estimating, on the expenditure side, the rate of acceleration of Federal spending, and, on the receipts side, the extent of the increase in revenues in response to changes in personal and business incomes. A further consideration is that Government expenditure programs generate demands for goods and services several months in advance of the actual disbursement of Federal funds. Holders of Government contracts must order materials and equipment and hire labor before they can begin to produce. Final payments are not made by the procurement agencies until it is certified that the terms of the contract have been met, which is usually dependent upon actual delivery or verified work in place, including the accumulation of inventories. It is estimated that the amount of net accounts payable by the Federal Government to business concerns as a result of work done or in process was over 2 billion dollars at the close of the fiscal year 1951. These payables are of significance in assessing the relation of formal budgetary balance to the growth of inflationary pressures.

The budget surplus of 3½ billion dollars in the fiscal year just ended is a source of gratification, but we cannot be complacent on this score.

The surplus is the product not only of the higher tax rates which became effective in the latter half of calendar year 1950, but also of the inflation of prices and incomes since Korea. The fact that a limited inflation may create the appearance of budgetary strength is a paradox inherent in the inflationary process.

The budgetary outlook is for rising receipts, but for more rapidly rising expenditures. In the absence of new tax legislation, the tendency will be for expenditures to exceed receipts by increasing amounts during the fiscal years 1952 and 1953. The quarterly movement of budget receipts and expenditures and the public debt is shown in chart 24 for the period since the beginning of 1950.

Military expenditures, including military end-items shipped to our allies, were at an annual rate of about 29 billion dollars during April-June of this year. By the same quarter of next year, they are expected to rise to an annual rate of between 50 and 55 billion dollars, according to current budget expenditure estimates. The advance in the rate of total budget spending during the same period will be larger than the increase in military expenditures, due in part to the expansion in the atomic energy program and in various defense production activities.

With present taxes and the scheduled increases in expenditures, it is estimated that the deficit will rise to an annual rate (seasonally adjusted) in excess of 15 billion dollars by the end of the current fiscal year, compared with about a 2-billion-dollar rate in the quarter just closed. This estimate makes liberal allowance for the effect of increasing national income on tax revenues. With Federal expenditures for the fiscal year 1953 expected to total between 80 and 90 billion dollars, compared with the fiscal 1952 estimate of 68 billion, an even larger deficit rate is indicated for that year.

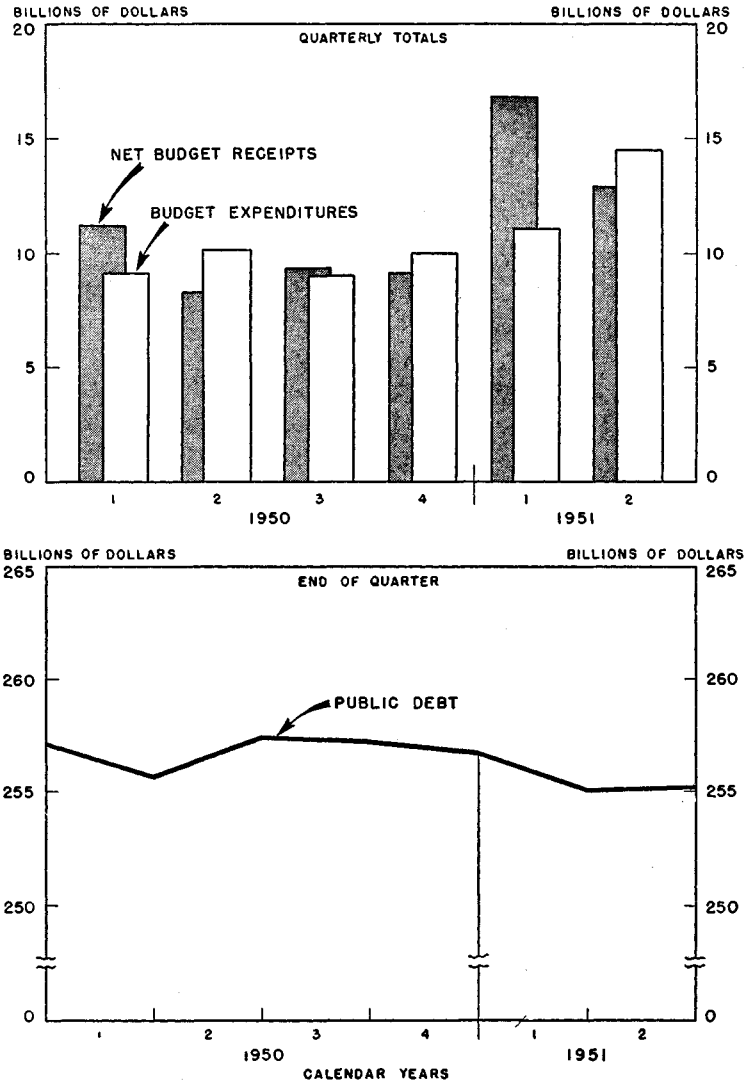
As was emphasized when the 10-billion-dollar program was first presented, it is a minimum program which, if speedily enacted, would meet the immediate revenue needs. The tax bill passed by the House of Representatives, which is estimated to yield about 7 billion dollars in a full year of operation, will not satisfy pay-as-we-go requirements. With the effective dates provided in the House bill, the yield will be only 4½ billion dollars in the fiscal year 1952.

Taxation as an instrument of economic stabilization. The major contribution of taxation to economic stabilization is through its direct and indirect effects on spending. Under the assumptions made with respect to the various factors which will determine the trend of production, income, and expenditures, a rise in personal income of 15 to 20 billion dollars was indicated for the period a year hence. Considerably more than the 10-billion-dollar tax program would be needed to absorb the additional spending which would be created by a growth in income of this magnitude. The effect of additional revenue changes on the "inflationary gap" will ordinarily be much less than dollar-for-dollar. A part of the tax increase will be paid

CHART 24

FEDERAL BUDGET RECEIPTS, EXPENDITURES, AND THE PUBLIC DEBT

The large budget surplus in the first quarter of 1951, when heavy income tax payments fell due, was followed by a budget deficit in the second quarter. The public debt was reduced by about 2 billion dollars during the year ended June 30, 1951.



SOURCE: TREASURY DEPARTMENT.

out of idle savings, for example, rather than out of funds that would otherwise be spent. To the extent that this occurs, the anti-inflationary effects are less direct than when active funds are tapped; nevertheless, the effects should not be disregarded. If the same amount of funds had to be supplied by Government borrowing, debt management and credit control problems would tend to be aggravated.

The President's February tax message recommended an immediate increase in personal income taxes to bring in 4 billion dollars annually in additional revenue, increases in selective excise taxes to yield an additional 3 billion dollars, and an increase in corporate income taxes to yield 3 billion dollars. The first two of these recommendations would have a direct impact on the growth of consumer spending power, either through a reduction in the disposable income of individuals (i. e., the amount of income available to individuals after payment of personal taxes) or through the absorption of purchasing power as money is spent on goods and services subject to Federal excises. The increases in excises would also tend to divert some spending away from those taxable items which require for their production raw materials which are expected to be in particularly short supply.

The proposed increases in corporate taxes will contribute to stabilization, through a reduction in dividend payments, and by curtailing the supply of funds available for corporate spending or investing. The increases are also needed because excessively high profits after taxes increase pressure for wage increases of a size and character that would not be consistent with over-all stabilization objectives.

Relation to consumer spending. Some evidence as to the probable anti-inflationary effectiveness of last year's increase in the individual income tax, and of the increase in the individual income tax and excises included in the 10-billion-dollar tax proposal, can be obtained from an analysis of the indicated source of the additional tax payments by broad income groups. It is important to know the extent to which the additional payments will come from those income groups which normally account for the bulk of the spending in consumer markets. While this is not the sole criterion for appraising the tax proposals, nor even the most important of the several criteria which must be applied, it is a means of gauging the probable effect on consumer spending.

The results of this analysis are summarized in table 10.

At money income levels in prospect for the fiscal year 1952, the income range between $3,000 and $7,500 a year will include about half of all spending units, and somewhat more than half of total money income before taxes. This is the broad middle income range where higher taxes, if properly distributed, can yield significant amounts of additional revenue and result in a nearly equivalent reduction in consumer spending, without making serious inroads upon essential living standards. Much of the saving in this income range takes the form of insurance commitments and mortgage repayments.

TABLE 10.—*Actual and proposed increases in individual income and excise taxes, by income group, estimated for fiscal year 1952*

[Percentage distribution]

Item	All income groups	Annual money income		
		Under $3,000	$3,000 to $7,500	Over $7,500
Actual and proposed increases since Korea in individual income and excise taxes	100	10	53	37
Spending units	100	41	49	10
Money income before taxes	100	15	54	31
Consumption expenditures (assuming "normal" spending habits)	100	21	56	23

EXPLANATORY NOTE.—The distribution of spending units and money income before taxes is based upon the distribution in the 1950 Survey of Consumer Finances sponsored by the Board of Governors of the Federal Reserve System. The upward shift in spending units from 1949, which is the year covered by the 1950 Survey, to the fiscal year 1952, was estimated under the assumption that the projected rise in total income was distributed proportionately throughout the income scale. Consumption expenditures were calculated by deducting from money income before taxes in each income class, the estimated personal tax liability and saving computed on the basis of the 1949 saving ratio. The estimated distribution of the actual and proposed increases in individual income and excise taxes was calculated as follows: (1) The increases in the individual income tax were obtained by adjusting the average Federal income tax liability, expressed as a percentage of money income in each income class in 1949, for the rate changes in the Revenue Act of 1950 and for the further advance proposed by the Treasury; (2) the proposed increases in excise taxes were distributed partly on the basis of the distribution of consumption expenditures and partly on the basis of detailed information on expenditure patterns for commodities covered in the Treasury's tax proposals. In view of the limited current information about family size and composition, taxpaying status, and consumption expenditures, it was not possible to make refined adjustments for the tax changes at each income level. Nevertheless, it is believed that the results shown in the table are adequate for use in terms of broad income groupings.

There is no comparable taxpaying capacity in the income group below $3,000, even though this group will include approximately two-fifths of all spending units, because the surplus of income over minimum living costs is very small for this group. The price rise has already brought serious hardship to many families in this group, particularly to those near the bottom of the scale, who are often dependent upon fixed incomes such as pensions and insurance payments.

At the other end of the income scale are single persons and families earning more than $7,500 a year. Only one-tenth of the spending units are estimated to come within this highest income group, but they will receive 31 percent of total money income before taxes. The highest tenth of the population will account for an estimated 50 percent of the total Federal income liability under the rates in effect before last year's revenue legislation. This group is responsible for the bulk of the net personal saving in the economy, and for almost one-fourth of total consumer spending. Additional tax levies on these persons will come partly out of reduced savings, but families with incomes in the lowest part of this range will be obliged to limit their consumption expenditures.

The significance of the estimates in the table is to show that more than one-half of the combined total of increases in the individual tax enacted last fall and increases in the individual income and excise taxes proposed by the President, will come from the broad middle range where the contribution to

economic stabilization would be especially helpful. Approximately one-tenth of the increases (mostly in the form of steeper excises) will come from the group under $3,000, and less than two-fifths from the group over $7,500.

The preceding estimates of the tax distribution do not, however, allow for the corporate income and excess profits taxes, which account for 40 to 45 percent of the total actual and proposed increases since Korea. These taxes are likely to have a more than proportionate effect, in relation to income, on the group over $7,500, because of the concentration of stock ownership in this income range. Ordinarily, increases in the corporate taxes tend to reduce dividend payments and retained profits. To some extent, they also affect prices and costs, although this effect would be especially limited in a period of price control.

Relation of tax increases to rising incomes. The impact of personal income tax increases on individual taxpayers is greatly affected by whether their incomes are rising, standing still, or falling. The same defense effort which requires heavier taxes is also creating larger incomes and profits. Despite the heavier personal income taxes provided by the Revenue Act of 1950, there have been large increases since the Korean outbreak in personal incomes after payment of taxes. Comparing the first half of 1950 with the same period this year, we find that disposable personal income rose from 197 to 220 billion dollars.

The rise in personal income after taxes is expected to continue. It was estimated above that, under the impact of the increase in production and in national security spending, personal incomes may rise by 15 to 20 billion dollars over the next year, and disposable income by 2 to 3 billion dollars less than this amount, allowing for present tax rates. Such a rise in disposable income would be several times larger than the proposed increase of 4 billion dollars in the individual income tax, and about twice as large as the proposed increase of 7 billion dollars in the individual income tax and the excises combined. For the population as a whole, therefore, these taxes would not prevent a further rise in disposable income.

This point can be developed further by referring to some illustrative calculations of the effect on particular taxpayers of the proposed income tax increases, taking different assumptions as to changes in their current dollar incomes. When ranked by size of income, the middlemost spending unit in this country had an annual money income of approximately $3,000 in the period just before the start of fighting in Korea. By the first half of 1952, the average consumer undoubtedly will have a substantially higher income; on the basis of the projections presented in this Report, which allow for wage rate changes, longer working hours, new entrants into the labor force, and other prospective changes, the average family income would be 15 to 20 percent higher than in the second quarter of 1950. A family of four with a $3,000 income would have paid $54 in Federal income taxes before Korea. If we assume a 15 percent rise in income, this family would have

$3,450 before payment of taxes and, under the proposed rate increases, its tax liability would rise to $175 (compared with $121 under the rates in effect before Korea). The family's income after taxes, therefore, would be $3,275, or $329 more than what it had before Korea when both income and taxes were lower. In other words, the assumed rise of 15 percent in income before taxes would mean a rise of 11.2 percent in income after taxes for this family. If a rise of 20 percent is assumed, the indicated rise in income after taxes is 15.2 percent. If we take a married person with two dependents who was at the $4,000 level before Korea, the increase in income after taxes would be 10.0 percent with a 15 percent rise in income and 14.1 percent with a 20 percent rise.

While, on the average, income after personal taxes will probably rise under the impact of the defense program, even with the proposed individual income tax increases, many families with relatively fixed incomes will have no alternative but to adjust to a lower level. Even when disposable income rises, this does not necessarily mean an improvement in the individual's real income position and in his standard of living. In measuring real income, price rises must be taken into account.

Impact of heavier taxes. It is always easy to find reasons why taxes should not be raised, or why they should be raised in a different manner than that proposed. Recent months have provided no exception in this respect. The statements of witnesses before the House Committee on Ways and Means reflect sharply divergent views, with virtually every feature of the proposed tax program being severely criticized by some group or other, often for very different reasons.

Among the matters over which concern has been expressed is the question of whether the tax proposals are consistent with the need to preserve adequate work and management incentives. This is an important consideration, since our production planning and economic control programs rest on the assumption that further increases in total output will be possible in the months ahead as more workers are drawn into the labor force, the workweek lengthened, and productivity continues to rise. Will these avenues for increased production be closed if the tax proposals are enacted?

Under the proposal for the individual income tax, the actual tax liability at any given money income level would generally be lower than under the highest wartime rates. This results because of higher personal and dependency exemptions than during the war, and because of the adoption of income splitting in 1948 which gave substantial benefits to married persons, particularly in the higher income brackets. Whatever evidence is available suggests that considerably higher wartime rates would have been possible in the United States, without any serious damage to work and investment incentives. It would seem, therefore, that the proposed rates are wholly consistent with the need to attract new entrants into the labor force, to provide sufficient inducements to earn more pay by working

longer hours, and to encourage necessary investment and entrepreneurial undertakings.

Incentive questions also arise under the corporation and excess profits taxes. The rates proposed for the regular corporate income tax are considerably higher than the peak wartime rates; on the other hand, both the rates under the excess profits tax proposal and the proposed maximum effective rate limitation of 70 percent are below the peak wartime levels. Moreover, the accelerated amortization provisions ease the impact of these rates on businesses undertaking defense-related facilities expansion. Perhaps these rate comparisons, however, are less important than other considerations, such as the large number of profit opportunities in a high production defense economy, the relatively low business risks that are ordinarily involved, and the generally satisfactory level of business profits that would prevail even after full allowance for the proposed tax increases.

It is important to realize that the economic decisions of businesses and individual workers are always tempered by psychological factors. When taxpayers are convinced of the necessity and fairness of a particular tax program, they will be more ready to carry the heavier tax load and to work longer and harder and invest more time and capital, even though an increased share of additional earnings must be paid in taxes.

Another set of questions about the 10-billion-dollar tax program revolves around the general point as to how closely taxes are approaching the limit of what workers and business can bear. If the ratio of all Federal, State, and local taxes combined to national income were taken as a measure of the tax burden, it would appear that the present burden would be about the same as that reached during World War II. Such a comparison, however, provides a highly misleading measure of the real economic burden in the two periods. The economic burden is more accurately measured by the proportion of total national production diverted to war or defense purposes, and by the aggregate volume of goods and services remaining for civilian purposes, since taxes finance but do not create this burden.

At the peak of the war, the military program took 45 percent of the gross national product, or somewhat over twice the maximum percentage which will be required for the defense mobilization program as now conceived. With the present program and the projected increase in production, it is estimated that about 1,330 dollars of goods and services per capita will be available for personal consumption during the first half of 1952, compared with 1,130 dollars (measured in today's prices) during the years 1943 to 1945. With a far lower economic burden at present than during the war, we are paying about the same proportion of our national income in taxes. The significance of this fact is that our present tax policy represents a decision to face the burden on a current basis, which is desirable for a partial and possibly protracted mobilization.

The ratio of taxes to income is a general measure of the extent to which the Government, through the use of fiscal measures, has taken steps to curtail private spending and thereby reduce inflationary dangers. The more closely such spending is brought into line with available supplies, the better the opportunities for achieving an equitable sharing of the economic burden.

The economic burden of a prolonged defense mobilization effort is not determined by the method of financing. If the size of the tax bite is lowered through borrowing, there will be more liquid asset accumulation, but not any more goods and services for consumers to buy; and the requirements for debt service and debt retirement will be increased in the post-emergency period when those who are now in the armed forces will share with the rest in paying the necessary taxes.

While a tax-income ratio which is higher than at present by the amount of the 10-billion-dollar tax proposal will not mean any heavier economic burden for the country as a whole, it must be recognized that the tax increases may nevertheless bear heavily upon families living on fixed incomes. Such families, together with low-income families generally, are, however, also the groups which would be hardest hit by an inflationary price rise which the tax increase will aid in preventing. The earlier comparison of the proposed tax increases with the projected aggregate rise in income shows that enactment of the tax proposals will not prevent the majority of families and single individuals from ending up with larger disposable incomes in terms of current dollar amounts, although not necessarily in terms of actual purchasing power.

Curtailment of less essential Federal spending

Full attention should continue to be given to the possibility of further savings in budget expenditures, since such savings will contribute to the pay-as-we-go objective and aid the stabilization program. Soon after the start of fighting in Korea, the President took steps to curtail Federal spending for less essential public works and other programs, and to review all budget requests against the more exacting criteria which must be applied in an emergency period. These steps have resulted in important savings.

Some of the reductions which have already been made will not be fully reflected in expenditures until the fiscal year 1953 or later. This is true, for example, of the reductions in authorizations for rural electrification loans, and grants to States for hospital construction. The expenditures in the 1952 Budget for these programs will be made almost wholly from funds obligated in prior years. In the case of some other construction programs, it has been necessary to bring about a significant shift of emphasis to projects which are vitally important to the national security effort.

National security programs, veterans' benefits, and interest on the public debt account for more than 85 percent of all Federal expenditures in the

fiscal year 1952. A large part of the remaining expenditures are for such programs as public assistance grants, price support activities, mortgage purchases by the FNMA, and grants for public roads; programs of these types are fixed by law and are not subject to budgetary or appropriation control in any single year. It is readily apparent that very large reductions in expenditures are not possible in the absence of legislation requiring major curtailments in programs specifically prescribed by law.

While economy should be practiced, it should be true economy. The short-sighted stripping down of essential services, such as educational and health services would be inconsistent with building our economic strength. That strength depends upon human resources even more than upon plant.

State and local participation in the stabilization program

During World War II a special effort was made by State and local governments to conduct their own financial affairs in such a manner that they supported, or at least did not counteract, the national stabilization program. Organizations representing these governments formulated specific policy recommendations to guide State and local actions, and these recommendations were extensively applied in the day-to-day operations of government.

Once again it has become important that State and local governments follow policies consistent with national needs and objectives. To the extent feasible, these governments should restrict new and regular expenditure programs to activities which will best promote national defense and security. Whenever State and local tax revenues exceed immediate needs, the surplus should be used in ways which will both harmonize with efforts to restrain inflation and reduce the future financial problems of the State and local governments. Debt financing should, of course, be held to a minimum, and debt repayment should be encouraged. As described in the section on debt management and credit policy, State and local governments are already cooperating in the Voluntary Credit Restraint Program.

Credit policy

The significant rise in the general price level, since the outbreak of hostilities in Korea, has been accompanied by a rapid expansion in private credit, particularly bank loans. The loans of all commercial banks increased by more than 9½ billion dollars in the 9-month period ending March 31, 1951. The sharp expansion in loans was halted in April and May, when the combined loan increase for the 2 months amounted to about 100 million dollars. At that time of the year, there is usually a seasonal downturn in business loans.

As we enter the second half of 1951, a new upsurge in bank loans may be at hand, partly because of the seasonal requirements of some indus-

tries, and partly because of the growing needs of expanding defense production. If we can strengthen the restraints upon prices, inventory accumulations, new housing construction, and the output of some nonessential durable goods, the total demand for loans may abate, even though loans to expand defense production will increase. But at this time, there are no signs of that abatement. The problem of restraining bank credit appears to be again very real.

In shaping our credit control measures, it is essential that we assess the credit expansion problem accurately, and adopt restraint policies designed to meet the specific requirements of the present national emergency.

The primary cause of the inflation in the past year has been the unprecedented rush for goods by business and consumers, generally in anticipation of the effects of the expanding national security program. This extensive demand for goods has been financed in several ways. It has been financed out of expanding current incomes, by the liquidation of savings out of past income, and by credit expansion. Financing by credit expansion has been facilitated by the large amounts of Government securities held by financial institutions, and by the fact that these institutions could sell their holdings to the Federal Reserve System to obtain loanable funds. Accordingly, a more stringent policy of general credit restraint on the part of the Federal Reserve would have tended to reduce the total amount of purchases by making it somewhat more difficult to finance a portion of these purchases. But in view of the alternative methods of financing available, it is evident that any feasible Federal Reserve policy would only have tempered the over-all demand for goods, and would not have curbed it sufficiently to have prevented much of the rise in prices which has occurred.

In the current national emergency, measures of general credit restraint must be supplemented by selective measures. General credit measures do not distinguish between essential borrowing and nonessential borrowing. The fact that some credit extension serves a useful purpose in helping us to reach our defense goal as rapidly as possible, while other credit extension is less useful or even harmful, makes it necessary to use credit controls as selectively as possible. Selective controls, such as those imposed on consumer credit, real estate credit, and credit for security markets have a direct impact on nonessential credit extension, and so have a continued usefulness in the mobilization period. General credit controls reach to areas not touched by selective credit measures.

Outside the area of selective credit controls, direct controls over the production of goods also reduce the demand for credit by curtailing the goods which are available for purchase with borrowed or other funds. Selective means of restraining credit expansion must always be supplemented by direct controls of materials. Many firms can pay for much or all of their investment in plant and equipment without borrowing. Withholding of

credit from some firms, while others were able to resort to other means of finance, would not assure the balanced growth of production required by mobilization.

Selective credit controls. Because of the need of curtailing credit for some purposes, while funds have had to be made available for other purposes—and sometimes in increasing amounts—credit policy has made use of several selective controls. These controls are intended to restrict credit for the purchase of certain kinds of goods, especially those the output of which must be curtailed to help divert scarce materials to production for the security programs. Such controls help to keep demand more nearly in balance with smaller supplies. They also limit somewhat the expansion of the money supply which accompanies lending by commercial banks, and to that extent hold down the rise in spending pressures.

The first step in applying selective control was the tightening in July 1950, at the request of the President, of the terms of residential mortgages guaranteed or insured by Government agencies. In October, under authority derived from the Defense Production Act, the Federal Reserve Board, with the concurrence of the Housing and Home Finance Administration, imposed regulations on conventional mortgages on new one- and two-family houses. At the same time, the terms of Government insured or guaranteed mortgages on similar houses, both old and new, were brought into conformity with the Board's regulations. In January 1951, the Board's regulations and a comparable tightening of Government terms were extended to three- and four-family houses and apartments. In February, the Board also applied regulations on loans for most new commercial construction.

The selective control of residential mortgage credit was intended, with the complement of restrictions on the use of some materials used in construction, to reduce new housing starts during 1951 about one-third below the record level of 1950. Results at first were disappointing. New starts in January 1951, including public housing units, which are not subject to these controls, were nearly 10 percent above January 1950. A large backlog of financing commitments had been entered into, before the October controls became effective. This, along with the continued availability of building materials, and the desire of builders to undertake as much construction as possible before materials controls could have a real impact, have been largely responsible for delaying the effect of this selective control. In the second quarter of 1951, however, housing starts were about 25 percent below the level of the same period last year, and it now appears probable that some progress toward the announced goal of curtailment is being achieved.

In September 1950, also under the authority provided by the Defense Production Act, the Federal Reserve Board placed regulations on instal-

ment loans for the purchase of automobiles and certain other consumer durables. The terms of the regulations were stiffened in October. The purpose of these regulations is similar to that of the controls on housing and commercial construction credit. The consumer instalment credit regulations were, however, more immediately effective. Total instalment credit, which had expanded about 10 percent during the third quarter of 1950, was held to a rise of less than 1 percent during the fourth quarter. During the first half of 1951, instalment credit outstanding declined about 600 million dollars, or 4.5 percent, compared with a rise of 1.2 billion dollars during the same period of 1950. The drop in total instalment credit reflects not only the effect of the regulations, but also the influence of other factors which have caused consumer demand to subside somewhat from the high levels reached after Korea.

The authority of the Board of Governors to regulate mortgage credit would be more effective, if expanded to cover old houses. Mortgages guaranteed or insured by Government agencies on both new and old houses are already subject to terms comparable to those of the Federal Reserve Board's regulations, which under the present law apply to new units only. The restraint of conventional borrowing for the purchase of old houses would not, of course, assist in directing materials to defense production; but it would help to check inflation. Furthermore, funds to make the higher down payments required on new houses are often obtained by selling old houses under very liberal credit terms.

It is desirable that Congress provide authority for placing margin requirements on speculative trading in commodity futures. Such legislation would further strengthen credit policy in combating inflation. It would apply to commodity markets a principle of regulation imposed more than 15 years ago on the securities markets.

Voluntary credit restraint program. On March 9 of this year, a voluntary credit restraint program, including the major financial institutions throughout the Nation, was instituted by the Board of Governors of the Federal Reserve System, pursuant to Section 708 of the Defense Production Act. A statement of principles to be used by all lenders as a guide in distinguishing between essential and nonessential loans has been distributed to all of the participants in the program. The test for desirable lending in the present national emergency was declared to be whether a particular loan would commensurately increase or maintain production, processing, and distribution of essential goods and services.

A National Committee, under the direction of a member of the Board of Governors of the Federal Reserve System, has been established as a general supervisory body, as well as some 40 regional committees covering all sections of the country. The statement of principles of the program serves as an over-all guide to lending institutions in their lending activities.

In cases, however, in which lending institutions are doubtful as to whether a particular loan request can be granted within the framework of the program, the regional committees stand ready to act as the ultimate judge.

The continuing effort to make the program of voluntary credit restraint more effective should receive the full and active support of private and Government lenders. Voluntary restraints have the selectivity so necessary during the mobilization period. In order that the campaign of voluntary control may be as effective as possible, it is necessary that the lending policies of Government agencies continue to be kept in conformity with those of private institutions. It is also essential that the voluntary credit control committee be guided at all times by the production goals set by mobilization agencies.

Lending activities of Government agencies. At the same time that Government insured or guaranteed residential mortgages were tightened, other Government owned or sponsored lending agencies were requested to reorient their lending policies to the needs of defense. New programs of defense financing have provided credit for the expansion of defense production, whenever needed funds have not been obtainable from private sources. Credit for purposes not related to military or essential civilian output has been curtailed.

As has been observed in the discussion of the voluntary credit control program, it is necessary that the lending policies of Government agencies adhere to the guides established for private lending agencies, if the voluntary program is to work effectively. This requires that the various Government agencies continue to scrutinize their lending activities with the utmost care.

Reserve requirements. Early this year, the Board of Governors of the Federal Reserve System raised the reserve requirements of member banks 2 percentage points against net demand deposits, and 1 percentage point against time deposits. This action raised the reserve requirements of member banks to the full limit authorized by statute, except for an additional 2 percentage points which may be imposed on net demand deposits held by central reserve city banks—New York and Chicago.

Additional authority to control bank reserves would be a valuable means to restrict credit under several possible conditions. Any such new authority over reserves should be adaptable to meet varying circumstances. It is also imperative that any additional requirements for bank reserves imposed by the Federal Reserve should be such that they do not have a disruptive effect on the market for Government securities.

The report of the President's Committee on Credit Policy recommended that, as an emergency measure, legislation be sought to empower the Federal Reserve authorities for a limited period to impose additional reserve requirements. The report suggested that two plans had the greatest promise, namely: (1) the loan expansion reserve plan and (2) the primary reserve plan with a Government securities feature, which provides for addi-

tional required reserves with the option, under conditions to be prescribed by regulation, of holding the additional reserves in the form of cash or Government securities.

The report of the President's Committee also recommended that, in view of the emergency, any additional reserve requirements should apply to all insured banks; and that the feasibility of permitting non-member insured banks to hold the additional reserves in balances with their correspondents should be explored. Broadening of the authority in this manner would increase its effectiveness, and would avoid placing on member banks a disproportionate share of the burden of checking inflation.

We believe these recommendations should be adopted.

Use of executive authority. The authority exists under emergency legislation for the President by executive order to put a positive limit on the volume of loans which may be made. These powers are available should the situation with respect to credit expansion become critical.

Debt management

The policies and operations of the Treasury, in the management of the public debt, have a significant bearing on the stability and well-being of the Nation's economy. The successful merging of revenue measures and borrowing programs, in such a way as to make the most effective contribution to the productive powers of the Nation, is one of the most difficult and most important problems on the domestic front.

A weapon of great importance for keeping inflationary forces under control is a debt management program which is directed toward placing the largest possible proportion of Government securities in the hands of nonbank investors, and reducing the proportion held by the commercial banking system. In the last half of the calendar year 1950, nonbank holdings of Government securities reached an all-time peak, while holdings of the commercial banking system declined to a new postwar low. This was accomplished despite the fact that the over-all decline in the amount of public debt outstanding was less than 1 billion dollars during this period. The policy of reducing bank holdings of Government securities was aided during the first 6 months of 1951 by the existence of a budget surplus. Because of the prompt action of the Congress in enacting two new revenue-producing measures within a few months after the outbreak of aggression in Korea, the Federal Government operated with a budget surplus during the first year of mobilization. Receipts during the fiscal year which ended on June 30, 1951, exceeded expenditures by 3½ billion dollars. The surplus from January through June 1951 was, in fact, 4.1 billion dollars. A part of this surplus was used to reduce the amount of total debt outstanding; and a large part of this reduction occurred in the holdings of the banking system.

Unfortunately, it will not be possible in the period ahead to continue to reduce the total amount of debt outstanding. In the absence of new tax

legislation, the budget of the Federal Government for the current fiscal year would show a deficit of about 10 billion dollars.

In this situation, the most that the Treasury can hope to do is to continue to emphasize its program of shifting holdings of Government securities out of the banking system into the hands of nonbank investors. This objective can be furthered by continued careful attention to the sources of funds available for investment in Government securities; and a continuation of the program of carefully selecting new and refunding issues of securities which are suitable to the needs of the various investor classes.

An important measure in carrying out this policy is the savings bond program. The Treasury has carried on an intensified payroll savings campaign—to reach the expanding incomes of consumers and so draw inflationary funds from the spending stream—since shortly after the present disturbed international situation was forced upon us. The Secretary of the Treasury announced just a few days ago that a Nation-wide savings bond drive would get under way commencing on Labor Day.

Since the Federal Government operated with a budget surplus for the fiscal year 1951 as a whole, all of the debt operations of the Treasury during the year were, on net balance, refunding operations. They were of considerable significance, and in the first half of 1951 varied in character.

At the request of the Treasury, the Congress enacted legislation which permits holders of maturing Series E bonds to maintain their investment in these bonds and continue to earn interest on their face amounts for up to 10 additional years. This is an important step in providing an incentive for individuals to maintain the savings which they hold in this form.

On March 4, 1951, the Treasury announced that it would exchange a portion of its outstanding long-term marketable bonds for a new nonmarketable issue. A new investment series of 2¾ percent, 24–29 year nonmarketable bonds was offered in exchange for the outstanding 2½ percent marketable bonds of June 15 and December 15, 1967–72. Nearly 13.6 billion dollars of the outstanding amount of 19.7 billion dollars of the two marketable issues was exchanged for the new nonmarketable issue.

The Treasury also announced, on May 14, 1951, a new series of Treasury savings notes, and the discontinuance of the sale of old Series D savings notes. The new notes are similar to the old series, except that the interest return will run from 1.44 percent, if the notes are held for 6 months or less, to 1.88 percent if the notes are held for the full 3-year term. This compares with 0.98 percent for 6 months, and 1.40 percent for 3 years, on the old issue.

In June, another large refunding operation was carried through. An offer was made to exchange the 1.6 billion dollars of 2¾ percent partially tax-exempt Treasury bonds called for redemption on June 15, and the 8.4 billion dollars of 1¼ percent Treasury notes maturing July 1, into 9½

month, 1⅞ percent certificates of indebtedness. More than 9.5 billion dollars, or nearly 95 percent, of the maturing issues were exchanged for the new security.

In the first week of the new fiscal year, the Treasury started a "new money" borrowing program by asking for tenders on its weekly Treasury bill offering, in an amount 200 million dollars in excess of the maturing issue. Already 800 million dollars of "new money" has been borrowed in this fashion. There will continue to be deficit financing in the period ahead. The exact amount depends upon the magnitude and nature of the new taxes provided by the Congress. But in any event the amount will be substantial. Its successful financing will require a confident and stable condition in the market for Government securities.

On July 12, the Secretary of the Treasury announced the first large refunding operation of the current fiscal year. An 11-month, 1⅞ percent certificate of indebtedness was offered in exchange for the 5.4 billion dollars of 1¼ percent notes maturing on August 1.

Price policy

Earlier in Part II of this Review, the Council indicated why price control is an essential feature of an effective stabilization program, particularly during the early stages of the very large defense build-up. We also expressed the view that the economic outlook does not now justify the abandonment or weakening of price control. But price control, and other measures, should be geared to the kind of mobilization which we are now undertaking, its likely duration, and its probable impact upon the economy. The problem is to find the most practical kind of price control for the situation now confronting us.

Progress of price stabilization to date. There have been three stages in the progress of price stabilization thus far: (1) the initial period, when major reliance was placed on voluntary restraint, in combination with general measures to reduce demand; (2) the imposition of direct, mandatory controls by the issuance of the general freeze in late January; and (3) the subsequent "interim" period of adjustment.

With the passage of the Defense Production Act, the task was begun of organizing an Economic Stabilization Agency and Office of Price Stabilization to be ready if direct controls should later prove to be required. Prior to the issuance of the General Ceiling Price Regulation in late January, the Government had increased taxes, imposed credit restrictions, and established a number of controls over the flow of scarce and essential materials. Moreover, business, labor, farmers, and consumers had repeatedly been urged to exercise restraint in their buying and selling, and in their price and wage policies. 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 as the Communists were driven back in Korea. For

6 weeks before the blow from the Chinese, the wholesale price index advanced very slowly. The course of prices of basic raw materials had changed from an upward rush to a series of fluctuations.

The Chinese intervention in late November created a new situation, and made positive the necessity for intensified mobilization efforts. It also set into motion a new wave of price increases. Several direct actions were taken to curb price advances. Efforts were redoubled to provide an adequate staff for the Office of Price Stabilization. Meanwhile, a set of Voluntary Pricing Standards was announced; meetings were held with producers of a number of basic industrial commodities to explore ways of stabilizing prices in those fields; and several hundred large firms were requested to give prior notice of intended price increases. Earlier, the first price ceiling regulation had been issued, controlling manufacturers' prices of new automobiles. The great difficulties encountered in building up staff hampered and delayed the development of more effective price control.

In spite of the conscientious efforts of many sellers to comply with the voluntary standards, the price increases continued apace. In response to this situation, and in spite of a still short-handed staff, the Office of Price Stabilization in late January issued the General Ceiling Price Regulation freezing most domestic prices. There were some major gaps in the coverage of this regulation, required by the farm provisions of the Defense Production Act and by the complexities of applying a freeze-type regulation to all kinds of markets. A companion regulation freezing wages and salaries was issued simultaneously, as required by the Defense Production Act. This action was in sharp contrast to the development of price control in World War II, which began with selective controls and subsequently culminated in the General Maximum Price Regulation some 14 months later, with wages remaining uncontrolled for several months more.

A general price freeze, however, cannot be more than a stopgap measure. The third stage in the evolution of price stabilization has therefore been the effort to introduce necessary flexibility.

During the past five months, four broad areas of activity may be distinguished: (1) the issuance of margin-type regulations for most commodities sold at retail, and many sold at wholesale; (2) the development of "interim" regulations calling for new ceiling prices to be computed by adding to pre-Korea prices the subsequent increases in costs of labor and materials (but not including overhead cost increases) with a view to the restoration of pre-Korea gross seller margins for most manufacturers, and at the same time providing for rollbacks of prices which had advanced excessively; (3) the institution of a group of regulations covering specific commodities, at the primary market level, and largely in dollars-and-cents terms—e. g., soybeans, scrap metals, hides and skins, cotton, cocoa, coffee, and wool; and (4) the issuance of the beef regulation, the first tailored regulation setting dollars-

and-cents ceilings from the primary to the consumer level with more such regulations to come.

The establishment of margin-type regulations at retail and wholesale was designed to relieve distributors of the squeeze created by the lag between prices and replacement costs, establishing a more normal margin structure by rolling back excessive margins, and preparing a firm foundation, particularly in the case of food, for the future development of dollars-and-cents price ceilings. Margin-type regulations permit the pass-through of cost increases into retail prices; likewise, they require retail prices to be reduced when costs have been reduced. The effectiveness of a margin regulation at retail in maintaining stable prices depends on the effectiveness with which suppliers' prices are stabilized. The structure of the plan is strongly influenced by considerations of practicality. Thus the maintenance of dollars-and-cents gross margins would lead to less price increase than the percentage mark-up formula. However, specified dollars-and-cents mark-ups, like dollars-and-cents price ceilings, are workable only in highly standardized commodity areas where changes in products are infrequent, which rules out their use in a major sector of the broad market territory covered by the present wholesale and retail regulations.

Another major step has been the program to reprice manufactured goods. The general manufacturers' formula, in essence, sets new ceiling prices by permitting manufacturers to add to their pre-Korea prices only increases in labor and material costs occurring after July 1, 1950. The regulations also provide that cost increases after specified dates shall not be included. In the case of labor increases, the cutoff date is March 15; in the case of materials, the dates vary. Since one manufacturer's price is frequently another manufacturer's cost, the intention is to require recalculation to take account of the changes in costs brought about by the first calculations under the manufacturers' regulations themselves. The manufacturers' formula would require rollbacks, where prices being charged were in excess of the ceiling prices as computed under the formula. The effective date of the manufacturers' regulations has been postponed, pending the renewal of the Defense Production Act.

At the time of the price freeze, many cost-price and interprice relationships were untenable from any continuing point of view. Price relationships are rarely, if ever, in complete equilibrium, but the wide variations in the rates of different price increases prior to the price freeze had greatly distorted earlier, more normal relationships. The distortions involved serious inequities among businesses. Much more important for the future of the economy, many of the distortions had to be corrected if goods were to continue to move through the markets in the large volume required for a high employment economy in general and a defense economy in particular. Much of the effort reflected in the price orders thus far issued to modify the general price freeze has been directed to reestablishing tenable

relationships among relative prices. By combining some adjustments upward with some rollbacks, the general purpose has been to correct inequities and disparities with a minimum impact on the general price level. Once this interim action has been completed, it should be possible to hold firmly the great majority of prices without further adjustment.

Upon completion of its "interim" phase, the price-control effort should look to the development of a program geared to future requirements. The time is a particularly appropriate one, therefore, for considering what the central principles of such a program should be.

Principles for further price control. Generally speaking, stability of the general price level is a desirable objective. The exceptions to this rule occur (a) after a severe deflation when a general upward movement of the price structure is a necessary component of economic recovery, and (b) in a period when general downward price adjustments are needed to maintain maximum employment and production.

Since the Korean outbreak, neither of these extreme situations has occurred, and neither is foreseeable in the near future. A general upward movement has not been and is not now needed, because, broadly speaking, profits have supplied ample funds and incentives to sustain a level of business investment even higher than would be desirable. A general downward movement of prices, while very desirable from the viewpoint of consumers, would not be consistent with the business sentiment required for a vigorous expansion of production, especially in those commodities where rising costs have caught up with rising prices. Price stability is conducive to defense planning and to business planning. Also, the erratic behavior of consumers is minimized if they anticipate price stability.

After the general price freeze in late January, no further price action would have been urgent if price stabilization were the only objective to be sought. But price stability cannot be the only objective, since we cannot disregard other vital objectives such as equity and reasonable balance in the price structure and the maintenance and expansion of necessary production. These objectives depend upon some flexibility, even under stabilization. Consequently, in the period ahead, the question is not *whether* the pattern of ceiling prices will need to be modified, but rather *how* it should be modified and under what circumstances.

Formulae to allow prices in general to rise after a price freeze would be needed only if the freeze worked general hardship or inequity or operated upon the financial position or intentions of wide segments of business in a manner inconsistent with necessary productive expansion and fair returns upon investment and effort. Only if this happened or threatened would other objectives outweigh the gains to be derived from general price stability in a defense emergency. Since this contingency has not arisen and is not a foreseeable prospect, the problem now is not to devise formulae for general

price increases, but rather to take steps which modify the price freeze at those points where modification is urgent.

These modifications, however, should not allow the exceptions to obscure the general rule that the price line in the main should be held. Although some price increases are needed to restore balance or to provide incentives and encourage production, the argument that they are needed for this purpose is often pushed too far. Price stability, in the main, achieves equitable results and encourages production, by discouraging inventory speculation and thus tending to increase the output of final goods; by facilitating the system of priorities and allocations; by spurring cost reduction techniques; and by reducing the causes of labor disputes.

Some specific prices may have to be adjusted for reasons of fairness or in order to increase the flow of production of specific commodities, in which an expansion is particularly desired to promote the defense effort. A number of these price adjustments will relate to goods purchased by the armed forces, and will be made in the process of contract negotiation. Some of them, however, may be required in other goods as well. It may be necessary to upset old cost-price relationships which have been in relatively stable equilibrium, in order to achieve the dynamic result of expanding particular lines of production.

Finally, incentives to efficiency must be adequate to assure that resources will produce the maximum total volume of production. Under the price adjustments, efficient firms should be rewarded, not penalized. Treating all producers of a commodity as a unit should be helpful in this respect. In a few industries, notably some of the mineral industries, it may be so important to expand that special encouragement must be given to high-cost producers. Such encouragement should be given through carefully designed subsidies for increased production rather than through price increases.

The incentives argument always has an appeal, and in some cases quite validly so. But reasonable incentives do not require realization of the highest profit aspirations that anyone might be able to make good on in a free market under inflationary pressures. Nor should price be regarded as the retarding factor, in those situations where necessary production is in fact retarded by other conditions such as unavailability of materials or manpower. There are many instances where more careful programming, and more effective and expeditious allocations to the right places, will do far more to break bottlenecks in production than price increases, and with less danger to the structure of inflation control. In the main, price increases to provide incentives cannot be a general rule if there is to be effective stabilization. Such increases should be processed as special cases.

There will be pressures to raise other prices, particularly as various costs get out of line. Thus, a wage increase that is not accompanied by an equal or greater increase in productivity gives rise to pressure for upward price adjustments. It is clear that if prices are to be stabilized, wages must

be stabilized also. However, it does not follow that every increase in costs, whether of labor or other factors, must be followed by an increase in prices. If the upward spiral is not to continue indefinitely, it is important that this not happen.

If an industry, despite increases in costs, still has funds and incentives adequate or more than adequate to bring forth desirable production, price adjustments upward are in the main unnecessary. The absorption of increases in costs without price increases is a large part of the history of our industrial and technological progress, and is particularly important during a period when general price stabilization is essential. On the other hand, the denial of price increases to an industry or business which has not experienced cost increases may nonetheless be injurious to the defense program and the national economy, if that particular industry or business genuinely needs more incentives to do its job.

This does not mean that business costs are irrelevant to price policy; it does mean that the adjustment of prices upward or downward on an arbitrary basis in response to cost changes, without consideration of the over-all financial position of the industry or business after taking account of these changes, is much too narrow an approach to the basic issues underlying price adjustments under price control. The more appropriate approach is to take account of cost factors along with other relevant factors.

The machine tool industry is perhaps a good example of a case where the application of a cost formula did not provide adjustments needed in view of the vast expansion now required of that industry. The problem was met by the issuance of a special price regulation for machine tools, providing a liberal basis for the calculation of price adjustments.

The allowance of price adjustments on a more or less automatic basis to cover changes in costs is sometimes likened to cost-of-living adjustments in wages. But the resemblance is only superficial. Cost-of-living adjustments do not of themselves permit any increase in real wages; they simply recognize that price inflation is neither an equitable way of reducing wages nor conducive to high morale. Such cost-of-living adjustments are not inconsistent with other restraints which prevent wages from rising as they would rise in a free market under defense conditions which make labor very scarce. In contrast, the allowance of price adjustments on a more or less automatic basis, to cover changes in costs, regardless of profit margins, would probably tend to push profits higher and higher in ratio to other incomes, and would reject the principle of absorption of some cost increases which has been typical of American business progress.

To be sure, wages affect business costs, and consequently business prices cannot be stabilized if wages and farm prices move upward without restraint. This is one reason why an effective stabilization program must deal with wages as well as business prices. Nonetheless, stabilization efforts must move forward in each sector of the economy simultaneously, instead of

each sector waiting for some other sector to be completely stabilized first. A sound stabilization program should not permit further price increases to result automatically from cost increases, but instead should determine whether the cost increases are of a magnitude to impair adequate earnings related to production needs and incentives.

The foundations for this approach have been laid in the Economic Stabilization Administrator's letter of April 21 to the Director of Price Stabilization, outlining a longer-range price policy. This letter directs the price control agency, as a general rule after the completion of "interim" adjustments, not to permit any general increase in ceiling prices for any industry unless its present rate of profits before taxes is below 85 percent of its profits in the three best years in the period 1946 to 1949, adjusted for changes in net worth. This formula is based on the present excess profits law. The directive also ensures that future cost increases will be absorbed to a reasonable extent, and will not automatically form the basis for future price increases.

The Council is not in a position to evaluate whether this formula is correct in detail, or whether the profit level set forth in this formula is necessarily the most desirable one. The formula does, however, offer the prospect of putting price control on a more sustainable basis under current and foreseeable conditions. Since the formula is on an "industry" basis, it needs to be accompanied by standards permitting individual manufacturers to receive relief where they need it in line with production objectives or considerations of equity. Initial action has been taken in this direction.

As part of the transition from the interim stage of price stabilization just indicated, regulations tailored to the needs and complexities of different industries should be developed as rapidly as possible. This will have the added advantage of permitting more effective compliance and enforcement. In particular, it is necessary to develop many more dollars-and-cents ceilings, especially at the consumer level.

Thus, the Council feels that price policy should now focus upon holding the line in general, while specific energies should be dedicated to the swift working out of adjustments in those limited situations where additional production incentives are required and cannot otherwise be achieved, or where elementary fairness requires adjustments in limited instances. While some rollbacks may be essential, and while some other actions may be needed for equitable reasons, they should not be allowed to divert energy from the policy of holding the price line in general. This policy would in the judgment of the Council commend itself to the public and serve the needs of the kind of defense mobilization now under way.

A coordinated relationship between price and production controls is necessary to assure that they do not work at cross purposes. Production controls should be used to facilitate stabilization. During World War II, a serious problem was the dropping of low-priced lines and their upgrad-

ing to higher price lines. This was particularly troublesome in apparel and house furnishings. Up to now, the problem in these fields has been the large rise in prices generally, rather than the dropping of low-priced lines. However, this problem may appear first in consumer durable goods, with heavy cuts in civilian uses scheduled for steel, copper, and aluminum. This problem bears close watching. The need for such coordination has been recognized in a directive of January 26, 1951 issued by the Director of Defense Mobilization, which instructs the production agencies to cooperate with the OPS in ensuring an adequate supply of essential and low priced consumer goods.

One of the most inflationary sectors of the United States price structure since the Korean outbreak has been the extreme rise in basic imported raw materials. Basic raw materials form the group whose prices are most sensitive to changes in demand. It is obvious that, as long as these are free to move, they are a source of great difficulty in holding the price line, and in keeping down the cost of the defense effort. At present, most of these prices are below the peaks reached early this year. However, as long as world-wide demand for these products continues greater than normal because of the mounting defense program of the free world, there is always the possibility that they will resume their upward flight.

In the case of these commodities, we are faced with a real dilemma. We can put rigorous control on their prices when sold in the United States. But if we do so, we run the risk that the domestic level will be enough below the world level to prevent us from obtaining an adequate supply. If we follow rising world prices, we introduce a major factor of instability into our economy. Ideally, international allocation at reasonable prices would achieve effective stabilization, and assure the free nations of a fair share of these basic commodities. These problems are being discussed at a number of international conferences, with a view to arriving at the best methods of handling these problems. The international allocation agreements recently arrived at for tungsten and molybdenum include price provisions.

Meanwhile, in two cases, tin and natural rubber, the United States Government has taken over the importing function. Prices of these commodities have declined, in part because of the more orderly buying procedures, in part also because of the lower levels of current United States purchasing. In the event, however, that international agreements cannot be arrived at, and the price rise of imported materials is resumed, it may be necessary to use subsidies in some cases to prevent unfavorable repercussions on the domestic price levels.

Subsidies and food prices

The major function of price in a free economy is to induce the production of the goods desired by the people, in the volume they demand and are

willing to pay for. When, as at present, circumstances require that prices be put under control, one of the major principles determining price policy is the achievement of maximum production, particularly of goods most needed for the defense program. Another method of stimulating production, which is an alternative to higher prices, is for the Government to pay the producer a subsidy in addition to the price he receives from his customers. The funds to pay subsidies come out of Government revenues, that is, out of taxes instead of out of prices. In some kinds of situations, the granting of subsidies is preferable as a production stimulant to permitting price increases, while in other kinds of situations subsidies are undesirable.

The clear occasion for the use of subsidies to induce needed production is where it is necessary to secure supplies from high-cost sources of production, which will not respond to the price offer which is bringing the bulk of the needed output into the market. Where the high-cost producer can be clearly identified, and it is therefore possible to determine the differential in price which is required to cover his extra cost, the subsidy payment is not only permissible, but it is an excellent method to obtain additional supplies. If a market price of $1.00 per unit is high enough to lead to the production and sale of 1 million units of a necessary commodity, but the production of an additional 100,000 units would require a price of $1.25, there is no justification in a period of emergency for permitting a demand for 1,100,000 units to bring about a market price of $1.25 for the entire supply, if it is possible to pay the extra 25 cents only to those who are burdened by the higher cost.

The need for use of subsidies to minimize market price increases becomes more acute as the pressure of demand upon scarce supplies builds up, and as increasingly high-cost sources of additional supply have to be tapped.

The principle of differential subsidies to marginal supplies is particularly applicable, and it should be applied freely, in the case of minerals. High-cost mines can be brought into production in most mining fields if a higher price is paid. Current output, yielding a satisfactory profit at current prices, will continue without an increase in price, and the mine operator should not be given windfall profits because the national need for additional supplies in an emergency period compels the payment of higher prices for additional supplies. The high-cost production can be identified, the amount of additional payment therefor can be determined, and it should be paid in the form of a subsidy while the general market price is held.

The same policy is proper in the case of imported commodities, both minerals and other goods. Where higher-cost imported goods must supplement the domestic supply of the same commodities in order to meet essential requirements, the domestic price should be held and subsidies in the necessary amount should be paid to the importer. The high-cost supplier is, in such a case, easily identified, and the necessary differential is readily determined. The policy may well be extended further with respect to some

imported goods, where they constitute the entire supply and are important elements of cost. In order to limit the effect upon the cost of domestic production into which foreign materials enter, it is sound policy in some cases for the Government to fix a low price on the sale of imported materials and to absorb the loss. These policies were applied in many cases during World War II.

The question has also arisen as to whether subsidies should now be used generally to hold down the price of food, by making payments to farmers in lieu of price increases which otherwise might be necessary to obtain an adequate volume of farm production.

First of all in this connection, it is necessary to say something about farm prices and incomes in general, and about the national policy of farm parity and farm price supports.

There has been some tendency in recent years to misinterpret the trend of farm prices and farm incomes. Farm prices are more volatile than many other prices, and respond more sensitively to market changes. While they have at times moved upward more rapidly than other prices, they tend to move downward much more rapidly whenever any softening occurs in the general economic situation. Farm income declined much more rapidly than other major incomes in the 1949 recession, and even though farm income has risen substantially in the past year, a case can hardly be made that, by sound criteria, farm income as a whole is high in comparison with other incomes, although there are exceptions in the case of some farm commodities.

This being the case, there would seem to be no reason to tamper fundamentally with the parity principle, even in the course of the stabilization effort. Even in that effort, a fair relationship among groups should be maintained, and the parity principle does not operate to confer unjust benefits upon farmers as a whole.

Insofar as farm prices rise above parity, they can be subjected to controls the same as other prices, except where this is prevented by special legislation. The Council does not favor such special exemptions.

This brings us to the view that the maintenance of the parity principle, and of the customary farm price support program, is not inconsistent with effective stabilization on a fair basis. Parity prices of farm products rise and fall with the index of prices paid by farmers. If nonfarm prices are held, the parity index can rise only to the extent that there are increases in prices of feeds and other farm products bought by farmers. Insofar as the price of food to the consumer is determined by many other factors besides the price paid to the farmer, the effort to stabilize the consumer's food prices cannot be limited to a consideration of farm prices.

Since the stabilization effort should be permitted to control farm prices when they shoot above parity, the only sound basis for refraining from such control would be if higher prices are necessary to stimulate an adequate

volume of farm production. The case for subsidies, therefore, must rest on the ground that it is better to hold the farm price line and pay subsidies to stimulate the needed production. There was such a program of food subsidies during World War II, applying particularly to meat and dairy products, which involved payments of about 4 billion dollars. The rationale of this program was that it was necessary to prevent the spiralling effect upon wages and other costs of production if higher prices were paid for these food commodities in order to bring about the necessary volume of supplies. The record made a good case for the argument that the cost of the food subsidies was very much less than the cost in higher prices to consumers would have been, if market prices had been relied upon to bring forth the necessary goods.

However, a uniform subsidy, paid to all producers of a commodity in general use, should not be hastily substituted for a rise in price as an incentive to adequate production for a period of partial mobilization as long as now is in contemplation. It is more appropriate to an emergency situation of seemingly more defined length, and when the pressure on supplies is more similar to the World War II situation than is now the case.

At this time, it would not be prudent to embark upon a program to pay general food subsidies. There is now no marked deficiency in the supply of foods. The necessary increase in food production requires the liberal fulfillment of the needs of farmers for machinery, fertilizer, and labor. Supplying these needs, which we have ranked as equal with any of the demands of the defense program, is under present circumstances sounder than a general program of subsidy payment. Under changed circumstances, it would be appropriate to consider general food subsidies. The Council's analysis points to the danger of renewed and increased inflationary pressures. The recent floods are a reminder that food supplies are never certain. As the President said in his Message of April 26 to the Congress: "If we find that we cannot hold the line on food prices with powers recommended here, we shall need to consider legislation authorizing the use of other devices, including limited food subsidies, to prevent necessary price increases from being reflected in rises in the cost of living."

Wage policy

Discussion of wage stabilization policy should differentiate clearly among three main aspects of the wage problem. These three aspects are: wages as an incentive and reward to workers for their efforts and as a factor in the movement of manpower; wages as a factor in consumer purchasing power; and wages as a major element in business costs. The difficult problem of wage stabilization is to achieve a wage policy which will permit wages to perform their function as incentive and reward for production and treat workers fairly, while holding to a minimum the contribution of wages to higher prices. Wage increases may contribute to rising prices in two ways,

by adding to consumer spending power and by adding to business costs.

In considering wages as incentive and reward to workers, and as a factor in consumer purchasing power, it should be remembered that there are three distinct approaches to holding down consumer demand: (1) prevent incomes from rising, (2) siphon off income through taxation, and (3) encourage larger savings. All three are needed in a stabilization program. The problem of wage stabilization is sometimes discussed as if the first of these approaches were the only one available to hold down the demand of workers for consumer goods to the supplies available. But this imposes an impossible burden on wage policy, for it might follow that there should be no increase in the total of real wages during the next year or so, since consumer supplies cannot be increased appreciably due to the defense effort. Such a wage policy would be unattainable in fact, and insupportable even if it could be attained. With the employed growing in number, and with hours increasing in some industries, such a policy would require both a reduction in wage rates and a reduction in the real earnings of the average employee. This would be incompatible with the concept of wages as an incentive and reward to workers, or with fairness or industrial peace. In an expanding economy, it would result in other types of income moving forward while individual wages were reduced. It would represent a decision that, if a large portion of total income throughout the economy must go into savings to prevent inflation, only an unduly small fraction of this saving opportunity should accrue to wage earners. And such an unworkable policy, as applied to wages, would be compounded by the fact that increased personal income taxes cut heavily into take-home pay in any event.

Consequently, the essence of sound wage stabilization is to place considerable restraint upon swelling wage incomes, but not to impose such restraints as would disregard the function of wages as a reward and incentive for employees.

For the kind of partial mobilization period which now confronts us, the major elements in a sound wage stabilization policy seem to be the following:

First, Government action under current conditions should be directed toward restraining wage increases of the magnitude which an economy operating at such high levels of production could afford, if the defense output were not so great as to cut into rising standards of living.

Second, wage adjustments should be approvable at regular intervals to cover past increases in the cost of living. Maintenance of real wages during inflation cannot in fairness be disallowed. It is unlikely that any free government can successfully hold wages rigid if it is not successful in holding the line on the cost of living; and insofar as that line is held, the so-called "escalation" of wages is reduced to minor significance. As a corollary of this, however, it should be frankly recognized that "escalation"

of wages does become one of the moving factors in the spiral of inflation *if* the cost of living is not substantially stabilized; and, therefore, holding the line on the cost of living is essential to stabilization on the wage side as well as on the price side.

Third, a more difficult problem is presented as to whether wage increases should be permitted to reflect increases in productivity. Many workers, for example, those paid on a piece-rate basis, already receive higher wages when their productivity increases. Farmers and businesses receive higher incomes as their productivity increases. Neither production nor morale would be furthered, if large segments of workers were denied a return for their contribution, and they do make a very real contribution, to increased productivity.

However, if no restrictions whatsoever were placed upon wage increases based upon "productivity", wage stabilization would become almost impossible. Wage increases of any size might be negotiated and denominated as "productivity gains". Such gains, first obtained in particular sectors of the economy, would under a stabilization program tend to become generalized throughout the economy. Restraints need to be put on wage increases of excessive magnitude, because if such large wage increases became a general pattern, they would build up excessive inflationary pressure on the consumer side. In addition, while they might not require price increases in some strongly situated industries, they would when generalized require price increases in many other industries. Thus, in allowing productivity gains, certain safeguards merit consideration. In the first place, some limits should be set upon the size of these arrangements, and effort should be made to relate them to realistic appraisal of the amount of lowered unit labor costs. In the second place, more leadership and effort should be directed, not only toward providing just reward for increased productivity, but also toward doing everything possible to *achieve* increased productivity. Both labor and management can make great contributions toward this end. The Government may legitimately encourage them to do so, when the national need is imperative, and when the Government in the course of a wage stabilization program is being asked to allow incentives toward this end. In the third place, so long as there cannot be a general expansion of consumer goods, a policy of allowing productivity gains should be combined with efforts to stimulate voluntary plans for translating at least a portion of these increments of income into savings rather than into immediate spending. The possibilities along this line have been very inadequately explored, and much more vigor should be directed toward them.

Fourth, the wage freeze of January 25 generated a wide variety of inequities, many of which have not yet been eliminated. Obviously, the Wage Stabilization Board should seek to define types of inequities so that such situations can be dealt with promptly under uniform general policies.

However, not all cases of hardship or inequity can be anticipated by general regulations. If the mandate of Congress is to be followed, there must continue to be some independent appraisal, unless the claims of hardship or inequity are to be summarily dismissed.

Fifth, fringe benefits, such as private pension plans, should not be treated in the same category as wage increases, because they do not result in an increase in take-home pay, and consequently do not enlarge the immediate spending stream. They have the advantage of providing scope for collective bargaining, which is limited in other respects under a stabilization program. However, while fringe benefits do not add immediately to inflationary pressures on the consumer side, they are not generally needed to stimulate production, and, consequently, they should be held within a range where they do not add sufficiently to business costs to require price increases. This requires consideration, not only of whether a particular business can grant fringe benefits without cost increases, but also whether the general business area into which these fringe benefits are likely to expand quickly if started in one place can absorb them without price increases.

A wage policy along these general lines would cause total wage incomes to rise moderately during the next year or two, during a period when goods available for consumer use cannot be increased substantially because of the size of the defense program. But this disparity, if it is not permitted to become excessive through too loose a wage policy, should be corrected through appropriate tax policy and through inducements to voluntary saving. To try to handle the whole problem through an excessively restrictive wage policy would lose more by way of production incentives and worker morale than it would gain by way of stabilization. A balance must be struck between production and stabilization objectives, between necessary restraint and necessary incentives.

There remains to be considered the question of whether a wage policy along these general lines would be consistent with reasonable price stability. The answer to this question calls for analyzing separately the different phases of wage policy. Productivity increases, surrounded by the general safeguards suggested above, and held in the neighborhood of the average productivity gain for the economy as a whole, should be capable of absorption without price increases in most industries. That is the meaning of a genuine productivity gain. Fringe benefits, as has been indicated, should be held to a size that can be covered by business earnings without price increases; if the cost of private pension plans and similar devices needs to be passed on to the general consumer, then it would be better to finance such protection through taxes and embody it in the public social security system. Cost of living adjustments are required for reasons of fairness, whether or not they involve price increases; but if the cost of living line is held, this problem should not be substantial. In the case of wage adjustments to correct inequities and

substandards of living, or draw manpower into essential production, these actions need to be taken whether or not they necessitate price increases. In these instances, if properly administered, the necessity for the wage increases to help the economy to function efficiently outweighs the desirability of absolute and inflexible price stability. In general, if price increases are granted only where earnings are inadequate to stimulate production, and are not granted automatically whenever certain cost increases occur, the pursuit of the general wage policy indicated above would be consistent with the achievement of the price stabilization policy previously discussed.

The Council is fully aware of the difficult administrative and policy issues which have thus far prevented the development and enunciation of a rounded wage policy. The thorny issues confronting the Wage Stabilization Board should not be minimized.

Allowing for this, the Council feels that the further clarification of wage policies, toward which the Wage Stabilization Board is moving, is in the best interests of labor, management, and the general public. It would protect workers from the popular misimpression that wage stabilization is being undermined whenever there are departures from early regulations which were not intended to be a complete or durable wage policy. It would afford management a greater sense of stability regarding the general contours of wage developments than is possible so long as each major case tends to be construed by a part of the public as a new wage policy outside of any central frame of reference. It would be helpful to the informed public by providing a complete statement of wage policies just as soon as it can be formulated.

Such a statement would not deprive the Wage Board of its ability to handle new and hard cases on a pragmatic basis. It would not stultify collective bargaining, but on the contrary might make clearer the ambits within which collective bargaining can make a great contribution to the defense effort. It might even leave more play for collective bargaining than is now the case, by highlighting a few ground rules consistent with stabilization. The development of such a statement would not even prevent changes in wage policies, whenever new experience or altered conditions dictated the need. In a full-scale war, wage stabilization may command a degree of public support which permits each new case to be handled on a purely *ad hoc* basis. But wage stabilization in a partial mobilization does not automatically command that degree of public support. It can win that support only if it makes clear to the public at large the underlying reasons for what it is doing, and the soundness of these reasons in terms of the well-being of the economy as a whole. In the judgment of the Council, there is no way, short of a rounded and defined statement on wage policies, to accomplish this vital objective.

Savings programs

The degree of inflationary pressure that results from an excess of disposable income over the available volume of goods depends largely on the rate of voluntary personal saving. In general, the higher the rate of saving, the less the inflationary pressure. The form in which accumulations of personal savings are held is also important. If savings are invested in homes or in the physical assets of businesses, they become a source of demand much as if they had been spent on consumer goods.

The fraction of his income that an individual will save depends on various personal and social factors. Judging from past experience, if the proper atmosphere of price stability is maintained, campaigns to promote additional saving can have considerable effect in increasing the savings of certain groups and, accordingly, the total amount of saving. The rate of saving is also increased by shortages of some goods and by various kinds of direct controls. A higher rate of personal savings which results from this cause does not in itself reduce inflationary pressure; it merely measures or reflects the success of the controls. It is particularly important that such savings be converted into savings bonds or similar assets to hold down their future inflationary potential.

Some types of assets are more liquid than others; and it is desirable that as large a part of additions to saving as possible be converted into those types of financial assets which are least likely to be converted into demand for goods in the short run. Savings bonds are an especially suitable form of investment for this purpose, particularly since there is an incentive—in the form of a gradually increasing effective rate of interest—to hold these bonds to maturity. The campaign to promote the sale of United States savings bonds to individuals, particularly through payroll deduction plans, should be accordingly broadened and intensified. Bond campaigns add to total saving, and serve to convert holdings of money into less liquid assets.

Credit controls, by holding down the growth of consumer credit, can contribute to a high net rate of personal saving. Moreover, repayments of previously incurred debt also contribute, since a decrease in the volume of total consumer credit is made possible in most cases by less spending out of current income, that is, by positive saving.

The world-wide problem of inflation and stabilization

It was pointed out early in this Review that, in the past year, the price inflation generated by the rise in world demand has gone much further in most other countries than in the United States. (This fact is shown in table 11 and in appendix table B–27.) In Western European countries increases in wholesale prices since the Korean outbreak are, in 13 out of 16 cases, 20 percent or more, and in 7 they are 30 percent or more. This contrasts with 16 percent in the United States. Because the economies of

TABLE 11.—*Range of wholesale price increases in foreign countries since June 1950* [1]

Range of percentage increases	Number of countries in range		
	Total	Western Europe	All other
0 to 9	9	1	8
10 to 19	13	2	11
20 to 29	12	6	6
30 to 39	10	7	3
40 and over	2		2

[1] To the latest date for which data are available.

Source: Appendix table B-27.

these countries have been under great strain, and because in some of them the political and social situation is tense, inflation raises not only the question of equitable distribution of the economic burden of defense; it also raises the grave question of the ability of their governments to carry through the needed defense programs and maintain political stability. Similar questions affecting political stability and the security of the free world also arise from the acute inflations in some of the countries outside Western Europe.

This whole complex of questions is one of our major national security problems. The President's request for economic aid for foreign countries is designed to take it into account. The foreign aid program, however, can alleviate only the worst of the strains on the economies of countries receiving aid. Even with it, these countries will remain subject to intense inflationary pressures. In many of them, the rise in domestic prices has substantially exceeded the rise in the prices of the goods they trade in world markets, indicating that a considerable element of the inflation has been of domestic origin, even though it may have been set off by events which occurred outside. But in many other countries, the pressure comes mainly from world prices which they are powerless, individually, to control by purely domestic policies. It should be realized that in many countries, for example most of those in Western Europe, the value of merchandise imports or exports prior to the post-Korean price rise amounted to between one-fifth and two-fifths of their gross national products. This contrasts with less than 4 percent in the United States, where the influence of prices for foreign-traded goods is much less important.

The main burden of dealing with these pressures must fall upon the individual countries themselves. In Western Europe, the problem is particularly difficult because, in nearly all cases, the monetary inflation has been accompanied by a deterioration in the terms of trade which tends to reduce the supply of goods available for domestic use. Nearly all the Western European countries have taken action to restrict credit. In many of them tax revenues (including local government and social insurance taxes) already amount to about one-third of gross national product, contrasted

with about one-quarter in the United States. In some other cases, tax administration constitutes so serious a problem that tax increases of a type which would not raise the cost of living and set off new wage demands might be ineffective, and the governments concerned are not in a position to solve the problem of administration quickly. These are the very countries which have suffered sustained and progressive declines in the value of money over a long period of time and in which, consequently, the public willingness to save (in forms other than goods) is weakest and the reaction of expectations of price rises is quickest.

In view of this difficult situation, plus the fact that the basic problem is a general excess of world demand over supply, anti-inflationary action by all free nations is desirable. The knowledge that other nations were engaging in similar action would give each nation greater confidence that its own efforts would not be futile. The United States can greatly assist in the success of such a free world effort. As by far the largest single consumer of the world's production and the major importer of world-traded goods, we can exert great influence upon inflationary pressures. If we do not, only limited success can be attained by other nations. Thus, international considerations greatly reinforce the already strong domestic need for vigorous anti-inflationary action. In addition to action by example, the United States should exert its influence through international organizations, and in any other ways it properly can, to persuade others to take vigorous anti-inflationary action.

IV. Detailed Economic Developments During the First Half of 1951

After general control of prices and wages was ordered on January 26, 1951, the forces of the free market were limited in dominating and directing the course of the economy. While consumers and businessmen have been but little restricted as yet in making their own choices as to the volume and direction of their expenditures and investments, their decisions as to employment, production, and investment are no longer based upon the expected normal effects of free market forces.

The Expanding Economy

The measurement of the economy's production, in money terms, is found in the estimate of the gross national product, which is the sum of expenditures for personal consumption, for private domestic investment, for government purchases of goods and services, and for net foreign investment. All of these items being money figures directly affected by changes in prices, they must be recalculated in constant prices in order to derive an index of the volume of goods and services actually produced.

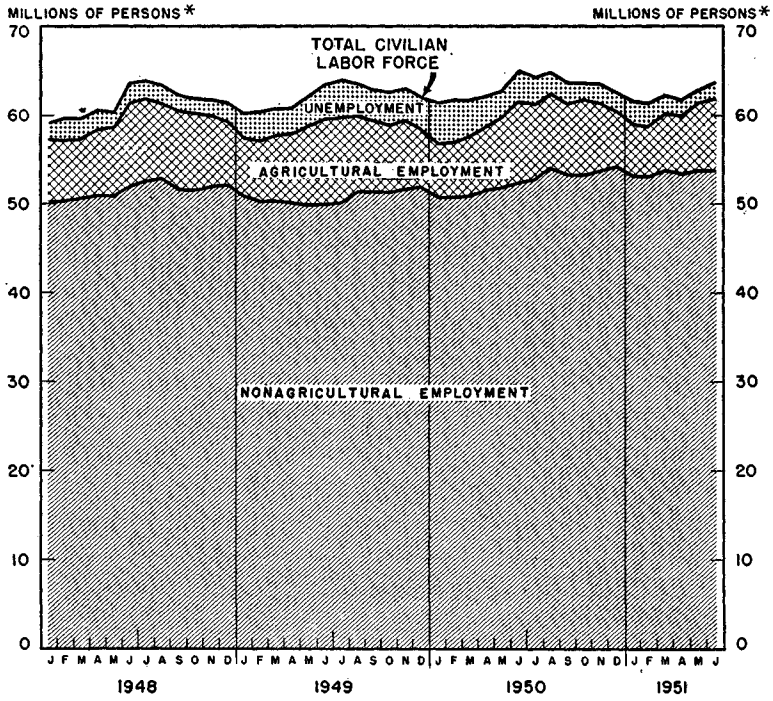
In the second half of 1950, rising prices and rapidly increasing production combined to accelerate the rapid increase in gross national product which accompanied the recovery from the recession of 1949. In the second quarter of 1950, gross national product in current prices rose to the record level of a seasonally adjusted annual rate of 275 billion dollars. In the third quarter, it sprang upward to 287 billion, and in the fourth quarter to 304 billion. The rise in the first quarter of 1951 was almost equally rapid, to 319 billion, and the estimate for the second quarter is 329 billion. (See appendix table B–1.)

About three-fifths of the increase in gross national product in the first quarter of 1951 was due to price changes. The real growth in the economy in that period was about 2 percent. The estimated increase of about 10 billion dollars in the annual rate of gross national product in the second quarter requires much smaller adjustment, price changes having been much less rapid, and a real growth in the neighborhood of 3 percent is indicated. (See appendix table B–3.)

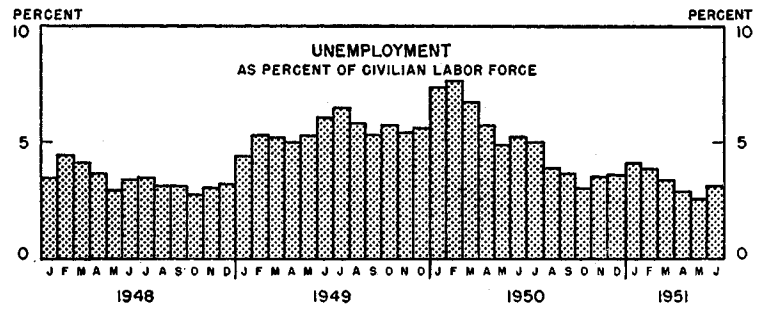
CHART 25

CIVILIAN LABOR FORCE

Since mid 1950, the civilian labor force has not increased, largely because men were being drawn into the armed forces. Nonagricultural employment has increased 2.1 million from the first half of 1950 to the first half of 1951, while agricultural employment has declined.



Unemployment, as a percent of civilian labor force, followed a declining trend from the February 1950 high of 7.6 percent to a postwar low of 2.6 percent in May 1951.



*14 YEARS OF AGE AND OVER.

SOURCE: DEPARTMENT OF COMMERCE.

Employment

There has been a considerable increase in employment and in the number of persons in our labor force since the Korean outbreak. In the first half of 1951, the total labor force, including the armed services, averaged about 1¼ million higher than in the first half of 1950. Only about ½ percent more of the population 14 years old and over were in the labor force in the first half of this year than in the first half of 1950. (See chart 25 and appendix table B–11.)

Civilian employment averaged 60.2 million in the first half of 1951 and reached a level of 61.8 million in June, which represents an increase of 300,000 workers over June 1950. Since January of this year, due mainly to the seasonal increases characteristic of agricultural employment, civilian employment has increased 2.8 million.

Nonagricultural employment, after expanding rapidly in the last half of 1950, has been relatively stable. At an average level of 53.4 million during the first 6 months of 1951, nonagricultural employment was 2.1 million higher than during the same period a year before. It is now at a level of 53.8 million workers, having increased 800,000 in the first 2 months of the year, after which it remained steady. The rise from January to June was largely the result of a seasonal increase in construction.

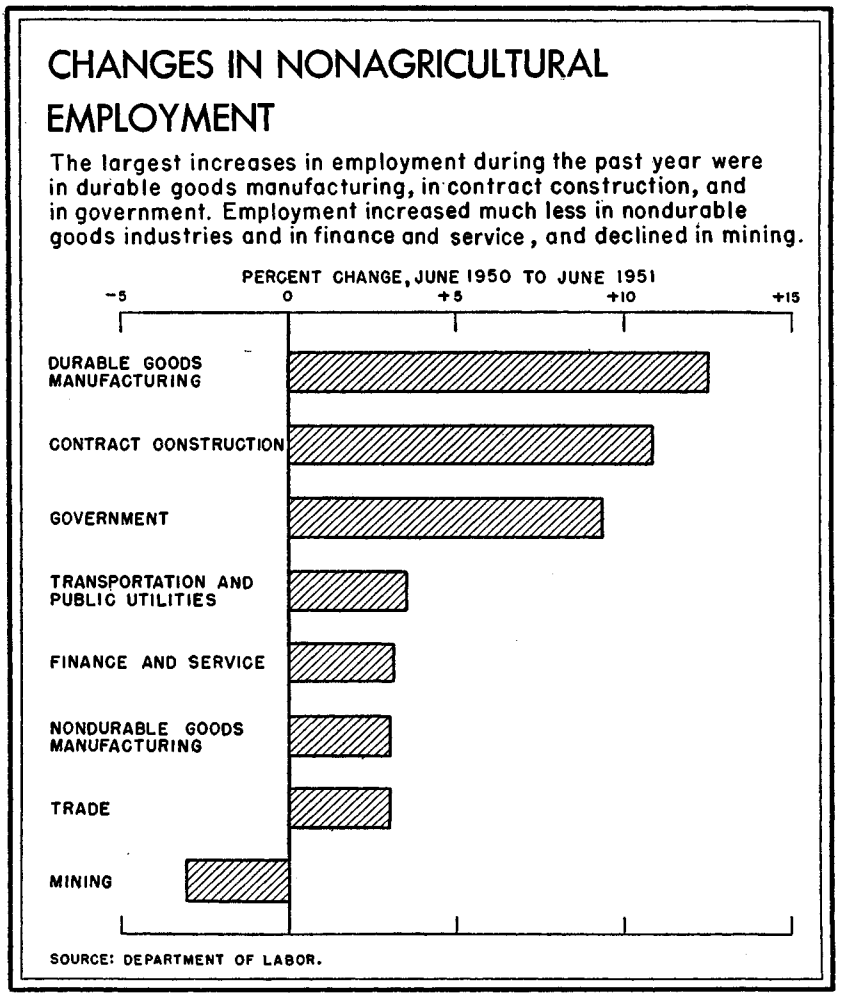
Despite the increased demand for food and fibers, agricultural employment has continued its long-run decline, averaging 500,000 lower during the first half of 1951 than in the comparable period a year before. In June about 8.0 million persons were engaged in farm work, this being a period of high seasonal farm employment. However, this level is more than a million lower than in June 1950.

The build-up of the armed services was the most significant development affecting the labor market during the first half of 1951. Although the total labor force expanded substantially because of continued increases in the armed forces, the civilian labor force averaged 62.3 million during the first half of 1951—about the same as in the first half of 1950.

Despite the new labor market demands arising from mobilization, there is not now a general manpower shortage, although a few important labor market areas are tight. The most pressing manpower problem arises out of shortages that prevail in certain key, skilled occupations, notably those in metal-working industries. There are also serious shortages within the professions of doctors, dentists, and nurses, and many kinds of scientists and engineers.

Manufacturing employment averaged 1.7 million higher during the first 6 months of 1951 than in the first 6 months of 1950, both durable and nondurable goods industries showing increases. The larger increase was during the second half of 1950. The smaller gains this year, which brought total

CHART 26



manufacturing employment to a level of 15.9 million persons in June, have been almost entirely confined to industries manufacturing durables. Employment in contract construction during the first half of 1951 was 360,000 higher than a year ago, and employment was up the same amount in trade. Government employment exceeded the level during the comparable period last year by 425,000. (See appendix table B–12 and chart 26.)

There was a considerable lengthening of the average workweek during the second half of 1950. During early 1951, however, changes became very irregular. From June 1950, the average workweek in manufacturing industries increased from 40.5 hours to 41.4 in December, and then dropped to 41.0 in January. During the first half of 1951 it remained close to that level. Hours in duarble and nondurable manufacturing showed contrary trends.

While average hours in durable manufacturing varied between 41.5 and 42.0 a week during the first half of 1951, indicating that a considerable amount of overtime was being worked, hours in nondurable manufacturing declined from 40.2 hours a week in January 1951 to 39.4 during June. (See appendix table B–13.)

In contrast to the overtime scheduled in some industries, about 9.8 million persons were working less than 35 hours a week in February 1951. However, the majority of these were employed part-time through choice. Only about 1.1 million persons with full-time jobs were on reduced work schedules because of economic factors. Pointing up the vast improvement in the general labor market situation over the past year, the proportion in this part-time group who were working shorter hours because of cutbacks resulting from declines in business activity dropped to 46 percent in February of 1951 from 61 percent in November and 80 percent in February 1950. On the other hand, roughly 40 percent of the group working part-time in February 1951 because of economic reasons were on reduced hours because of material shortages, compared with around 10 percent in the same period of 1950.

Unemployment

The increase in employment in the first half of this year over the first half of 1950 was made possible primarily through a reduction of unemployment rather than by net additions to the civilian labor force. During the first 6 months of last year, unemployment averaged almost 3.9 million. It averaged only slightly over 2 million during the first 6 months of this year, a reduction of almost 2 million in the number of unemployed. In May 1951, unemployment at 1.6 million had reached its lowest postwar level. There was, however, a seasonal increase in June, mostly students hunting for summer jobs, which brought the total number of persons unemployed to almost 2 million. (See chart 25 and appendix table B–11.)

There have been some instances of unemployment resulting from conversion to defense production, although to date none has developed on a large scale. In most cases, displaced workers have had no difficulty in finding other jobs. With unemployment at its present low level, and new jobs continuing to open up, conversion unemployment should not reach serious proportions.

In addition to the decline in unemployment from the first half of 1950 to the first half of 1951, there have been important changes in the duration of unemployment. In June 1950, the average duration of unemployment for those persons who reported they were unemployed at the time of the survey was 12 weeks. In June 1951, the average duration was 8 weeks. In the first half of 1950, about 37 percent of the unemployed reported that they had been without work for 4 weeks or less; in the first half of 1951, almost 50 percent of the unemployed had been without

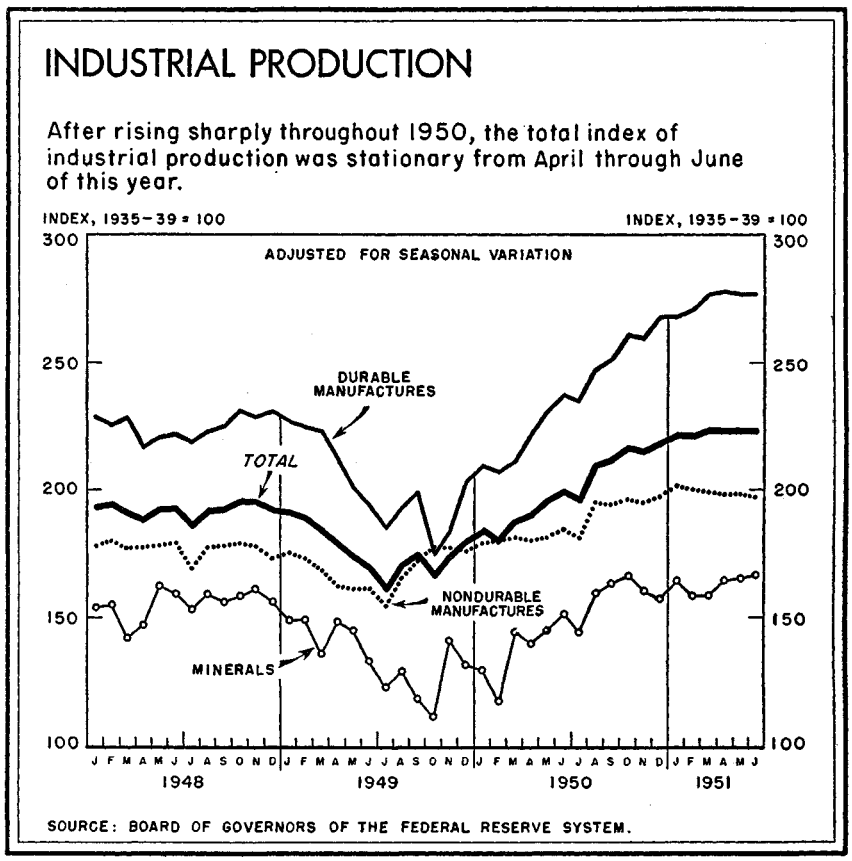
work for 4 weeks or less. The "hard core" of unemployment also declined: in the first half of 1950, 11.6 percent had been without work for 26 weeks or more, but in the first half of 1951, less than 8 percent had been without work that long.

Unemployment compensation claims reflected the drop in unemployment. From a weekly average of around 245,000 initial claims in June 1950, they dropped to about 195,000 in June 1951. Total weeks of unemployment claimed dropped by almost 40 percent from June 1950 to June 1951. In June 1950, they averaged about 1,565,000 a week, but in June 1951 the weekly average was around 945,000.

Production

The total output of goods and services (i. e., the gross national product corrected for changes in prices) reached record postwar levels in the first half of 1951, and was about equal to the peak war year of 1944. (See chart 13, page 61.)

CHART 27



Industrial production

The index of industrial production, which was 199 in June 1950 (1935–39=100), four points higher than the highest level reached in 1948, dropped to 196 in July, and then advanced rapidly as business was invigorated by the pressures of semimobilization policies. It reached 218 in December; and in January 1951 the advance to 221 marked continued substantial progress in economic expansion. After remaining at that level in February, the index rose to 222 in March and to 223 in April, where it remained for 3 months. (See appendix table B–17 and chart 27.)

The stability of industrial production since March reflects a combination of three factors affecting various industries. Some industries had reached practical capacity, and could expand only slowly. Some were affected by restrictions on the use of metals. Finally, some industries were unable to find markets for greater output.

Table 12 compares the May output of several industries with peaks reached since the beginning of 1950. The particular industries listed in table 12 were selected because trade comments suggest that the decline in output in these cases probably was due to the inventory situation or to a weakness in current demand rather than to a shortage of raw materials.

TABLE 12.—*Output of selected industries, May 1951 compared with 1950–51 peak*

[1935–39=100, adjusted for seasonal variation]

Industry	May 1951	1950–51 peak		Percentage decline from peak to May 1951
		Index	Month	
Furniture	175	198	October 1950	11.6
Cotton consumption	163	175	March 1950	6.9
Rayon deliveries	378	397	December 1950	4.8
Carpet wool consumption	[1] 138	228	October 1950	39.5
Apparel wool consumption	[1] 157	179	October 1950	12.3
Shoes	110	133	September 1950	17.3
Confectionery	[1] 128	158	August 1950	19.0
Malt liquor	157	185	January 1950	15.1
Whisky	117	178	March 1950	34.3
Cigars	105	127	March 1950	17.3
Bituminous coal	126	151	January 1950	16.6
Anthracite coal	81	108	March 1950	25.0

[1] April 1951 data.

Source: Board of Governors of the Federal Reserve System.

Irregular increases were registered in the durable goods sector through the first quarter of this year. The expansion occurred chiefly in those industries producing directly or indirectly for the defense program. Producers of machinery continued to increase their output sharply. The iron and steel industry produced at record levels while continuing to add to productive capacity. Production of two other basic metals—aluminum and copper—increased. In the first quarter of this year, primary production of aluminum was about 12 percent above the average for 1950. The industry produced at the full capacity of active plants, and productive capacity was being increased through reactivation of plants used in the

last war as well as through new investment. Output of refined copper showed a limited increase, with production 2 percent higher than in 1950. The aircraft and shipbuilding industries continued to expand rapidly. Freight car production increased from a level of 5,700 cars in December to about 7,000 in March. In the second quarter, the volume of production had reached the level of current capacity in some of the basic industries. Output of machinery, of nonferrous metals, and of iron and steel has remained about stable since March.

Consumers' durable goods production generally has fallen considerably since the beginning of 1951. In the first quarter, most consumer durable goods industries, although at a high level of production, were below the peak levels of output of the second half of 1950, when the upsurge of consumer demand pushed production to record highs. In the second quarter, there were cutbacks in the output of most major products, the largest decline being in television sets.

The total output of nondurable goods has declined somewhat since the beginning of the year. There has been a steady rise in the output of chemicals and allied products, largely synthetic rubber and industrial chemicals, under the impetus of defense needs. Output of textiles, however, has fallen, in part as a result of strikes in the industry in the spring, and also because of easing of consumer demand.

Average output of minerals in the first half of 1951 showed a small rise from the second half of 1950. Crude petroleum production has been at record levels, with output at over 6,000,000 barrels a day since early April. The mining of iron, copper, and zinc has also increased.

Output of electric power has been well above last year, but in the second quarter of 1951 the margin of increase over 1950 fell below that of the first part of the year.

Agricultural production

Domestic supplies of foods in the coming year will probably be at least as great as those of last year and fully adequate to meet normal requirements. The problem is the unusually high demand for meats and other relatively expensive foods. A further increase above the already high levels of meat production would either reduce our feed supplies or require an expansion of feed production.

The July 10 crop report indicates that prospects for 1951 crops improved greatly since the previous month. The total planted acreage is the largest since 1933, and present indications are that yields may be among the largest in recent years. The wheat crop is expected to be well over 1 billion bushels, and greater than the crop of last year. The corn prospects are especially good, present indications pointing to a crop of 3.3 billion bushels compared to 3.1 billion bushels last year. Cotton acreage this year is 58 percent greater than last year's small acreage, and is almost a million acres more than called for in the agricultural guides.

Services

Personal expenditures (corrected for price changes) for services rose about 1½ percent from the second half of 1950 to the first half of 1951. This compares with an increase of over 2 percent from the first to the second half of 1950. (See appendix table B–3.)

Prices

The year 1951 opened on a floodtide of price increases resulting from heavy buying that followed the Chinese intervention. The rise was almost as rapid as that which occurred in July, following the first outbreak in Korea, and it spread more generally through the price structure. To halt the upsurge, a general price freeze was imposed on January 26. By mid-February, prices had leveled off; and while there were moderate uptrends in some markets and downtrends in others, they remained remarkably stable for the next 2½ months. In the second quarter, some easing in prices developed as consumer spending dipped moderately and as businessmen became concerned about the rate of accumulation of inventories.

Since Korea, the major movements in prices have been as follows: from June to the issuance of the General Ceiling Price Regulation in January, consumers' prices rose 6.6 percent; the monthly index of wholesale prices rose 14.5 percent; the daily price index of 28 "sensitive" primary market commodities rose 45.8 percent. From the issuance of GCPR to midyear, wholesale prices rose 0.9 percent, and prices of primary market commodities showed a net drop of 11.8 percent; and from January to May, consumers' prices rose 2.1 percent.

The inauguration of controls

Between mid-December and mid-February the average price increase for the 28 basic commodities covered in the daily primary market price index was 9 percent. During the same period, the all-commodity wholesale price index rose 5 percent. Among its components, wholesale farm prices increased 8 percent, wholesale foods 5 percent, and wholesale industrial prices 3 percent. The consumers' price index rose almost 3 percent between December 15 and February 15. (See charts 28 and 30.)

The pace of price inflation during December and January forced the decision for an early price freeze. The General Ceiling Price Regulation, although containing certain exemptions, primarily in the case of farm commodities, froze most prices in the economy at the highest levels at which deliveries had been made between December 19 and January 25. As the first general step since Korea in a mandatory control program (automobiles had been controlled earlier), GCPR was unprecedentedly broad in its coverage.

While the institution of price controls was a major factor in halting the rise in prices in February, there were other important factors at work: the improvement in the military situation in Korea; the delay in cutting back the production of consumer durable goods, and the consequent continuing ample supply of civilian goods; the record Government cash surplus during the first quarter; and the credit restrictions.

Since January, the Office of Price Stabilization has been mainly concerned with building an organization and with shifting away from the stop-gap freeze to regulations designed to iron out the more serious distortions and inequities which were frozen into the price structure by GCPR.

Wholesale prices under controls

Although most prices were frozen late in January, the price advance continued until mid-February, primarily because of increases in the areas left uncontrolled, mainly agricultural products. But the control of other prices exerted a stabilizing effect on these prices also. (See appendix table B–25.)

TABLE 13.—*Changes in wholesale prices*

Commodity group	Percentage change		
	Korean outbreak to General Ceiling Price Regulation [1]	General Ceiling Price Regulation to June 1951 [1]	Korean outbreak to June 1951 [1]
All commodities	+14.5	+0.9	+15.5
Farm products	+17.1	+2.3	+19.7
Grains	+10.2	−4.3	+5.5
Livestock	+12.7	+5.8	+19.2
Foods	+12.4	+2.3	+14.9
Meats	+8.3	+5.3	+14.1
Other than farm products and foods	+14.5	+.1	+14.7
Hides and leather products	+28.6	−1.8	+26.3
Textile products	+30.3	−.3	+29.8
Fuel and lighting materials	+2.9	+1.0	+3.9
Metals and metal products	+9.1	+.4	+9.5
Building materials	+11.9	−.2	+11.6
Chemicals and allied products	+26.2	−1.1	+24.8
Housefurnishing goods	+18.9	+2.6	+22.1
Miscellaneous	+24.1	−.5	+23.5

[1] June 1950 used for date of Korean outbreak, and January 1951 used for General Ceiling Price Regulation.

Source: Department of Labor. (See appendix table B–25.)

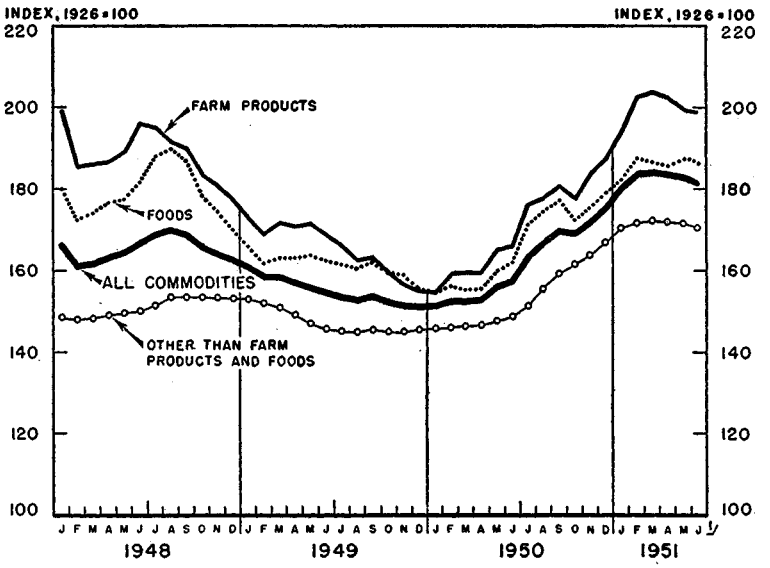
Wholesale prices of farm products, more volatile than other domestic prices during the first half of 1951, rose 8 percent between December and February as livestock prices increased sharply. Eventually, with livestock prices up even more but grains down, farm prices reached a peak one-half percent higher in March. Their course then became uneven but slightly downward, and at midyear they were at a level 2.3 percent above that of January. (See chart 28 and table 13.)

Farm prices rose somewhat more than nonfarm prices immediately following GCPR because farm products below parity in price are exempt from price control under the Defense Production Act when sold in raw

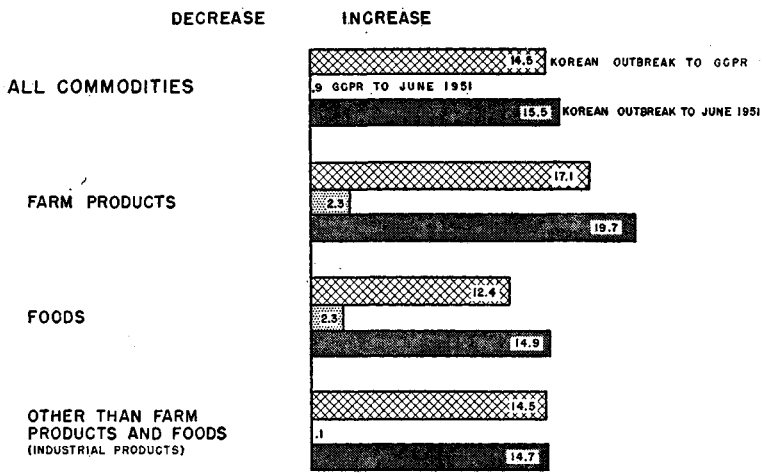
CHART 28

WHOLESALE PRICES

Wholesale prices reached a peak in the first quarter. In the second quarter, farm and industrial prices declined with the larger drop in farm prices; food prices fluctuated within a moderate range.



PERCENTAGE CHANGES



1/ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS, EXCEPT FOR TOTAL.

SOURCE: DEPARTMENT OF LABOR (EXCEPT AS NOTED).

or unprocessed form. At the time GCPR was issued, most of the major farm commodities, with the exception of cotton, wool, soybeans, and livestock, were selling below their parity prices. Furthermore, prices of farm commodities selling above parity were not included in the GCPR, pending the issuance of special regulations. As a practical matter, the freeze technique of price control is not a very workable or effective one for most farm marketings. Accordingly, OPS has applied specific dollars-and-cents ceilings at the farm level on several commodities where effective control is particularly required. The more important actions have affected cotton, wool, and soybeans. Control of producers' prices has been approximated in the case of cattle where average buying prices have been established for beef packers.

In their relation to parity, farm prices moved over a wide range in the first half of 1951. After reaching an all-time high of 313 (1910–14=100) in February, the Department of Agriculture's index of prices received by farmers dropped by June to 301. The index of prices paid by farmers meanwhile rose gradually during the first 4 months of the year and remained unchanged during May and June. The parity ratio relating to these two indexes, which moved above 100 immediately after the Korean outbreak, reached a post-Korean peak of 113 in February and by June had declined to 106. (See appendix table B–26.) There were wide variations among commodities. Thus, beef cattle, wool, cotton, and lambs continued well above parity. Rice, butterfat, and hogs were very close to parity. Some farm commodities were considerably below it.

Wholesale food prices registered a net increase of 4.1 percent in the first half of 1951 and at midyear were 2.3 percent above their GCPR level. They reached a high in February about 5 percent above the December level, and have not regained that point since. Wholesale meat prices—the single most important and, from the point of view of control, the most critical element in the food group—jumped 9 percent between December and February, but thereafter fluctuated in a relatively narrow range.

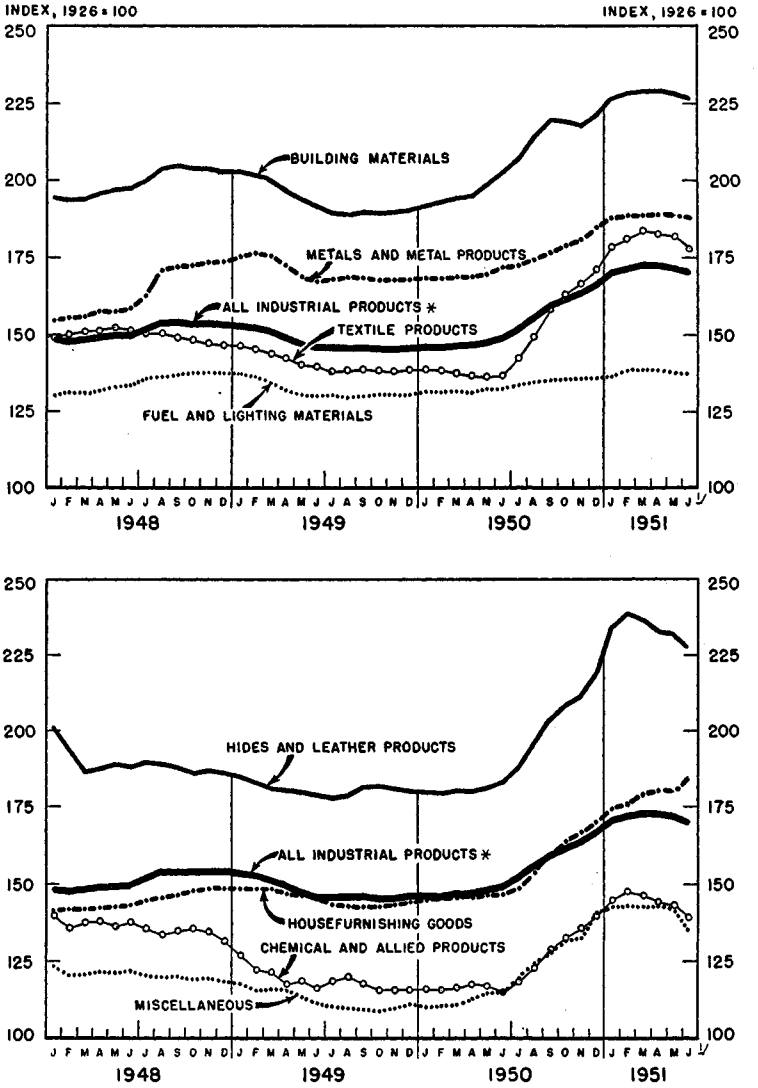
The markets which the wholesale index covers contain several production and distribution levels, and since the price controls now developed are roughly adapted to particular levels, there is no single pattern of controls in the "wholesale food" area. For those foods which move directly from the farmer to the consumer without processing, what is said above about the control of farm prices applies. With the exception of those processing industries which have since been removed from GCPR and subjected to other regulations, food processing is subject to the general freeze, with provision for a dollars-and-cents pass-through of any increases in farm prices which were below parity at the time of the freeze. Among the exceptions, the selling prices of beef packers have, since May, been subject to dollars-and-cents ceilings. In addition, producers of nonseasonal (mostly dry) groceries are to be subject to the General Manufacturers'

CHART 29

WHOLESALE PRICES

OF INDUSTRIAL PRODUCTS

Industrial prices reached a peak in the first quarter. In the second quarter declines occurred in prices of textiles, chemicals, hides and leather, and building materials. Metal prices generally stayed at about their ceilings.



* ALL COMMODITIES OTHER THAN FARM PRODUCTS AND FOODS.
J/ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF LABOR (EXCEPT AS NOTED).

Regulation when it goes into effect. Wholesale food distribution, still partly under GCPR, is now subject to a few dollars-and-cents ceilings, the major case being that of beef. The principal technique of control at this level since April, however, has been that of fixed percentage mark-ups as specified by OPS. Such margins, which approximate those established by OPA during World War II, are differentiated by type of wholesaler.

Industrial prices in the first half of 1951, while following the same pattern as the other wholesale price groups, have been the least volatile. They rose 3 percent between December and February, and rose fractionally in March. Thereafter, they were in a slow and steady decline, dropping about 1 percent during the second quarter. Among the industrial commodity groups, the prices of metals and metal products have been extremely stable throughout the half year. Building materials and fuel and lighting materials rose moderately in the first quarter and declined slightly in the second; textile and allied products rose briskly during the first quarter and have dropped moderately since; and chemicals and allied products have been subject to considerable price fluctuations—mainly because of variations in prices of fats and oils. (See chart 29.)

The general price behavior of raw materials is more clearly indicated by the limited daily index of primary market commodities than by the overall wholesale index, because the latter covers successive processing and distributive levels. Just as the daily index far outstripped the other measures of price inflation from last June to February, so it has been the most emphatic in recording the downward tone of prices since that time. Since February 16, the prices of the 28 "sensitive" primary market commodities have dropped on the average about 15 percent.

The pattern of price control of manufactured commodities was to be set by the General Manufacturers' Regulation, issued in late April, and was to have been effective in July. This pattern was followed in similar regulations which have been issued for the machinery, cotton and wool textiles, apparel, and shoe manufacturing industries. The objective of these regulations is, by sweeping action, to remove the principal distortions and inequities of the general freeze by restoring the same relationships between manufacturers' costs for labor and manufacturing materials on the one hand, and, on the other, the prices which existed in the pre-Korea base period. However, at midyear the application of these regulations was suspended, pending renewal of the Defense Production Act.

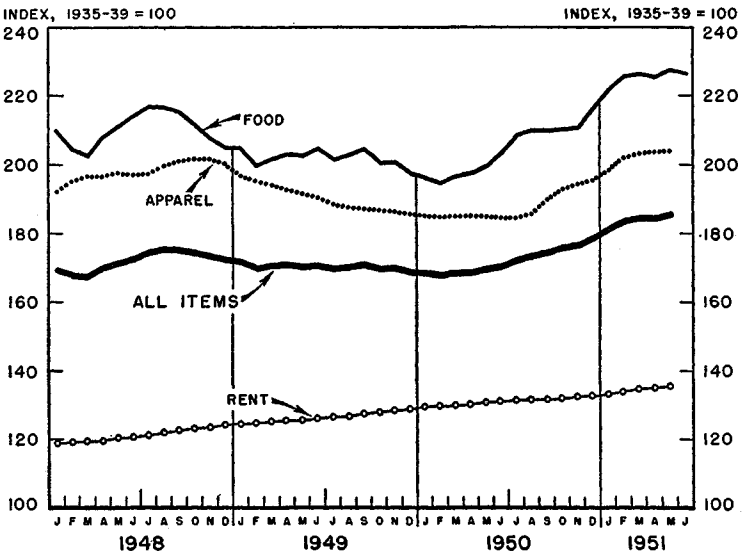
Consumers' prices under controls

In the three months ended February 15, consumers' prices rose at an average rate of 1.4 percent monthly. As with the other price indexes, the trend of the consumers' price index changed at this point. From mid-February to mid-March, it advanced 0.4 percent; from March to April, there was virtually no change; and in May consumers' prices again rose 0.4 percent, mainly as the result of seasonal movements in some fresh

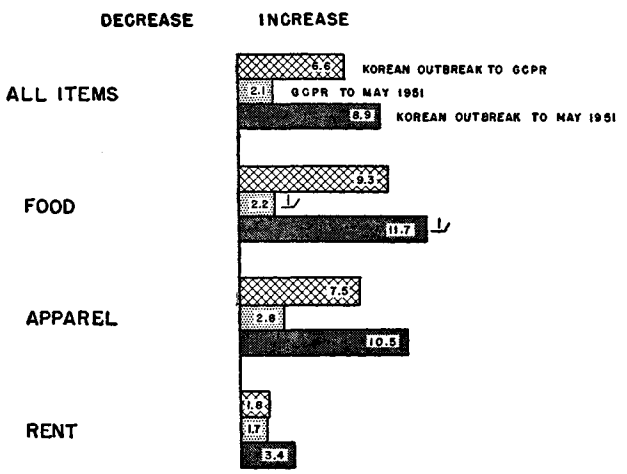
CHART 30

CONSUMERS' PRICES

Consumers' prices continued to reach new record levels in the first half of 1951, but since the institution of price controls, the rise has been very moderate. Rents maintained their postwar rate of increase.



PERCENTAGE CHANGES



1/ PERCENTAGE CHANGE TO JUNE 1951

SOURCE: DEPARTMENT OF LABOR.

fruit and vegetable prices. On May 15, consumers' prices as a whole were 2.1 percent higher than they were in January before the general freeze. (See table 14.) Retail food prices, which had dipped slightly in April, were 2.5 percent above the January level; apparel prices were up 2.8 percent; and housefurnishings prices were up 2.5 percent. Rents in May were 1.7 percent higher than in January; there was little change in the charges to consumers for fuel and public utilities. Preliminary estimates indicate that from May 15 to June 15 retail food prices declined 0.4 percent. (See chart 30 and appendix table B–24.)

TABLE 14.—*Changes in consumers' prices*

Item	Percentage change		
	Korean outbreak to General Ceiling Price Regulation [1]	General Ceiling Price Regulation to May 1951 [1]	Korean outbreak to May 1951 [1]
All items	+6.6	+2.1	+8.9
Food	+9.3	+2.5	+12.0
Apparel	+7.5	+2.8	+10.5
Rent	+1.8	+1.7	+3.4
Fuel, electricity, and refrigeration	+3.0	+.2	+3.2
Housefurnishings	+12.2	+2.5	+15.0
Miscellaneous	+4.9	+1.8	+6.7

[1] June 15, 1950, used for date of Korean outbreak, and January 15, 1951, used for General Ceiling Price Regulation.

Source: Department of Labor. (See appendix table B–24.)

Retail trade in the first half of 1951, and particularly in the second quarter, was marked by the most aggressive merchandising since the Korean outbreak. Retailers, especially in the consumers' durable goods area, resorted more extensively to liberal discount and trade-in policies and to clearance sales in order to move their heavy inventories. Much of such "effective" price reduction, it should be noted, is not fully reflected by the consumers' price index. The most dramatic instance of aggressive merchandising was the price war among New York City department stores, touched off in late May by a decision of the United States Supreme Court, which opened a big hole in the State price maintenance laws. In New York City where, before this episode, department store sales had approximated 1950 levels, sales jumped to 25 percent above the preceding year's level in the first week of the "war" and continued to show a considerable bulge during the first half of June even after the price slashing had largely subsided.

By midyear, most sectors of retail trade had been withdrawn from the General Ceiling Price Regulation and were in most cases subject to price controls of the percentage mark-up variety. This was true of the majority of goods that may be roughly characterized as the "department store type," of most dry groceries and some perishable foods at retail, and of

restaurant prices. Beef was the only major retail commodity subject to a dollars-and-cents ceiling. Most building materials, farm implements, retail services, and some other categories were still subject to the December 19–January 25 freeze prescribed by GCPR.

Wages

The first half of 1951 saw an abatement of the most rapid upward movement of wages and salaries in the postwar period. Labor income (wages, salaries, and other labor income), which reached the annual rate of 158 billion dollars in the final quarter of 1950 after rising 16 billion in 6 months, rose over 10 billion to a rate of 168.5 billion in the second quarter of 1951.

The customary indicators of wage earnings show a slow-down in the rate of increase. From July to December 1950, average hourly earnings in manufacturing increased by over 8 cents an hour; from January to June 1951, they increased by almost 5 cents an hour, with earnings in durable goods industries advancing by 5½ cents an hour. (See chart 31 and appendix table B–14.) While hourly earnings in all manufacturing industries continue to rise, in real terms (as measured by changes in the consumers' price index) they increased by only 1½ cents between January and June 1951. Real hourly earnings in durable goods industries rose almost 2 cents while real earnings in nondurable goods remained constant.

The rate of increase in weekly earnings was also slower in 1951. Average weekly earnings in all manufacturing industries increased by almost $4.70 between July and December 1950, but by about $1.70 between January and June 1951. Weekly earnings of workers in durable goods manufacturing increased by almost $3.00 during the first half of 1951, chiefly as a result of wage rate increases. Earnings of workers in nondurable goods manufacturing rose by only 10 cents during the same period; the reason was the drop of almost 1 hour in average weekly hours during 1951, which largely offset wage increases. (See appendix table B–15.) Real weekly earnings rose by about 25 cents in all manufacturing between January and June 1951. In terms of real wages, weekly earnings in durable goods industries were more than $1.40 higher in June than in January 1951, but real weekly earnings in nondurable goods industries dropped by $1.20 between January and June.

Wage stabilization

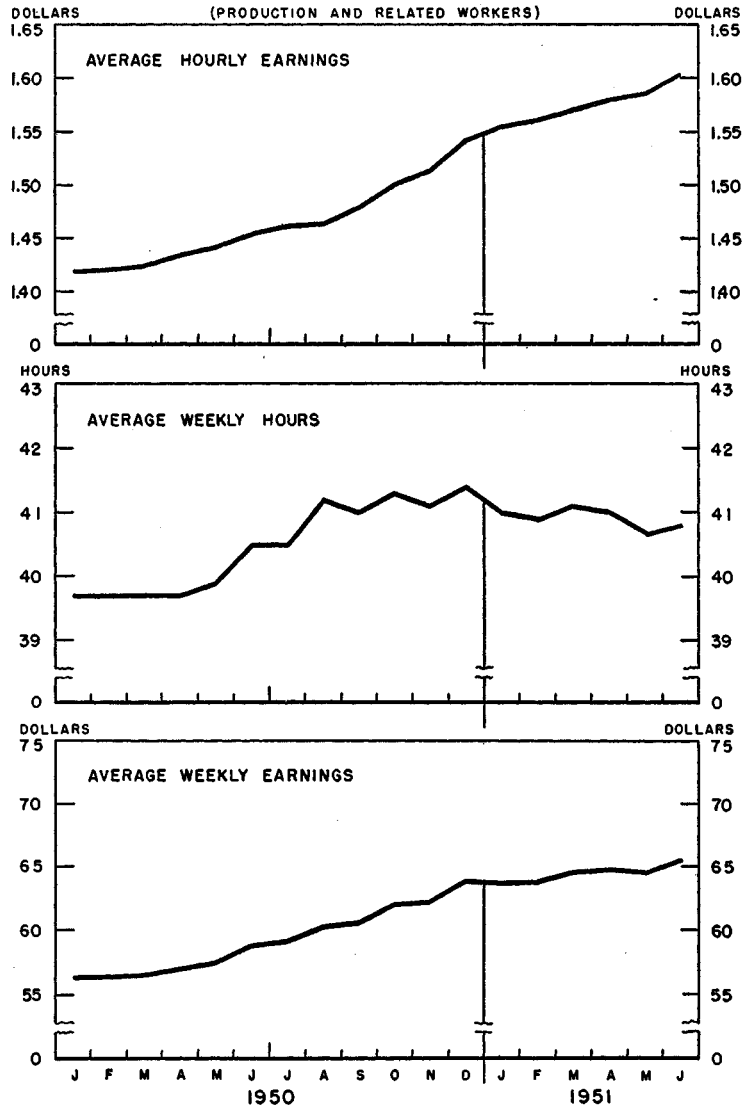
The pattern of wage negotiations during the first half of 1951 was greatly influenced by the actions of the Wage Stabilization Board. Almost every wage negotiation was conducted with an eye toward the Board's regulatory actions, whether the regulations had already been issued or were merely anticipated.

CHART 31

WAGES AND HOURS

ALL MANUFACTURING INDUSTRIES

Average hourly earnings for all manufacturing industries rose throughout 1950 and thus far in 1951. Since January, the average workweek has decreased. Average weekly earnings increased very slightly.



SOURCE: DEPARTMENT OF LABOR.

During the period immediately preceding the wage freeze, an unusually high number of wage settlements took place. It is estimated that at least 600,000 manufacturing workers and probably twice that number in non-manufacturing and government employment received increases during the month before the freeze. In many instances, formal reopening dates or termination dates were advanced in order to negotiate settlements before the anticipated freeze. The terms of the settlements varied considerably; in some cases provisions for future adjustments in the form of cost-of-living escalator clauses or deferred increases were included in the contracts.

On January 26, 1951, the Economic Stabilization Administrator issued General Wage Stabilization Regulation No. 1, which froze wages, salaries, and other compensation at the level prevailing on January 25 and provided that no wage rate at a higher level could be paid without prior approval of the Wage Stabilization Board. Following the issuance of Regulation No. 1, the Board issued a series of clarifying regulations which (1) exempted from the freeze agreements reached before January 25 which were to take effect within 15 days; (2) exempted actions raising wage rates in order to comply with minimum wage regulations; (3) exempted employees of non-Federal government units from Federal wage controls; and (4) clarified the status of merit increases and incentive pay under wage stabilization.

On February 27, the Economic Stabilization Administrator issued General Regulation No. 6. It provides that those workers who had not yet received wage increases of 10 percent over the level of January 15, 1950, may be permitted increases in wage and fringe benefits up to 10 percent. For the purpose of determining whether the increases already received by workers equal 10 percent, fringe benefits negotiated prior to January 25, 1951, are to be excluded. The Regulation also directs that consideration be given to granting wage increases in "rare and unusual" cases (those in which wage incentives are needed to attract labor to defense industry) and in situations where inequities exist. Regulation No. 8, which was issued on March 1, provides that cost-of-living clauses contained in contracts executed on or before January 25, 1951, will be allowed to continue in operation even if the 10 percent limitation is exceeded as a result. The Board has also issued a regulation pertaining to the establishment of wage scales in new plants, and so-called "tandem wage increases" which occur when wage rates in one type of work or plant consistently follow a pattern established elsewhere. These regulations are modified by two others. Wage increases granted to employees of religious, charitable, and educational institutions are permitted without Wage Board approval. The Board also in effect exempted the majority of farm workers from wage controls by providing that farm wages may be increased up to a level of 95 cents an hour without Board approval.

The Economic Stabilization Administrator has established a five-man board of public members to develop a stabilization policy affecting compensation of executive, administrative, professional, and certain sales and supervisory employees. In general, the authority of the board extends to the salaries of employees who are exempt from the overtime-work provisions of the Fair Labor Standards Act.

The Wage Stabilization Board has been confronted with a series of major cases in which both employers and employees agreed to wage increases and then petitioned the Wage Stabilization Board for approval.

In the first, and one of the most significant of wage cases, the Wage Stabilization Board decided in mid-May to allow the meat-packing workers a 9-cent increase, of which the major part was in excess of the 10-percent formula. These workers had received wage increases of 11 cents an hour during 1950. The Board held that it would not be fair to penalize the parties to the agreement because they used a broad form of reopening clause rather than a cost-of-living provision. Later an additional 2 cents was allowed for bracket adjustments.

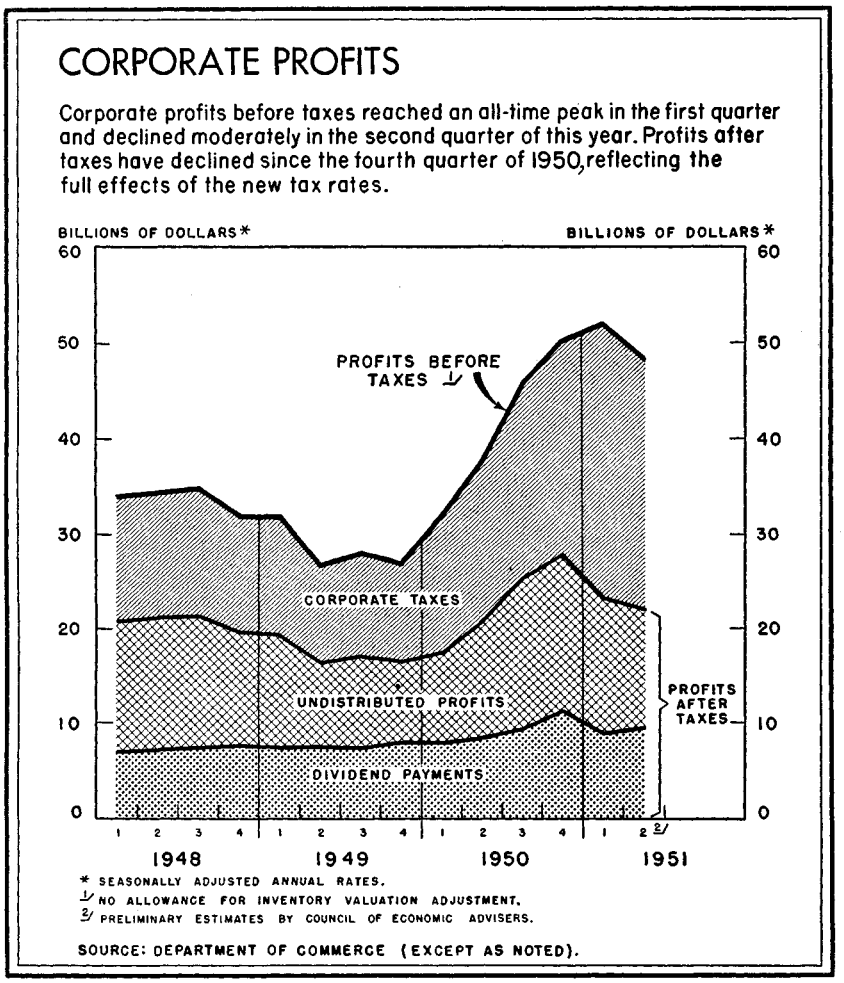
In late May and in June, the Board made several important decisions. In early June, the Board gave the go-ahead signal for increases provided in productivity or "annual improvement" clauses in contracts typical of the automobile industry, by ruling that payment of a scheduled 4-cent increase would be permissible even when it exceeded the 10 percent ceiling, if the increase could be granted without an accompanying price increase. Most automobile companies announced that their workers would receive the increase. On June 7, an over-ceiling wage increase of 15 percent was approved for Atlantic Coast shipbuilding workers on the grounds that shipbuilding wage rates were abnormally low in the base period. On June 28, an increase of 9 cents an hour was approved for 44,000 Westinghouse workers under the "tandem" provision. In this case, the standard for the 9-cent increase had been set by the General Electric Company in March.

Work stoppages

Both the number of work stoppages beginning during the first 5 months of 1951 and the number of workers involved were higher than in the comparable period of 1950. However, man-days of idleness resulting from stoppages were considerably less during this period in 1951 than in 1950. From January through May 1951, there were about 8.8 million man-days of idleness or 0.23 percent of estimated working time in all industries. During the same period in 1950, idleness amounted to 0.62 percent of working time, or about 21.7 million man-days were lost as the result of work stoppages.

After rising steadily through 1950 and reaching unprecedented levels in the first quarter of 1951, the trend of profits was moderately downward in the second quarter. In the second quarter of 1951, corporate book profits before taxes (not adjusted for inventory valuation) were running at an estimated annual rate of 48.5 billion dollars, compared with 37.5

CHART 32



billion a year earlier and with the peak rate of 51.8 billion in the first quarter of 1951. (See chart 32.)

There was a somewhat sharper decline in corporate profits after taxes, since they reflected the full effects of the higher corporate taxes passed in 1950. In the second quarter of 1951, corporate profits after taxes (not

adjusted for inventory valuation) were running at an estimated annual rate of 22.0 billion dollars compared with 20.6 billion a year earlier, and with the peak rate of 27.8 billion in the fourth quarter of 1950. The second quarter profits after taxes represented almost 4.5 percent on sales and over 9¼ percent on net worth compared with almost 5 percent and almost 9.5 percent, respectively, a year ago.

The net income of nonagricultural unincorporated business and the professions has since mid-1950 moved in a much less regular fashion than corporate profits. After reaching a peak in the third quarter of 1950, the net income of this group declined in the fourth quarter and then rose again to a new peak in the first quarter of 1951. It declined sharply in the second quarter, when it was running at an estimated 24.0 billion dollars before taxes (not adjusted for inventory valuation). This compares with 22.9 billion a year earlier and with the peak rate of 27.3 billion in the first quarter of 1951.

The net income of farm proprietors moved steadily and sharply upward since the Korean outbreak in response to the higher level of farm prices and increased marketings. In the second quarter of 1951, net income of farm proprietors before taxes was at an estimated annual rate of 17.1 billion dollars, compared with 12.2 billion a year ago, a rise of 4.9 billion or 40 percent. The peak had been reached in the second quarter of 1948, when farm income was at an annual rate of 18.6 billion dollars.

The shifting trends in the economy which marked most of the last 6 months and the differential impact of the growing security program were reflected in the divergent profit trends by industries. During the first quarter of 1951, substantial increases in profits before taxes were reported by the following manufacturing industries: fabricated metal products, machinery, paper and allied products, chemicals, and petroleum. The largest declines were reported by producers of electrical machinery, transportation equipment, and motor vehicles and parts.

From first quarter data, it appears that small manufacturers (those with assets less than 1 million), fared relatively as well as large concerns on a before-tax basis, but somewhat better on an after-tax basis. In general, the excess profits tax now in effect has a greater impact on larger than upon smaller firms.

The current rate of profits provides, in general, ample inducement to expand output and capacity. In spite of the large increase in corporate taxes, the current level of profits continues to be almost as large a source of funds as in any previous period. In the first half of 1951, the net availability of funds from profits after allowing for corporate taxes and changes in the cost of replacing inventories was at an annual rate of 16.9 billion dollars, compared with 17.0 billion in the first half of 1950, and with 18.3 billion in the second half. (Appendix tables B–34 through B–38 give details on profits.)

Money supply

Total money supply, including Government deposits with Federal Reserve banks and commercial and savings banks, which had increased 0.8 billion dollars during the first half of 1950, and 5.9 billion during the second half, or a total of about 4 percent for the year, rose only about 0.3 billion during the first half of 1951. The expansion of loans and investments of the entire banking system, including Federal Reserve bank holdings of Government securities, which had the effect of lifting the money supply, was in part offset by other factors, mainly a substantial gold outflow during the first quarter. (See appendix table B–30.)

In the first quarter of 1951, the privately-held supply of money (adjusted demand and time deposits, including those of governments other than Federal, and currency outside of banks) declined from 176.9 billion dollars to 172.5 billion. The weekly index of wholesale prices rose from 177.0 to 183.9 in the same period, and the index of consumers' prices advanced from 178.8 in mid-December to 184.5 in mid-March. Both the drop in money supply and the rise in consumers' prices were exceptionally rapid.

The opposite direction of changes in money supply and changes in prices in the first quarter of 1951 was an illustration of the uncertain relationship between the two in short periods. This phenomenon appeared repeatedly in quarter-year and half-year periods between July 1946 and July 1950. At the close of 1947, money supply was 170.0 billion dollars and it stood below that level throughout the ensuing 8 months of inflationary price advance. In the meantime, the index of wholesale prices rose from 163.2 to 169.8, and the index of consumers' prices advanced from 167.5 to 175.2.

A decline in the privately-held money supply is a characteristic of the first quarter of the year, particularly since World War II. The concentration of income tax payments in the first quarter has required heavy transfer from private deposits in banks to Treasury account. In the first 3 months of 1951, when Federal cash receipts exceeded expenditures by 6.9 billion dollars, the reduction in private bank deposits was exceptionally heavy.

With the conclusion of March tax payments, the privately-held money supply began to increase, rising by about 0.8 billion dollars in April, 0.4 billion in May, and 0.7 billion in June. Price advances, which had persisted in the first quarter despite the decrease in money supply, gave way to relative stability in price after March, during a period when the money supply expanded.

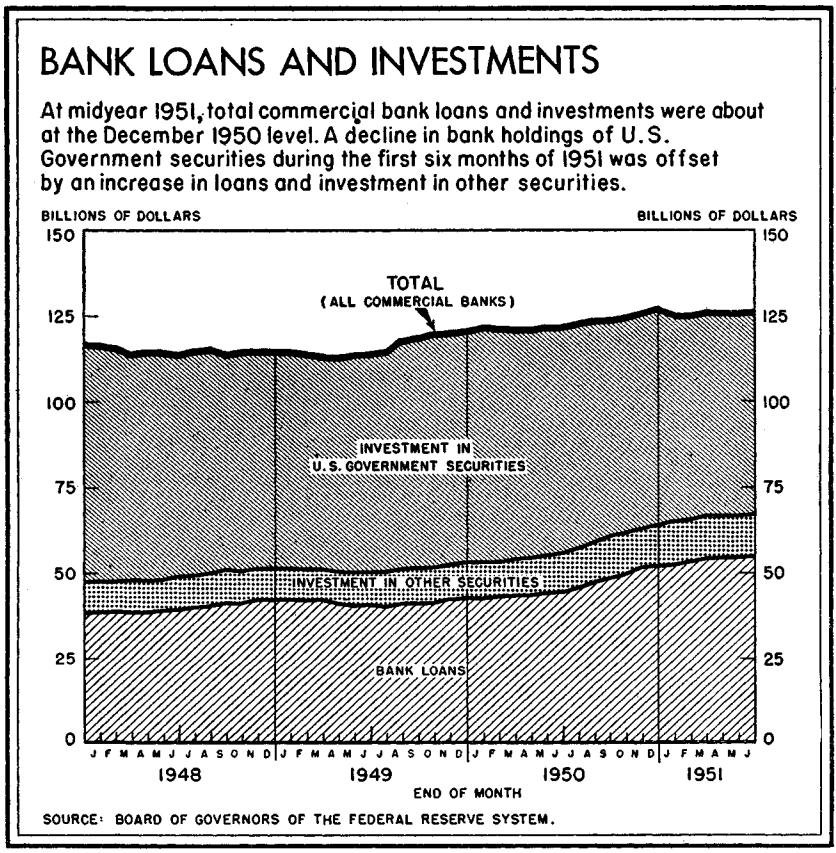
Credit

During the first half of 1951 the major kinds of private credit outstanding, after 6 months in which all had been carried upward, were

subject to a complex of forces that resulted in widely divergent changes. Credit restraints, direct controls of prices, wages, and materials, the rising credit needs of defense industries, seasonal factors, and the subsidence of anticipatory demand were responsible for changes in the pace and even in the direction of movement of the several classes of credit.

Total loans of commercial banks rose nearly 3 billion dollars, or about 5 percent, between December 1950 and June 1951, compared with 1.8

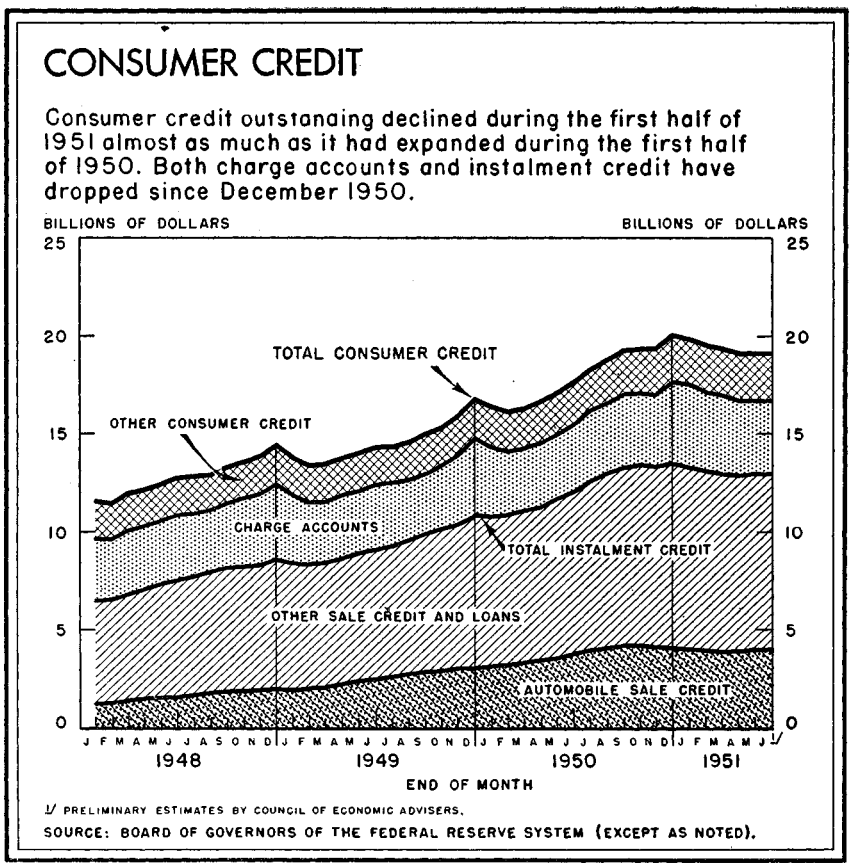
CHART 33



billion dollars, or 4 percent, during the same period a year before. During the second half of 1950, total loans expanded 7.4 billion, or about 16 percent. However, total earnings assets of commercial banks showed no change between the end of 1950 and mid-1951, as the growth of loans and a moderate increase in investment in other securities were offset by a decline in holdings of Government obligations. (See chart 33 and appendix table B–29.)

The changes in total bank loans since Korea largely reflected the behavior of commercial and industrial loans. Business loans declined

CHART 34



about 100 million dollars, or less than 1 percent, during the first half of 1950; jumped nearly 5 billion dollars, or 30 percent, during the second half; and rose nearly 2 billion, or about 8 percent, during the first half of 1951.

Seasonal declines are usual during the first 6 months of the year, and normally attain their maximum rate during the second quarter. There was no seasonal fall during the first half of 1951, as a whole, because increased borrowing, especially by defense industries, more than offset the effect of seasonal repayments. Business loans expanded during the first quarter, declined slightly between March and May, and resumed their climb in June.

Outstanding farm mortgage loans of all lenders, which had risen about 8 percent during 1950, continued to increase during the first half of 1951, though at a somewhat reduced rate. Nonfarm residential mortgage credit continued to rise during the first months of 1951, at a rate greater than that of the same period of 1950, but substantially under that of the second half

of 1950. Credit restrictions have operated to slow down the rate of growth, and the current trend would keep the total for the year well below the 20 percent expansion of 7.8 billion dollars during 1950.

In contrast with other forms of private credit, consumer credit outstanding showed a net decline in the first 6 months of 1951. During the first half of 1950, consumer credit outstanding expanded 0.9 billion dollars, or 5 percent; during the second half it soared 2.4 billion or nearly 14 percent; between December 1950 and June 1951, it dropped about 0.9 billion or 4.5 percent. The difference in the direction of movement of consumer credit, comparing the first half of 1950 with the first half of 1951, is largely accounted for by the 1.2 billion dollar expansion of instalment credit during the former period and the 0.6 billion contraction during the later. (See chart 34 and appendix table B–28.)

Flow of Goods and Purchasing Power

The substantial increase in the volume of production in the first half of 1951 lifted national income from the seasonally adjusted annual rate of 253 billion in the second half of 1950 to 274 billion in the first half of 1951. (See appendix table B–6.)

Among the constituent elements of national income, the one contributing most to the rise was compensation of employees, which increased from an annual rate of 165.2 billion in the final quarter of 1950 to 172.1 billion in the first quarter of 1951, and to 177.1 billion in the second quarter. The increase in private payrolls was from 130.3 billion to 138.0 billion, and to this there was added an increase from 7.6 billion to 8.4 billion in supplementary income from enlarged social security benefits and from expanding private pension programs. The largest proportionate increase was in government payrolls, which expanded from an annual rate of 24.8 billion to 28.0 billion during the half-year as a result of the growth of the military forces and of civilian employment by the Federal Government under the defense program.

Corporate profits have been discussed above. After adjustment for the increase in costs of goods in inventories, but before deduction for income taxes, corporate profits increased from an annual rate of 42.2 billion in the fourth quarter to 42.9 billion in the first quarter. For the second quarter-year, they are estimated at an annual rate of 46 billion.

The other large constituent elements in national income are income of farm proprietors and professional and unincorporated business incomes. Income of the latter group increased from an annual rate of 23.0 billion dollars in the fourth quarter to a rate of 24.1 billion in the first quarter, but it is estimated that it declined to 23.7 billion in the second quarter. Income of farm proprietors continued its advance which began following the Korean outbreak, rising from an annual rate of 15.0 billion in the second half of 1950 to 16.8 billion in the first half of 1951.

Personal income

Personal income, the principal elements of which are wages and salaries, interest, profits of unincorporated businesses, corporate dividends, and government payments of social security and other benefits, increased from an annual rate of 238.5 billion dollars in the closing quarter of 1950 to 244.1 billion in the first quarter of this year, and to 250.0 billion in the second quarter. Personal taxes, which must be deducted from personal income in order to determine the volume of disposable personal income, have increased greatly as the higher tax rates have become fully effective. In the first half of 1951, they rose to an annual rate of 26.9 billion dollars, compared with an annual rate of 21.6 billion in the second half of 1950. The increase in Federal personal income taxes was from an annual rate of 18.9 billion to a rate of 24.1 billion. Notwithstanding this larger burden of income taxes, disposable personal income climbed from an annual rate of 215.2 billion dollars in the last quarter of 1950 to 217.5 billion in the first quarter of 1951, and to 222.8 billion in the second quarter. (See chart 35 and appendix tables B–7 through B–10.)

Personal consumption expenditures

Consumers' spending in the first half of 1951 repeated the phenomenon appearing in the second half of 1950, when spirited buying had little connection with changes in personal income and when, in the closing months of the period, the decline in the volume of buying was contrary to the direction of change in income. In each instance, a wave of buying induced by emotional response to events outside the field of income, buying power, and markets brought about changes in prices which no forecast of income changes could have indicated. In each case, the behavior of consumers generated forces of inflation which did not disappear when the surge of buying subsided.

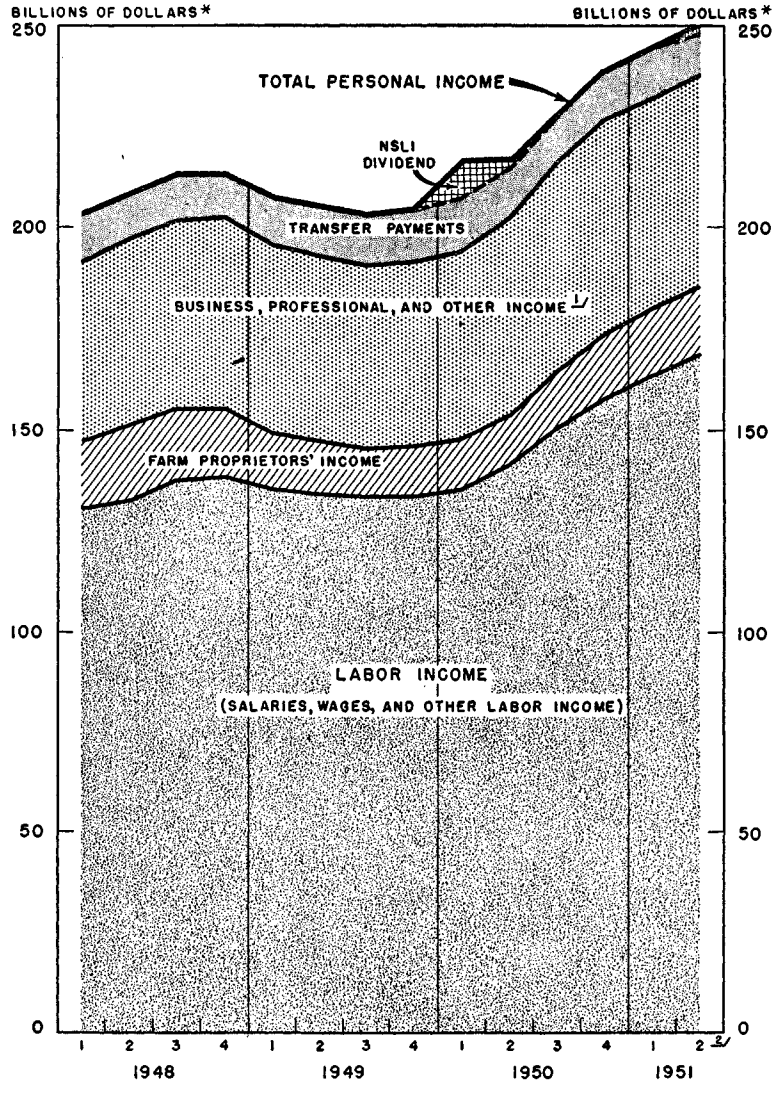
In July 1950, it was the original outbreak in Korea which touched off heavy consumer buying, largely directed to consumer durable goods which people believed might become very scarce when production was channeled into military equipment. The second surprising surge of consumer buying (seasonally adjusted) reached its crest in January, after a holiday season of only moderately vigorous buying and more than 5 weeks after the Chinese attack in Korea. It was probably due to popular disillusionment about the prospect of an early end to fighting in Korea following serious setbacks to United Nations' forces.

The index of department store sales, seasonally adjusted (1935–39=100), rose from 290 in May 1950 to 362 in July, and, after receding, climbed to the same level in January. The upward jump, equally vigorous in each incident, was each time followed by a sharp decline. The continued appearance on merchants' shelves of abundant stocks of goods in each period allayed consumers' fears of shortages, but the course of decline in

CHART 35

PERSONAL INCOME

Personal income in the second quarter of this year was 33 billion dollars higher than in the same period last year. All components of income increased, with the exception of transfer payments.



* SEASONALLY ADJUSTED ANNUAL RATES

1/ OTHER INCOME CONSISTS OF RENTS, INTEREST, AND DIVIDENDS.

2/ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED).

buying was more rapid in 1951 than in 1950. The department store index fell to 291 in October and to 290 in November, after the July peak. After the January rush to 362, it fell to 291 in March. The general price control order issued late in January, and the simultaneous improvement of the military situation in Korea, were important factors in dissipating the popular mood which had led to buying in anticipation of higher prices and shortages of goods.

Brief as was the January buying surge, it lifted the volume of personal consumption expenditures in the first quarter of 1951 to the record level of 208.5 billion dollars (annual rate), compared with 205.7 billion in the final quarter of 1950. The ensuing lull reflected a quiet market but not a receding market. The level of consumption expenditures was estimated to be at an annual rate of 202.6 billion in the second quarter of the year. (See appendix tables B–4 and B–9.)

Personal saving

In the estimates of national income, the figure of personal saving differs from all others in that it is not estimated directly, but is a residual figure which cannot be checked against direct information until later. The principal uses to which personal saving is put are additions to liquid assets such as cash, bank deposits, and Government bonds; additions to other securities; increases in private insurance reserves; investment in homes; net repayments of indebtedness; and increases in the physical assets of personal businesses and farms.

Current estimates of personal saving, being residual figures of relatively small size, are disproportionately distorted by small percentage errors in the estimates of the very large items of disposable personal income, and consumers' expenditures. They must be used with caution in an analysis of the economic situation and in formulating national economic policies.

The estimate of personal saving at the seasonally adjusted annual rate of 9.3 billion dollars in the first quarter places it well below the postwar peak of 16.8 billion in the last quarter of 1950. In the second quarter of the year, personal income increased and, as the higher tax rates were not great enough to match the increase in income, consumers' disposable income also increased. The estimated decline in personal consumption expenditures left a residual amount of personal saving of 19.8 billion dollars (annual rate). (See appendix table B–9.)

While the estimate of the extraordinarily large increase in personal saving in the second quarter of 1951 must be accepted with reserve, the importance of the conditions underlying the estimate must not be undervalued. Even with relative stability in wage rates in coming months, the operation of the defense program will bring about a steady increase in personal income, only a part of which will be taken by increased taxation. If in the same period the limitations upon the supply of consumers' goods and stable prices combine to hold down consumers' expenditures, there

will inevitably be an increase in personal saving. This was the situation which, with the added influence of rationing, accounted for the enormous saving during World War II. The present defense program will not affect consumer buying in the same degree, but it will undoubtedly lead to a substantial increase in saving.

TABLE 15.—*Liquid savings by individuals* [1]

[Billions of dollars, not seasonally adjusted]

Type of saving	1950, first quarter	1951, first quarter
Currency and bank deposits	−0.8	−2.2
Savings and loan associations	.4	.3
Private insurance reserves	1.1	1.1
Securities:		
United States savings bonds	.5	−.3
Other U. S. Government	.4	.4
State and local governments	.2	−.1
Corporate and other	.3	.7
Liquidation of debt:		
Residential mortgage debt	−1.3	−1.5
Other debt	.5	.8
Total liquid saving	1.3	−.8

[1] Includes saving of unincorporated businesses, trust and pension funds, and nonprofit institutions.

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

Source: Securities and Exchange Commission.

During the first quarter of 1951, the latest period for which data are available, liquid saving by individuals decreased about 0.8 billion dollars, compared with an increase of about 1.3 billion during the first quarter of 1950. As is shown in table 15, the principal factor in the decline was an unusually large drop in holdings of currency and bank deposits, reflecting heavy payments of personal income taxes.

BUSINESS INVESTMENT AND FINANCE

During the first half of 1951, gross private domestic investment in construction, equipment, and additions to inventory rose to the all-time record level of 62 billion dollars at a seasonally adjusted annual rate. This was an increase of 40 percent from the first half of 1950 and 15 percent from the second half. (See chart 36 and also appendix table B–5.)

These increases were more rapid than the growth of total national output. In the second quarter of 1951, gross private domestic investment absorbed 19 percent of gross national product, compared with 17 percent a year earlier.

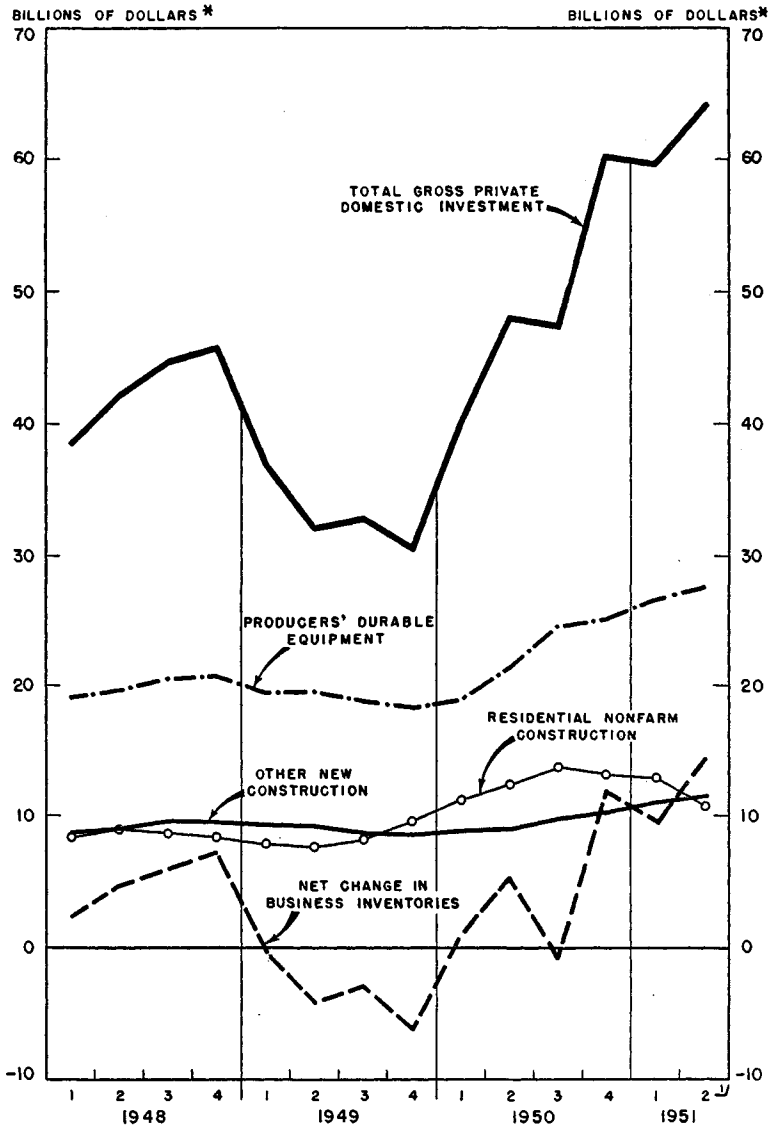
Most of the increase in total investment over the past year was accounted for by increases in purchases of producers' equipment and by faster accumulation of business inventories. Residential construction outlays in the first half of 1951 were at substantially the first half of 1950 level, while other construction rose 20 percent.

At midyear 1951, outlays for plant and equipment were still rising under the impetus of a general demand for facilities expansion and the selective

CHART 36

BUSINESS INVESTMENT

Gross private domestic investment, already at a record level just before Korea, has since risen rapidly. Equipment purchases and additions to inventory are at very high levels.



*SEASONALLY ADJUSTED ANNUAL RATES.

1/PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED).

stimulus of some urgently needed expansion programs. Inventory accumulation had not been halted, but housing construction was falling off, partly as a result of credit restrictions.

Plant and equipment

Nonfarm business expenditures for new plant and equipment have continued on a rapidly rising trend during the past 12 months. In the second quarter of 1951, the total volume of these outlays was at a new high, nearly one-third above the corresponding quarter of 1950. (See appendix tables B–5 and B–20.)

There have been marked differences in the behavior of the different major types of plant and equipment investment since Korea. Although the desire to expand and improve facilities has been intense in all sectors, the greatest acceleration has occurred in outlays for industrial facilities. In manufacturing, the outlays in the second quarter of 1951 were 74 percent higher than a year earlier, and in transportation facilities, 50 percent higher. In the trade, service, communications, and miscellaneous group, the increase was 23 percent. These changes reflect, in part, the effect of selective controls and aids designed to give priority to the expansions closely related to urgent defense needs, which lie largely in the industrial, transport and utility fields. Investment in electric utility expansion showed only a moderate increase, but this may be accounted for by the longer time required for building the heavy equipment needed for expansion in that field, as well as by severe shortages of copper and aluminum and the limited capacity of equipment producers. Furthermore, investment in electric utilities has been at a high level since World War II.

The emphasis on capacity expansion resulting from demands of the defense program is also shown in the fact that an increased proportion of plant and equipment outlays is going for plant construction. On the basis of sample surveys of expansion plans, and also the expansion goals for some specific defense-related industries discussed in Part II, it is evident that the increase of industrial capacity is proceeding considerably faster than it did during the prosperous period between World War II and mid-1950.

The remainder of 1951 is likely to show a continuation of the trend to more selective industrial expansion and some decline in investment outlays in the trade and service field as the impact of materials shortages and controls increases. A survey of investment expectations made by the Securities and Exchange Commission and the Department of Commerce during the second quarter of 1951 suggests a third-quarter level of total nonfarm plant and equipment outlays about equal to that of the second quarter, and 36 percent higher than in the third quarter of 1950.

Nonfarm inventories

Unusually rapid accumulation of inventories has prevailed since last fall. During the third quarter of 1950, the initial post-Korean buying rush de-

pleted nonfarm inventories at an annual rate of 1.8 billion dollars. But as production spurted ahead, inventories were built up rapidly. Stimulated by the large rise in demand and prices, and haunted by the fears of shortages, business generally placed large orders to ensure an uninterrupted flow of supply. In the fourth quarter, inventories were being accumulated at the very high annual rate of 10.6 billion dollars.

During the first half of 1951, and especially during the second quarter, much of the accumulation was involuntary in character as sales failed to meet expectations. The rate of accumulation dropped to 8.1 billion dollars during the first quarter of 1951, but rose again to 13.2 billion during the second quarter of 1951. An "excess" of inventories developed in consumer goods at the retail level, particularly in consumer durable goods, where the fears of shortage had been greatest. But this situation did not bring about a decline in total output, as it had done in 1949. The rapid growth of the national security program forestalled this. By June 1951, inventories were being readjusted in many areas to bring them in line with the current rate of sales.

Since the Korean outbreak, the book value of inventories in manufacturing and trade, seasonally adjusted, has risen at a record rate. By May 1951, the book value amounted to 69.9 billion dollars compared with 54.2 billion in June 1950, a rise of nearly 30 percent. Well over one-half of this rise reflected replacement of inventories at higher prices and less than half reflected physical accumulation.

Retail inventories grew at about the same rate as those in manufacturing, rising 30 percent from June 1950 to May 1951, while manufacturing inventories rose 29 percent. However, there were significant differences in trends. Durable goods inventories of retailers rose about 41 percent, while those of manufacturers advanced about 32 percent. On the other hand, retail inventories of nondurable goods advanced about 23 percent while manufacturers' inventories rose about 28 percent.

Retailers bought heavily in consumer durable items in anticipation of the much sharper impact of the defense program upon that area. Since production of consumer durable goods was maintained much longer than anticipated, and there was some falling off in sales in the second quarter, inventory accumulation of these items took place.

While there was a substantial increase in manufacturers' inventories from May 1950 to May 1951, most of it was in purchased materials and goods in process. Finished goods inventories rose 14 percent, mainly in the first half of 1951. The rise in purchased materials and goods in process was 43 percent, but the bulk of this accumulation took place in the second half of 1950. The rise in the first half of 1951 has been much slower, in part because of the stabilization of prices, in part also because of the restrictions on inventory accumulation of essential materials instituted by the National Production Authority. Inventories of goods in process have continued to grow steadily.

The ratio of inventories to sales a year ago was somewhat lower than in most previous periods. It declined further during the summer as sales expanded. But by the end of the year, it was higher than in June. By April of this year, it had advanced to about the 1949 level, which was the highest ratio of the postwar period but well below most prewar levels. In May, the ratio dropped slightly because of an improvement in the manufacturers' inventory sales ratio. The retail inventory-sales ratio showed the greatest rise and is currently well above any previous postwar figure. (See appendix tables B–21, B–22, and B–23.)

Construction

Total new construction activity in the first half of 1951, including both private and public, has been at a record level of about 32 billion dollars on a seasonally adjusted annual rate basis. This exceeds the rate in the first half of 1950 by nearly 20 percent, and that of the second half of 1950 by about 8 percent. (See appendix table B–19.)

A major part of these increases reflects higher construction costs. The cost increases, especially prominent in lumber and in plumbing and heating items, average about 12 percent from the first half of 1950 to the first half of 1951.

The rising trend of construction outlays was halted in the spring of this year, and by June the seasonally adjusted rate of total construction had fallen back below the January level. In recent months private construction—accounting for about 70 percent of the total—has been dropping substantially, while public construction has declined only slightly.

Over the past year, construction has come increasingly under the direct or indirect influence of Government controls. A Presidential directive of July 1950 ordering the tightening of FHA and veterans' housing credit terms was followed by Regulation X; prohibitions on certain types of recreational construction; the imposition of priorities on materials for essential defense use; limitation orders on the use of specific scarce materials including copper and aluminum; a permit system on commercial construction; the licensing of all projects using more than 25 tons of steel; and the application, beginning in July 1951, of the Controlled Materials Plan to the use of steel, copper, and aluminum.

Controls have helped to curtail new private residential building and certain types of recreational and commercial construction, especially during the past few months. It is to be expected that increasing priority demands for materials, particularly steel, and more comprehensive and effective controls over their use, will bring further curtailment of these and other types of construction not urgently needed for defense.

The most striking change in the first half of 1951 has been the increasingly sharp fall in new private housing expenditures, on a seasonally adjusted basis, from a February high. In the first 6 months of this year, an estimated 575,300 total new nonfarm dwelling units were started,

including both private and public, about 17 percent less than in the corresponding period of 1950. This number was swollen by an abnormally large number of publicly financed starts in June, when local housing authorities rushed to get as many units as possible under way before the end of the fiscal year, lest the Congress drastically curtail the public housing program for fiscal year 1952.

The recent downward movement indicates that the backlog of housing construction commitments made before the credit control restriction program went into effect has been largely worked off, and that the credit regulations are increasingly showing their effect. Increasing difficulties in getting scarce building supply items, and the requirement that building of units with more than 2,500 square feet be authorized by NPA, will further retard the rate of new construction in this field. Even so, it is probable that total housing starts for 1951 will run somewhat above the original objective of 800,000 to 850,000.

Private industrial construction, under the impact of the defense build-up and the very high level of business activity, shot up by more than 50 percent, on a seasonally adjusted basis, during the first 6 months of 1951. The average rate of outlays in that category during that period was more than double the average rate during the first half of 1950, and about 50 percent above the rate during the second half of 1950. In view of the very large industry plans for facilities expansion for the remainder of 1951, and some large private and public programs extending into subsequent years, it appears certain that private industrial construction will remain at a high level and probably rise somewhat further.

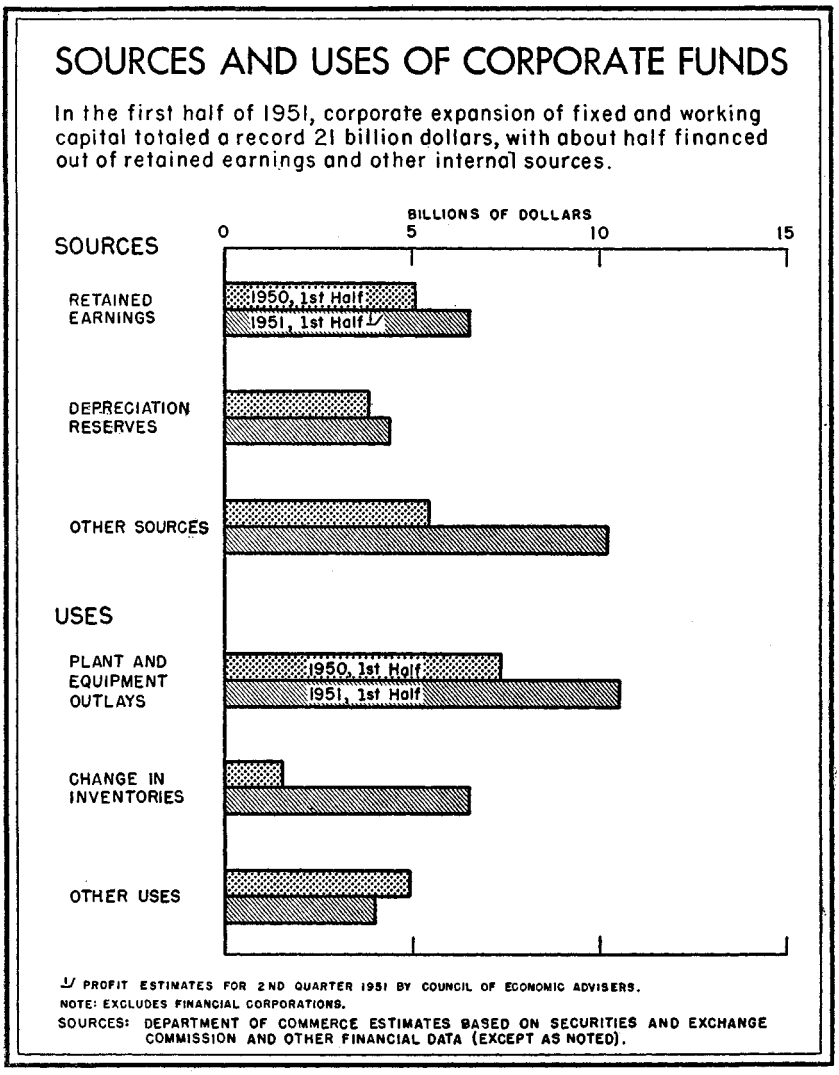
New public construction in the first 6 months of 1951 was running about 30 percent higher than in the corresponding period of 1950. In addition to the rapid step-up in military and naval construction, there have been increases in most of the other categories, especially residential and nonresidential building. Highway construction outlays are moderately higher than a year ago.

Corporate finance

During the first half of 1951, corporations used a record volume of funds to finance expansion of their fixed and working capital. Total uses of funds amounted to 21 billion dollars, 50 percent above the first half of 1950. About 30 percent of the total was for inventory financing. The rise in the book value of corporate inventories during the first 6 months of the year amounted to about 6.5 billion dollars, compared with a 1.5 billion dollar increase in the corresponding period of 1950. The financing of plant and equipment took about 3 billion dollars more than during the first half of 1950. (See chart 37 and appendix table B–39.)

More than half of the additions to capital was financed with funds from internal sources. Corporate retained earnings amounted to about 6.5 billion dollars during the first half of the year, 1.4 billion larger than during the

CHART 37



corresponding period of last year despite the increase in corporate tax rates and moderately larger dividend disbursements. A rise in depreciation allowances partially reflected accelerated amortization of some types of facilities begun in 1950.

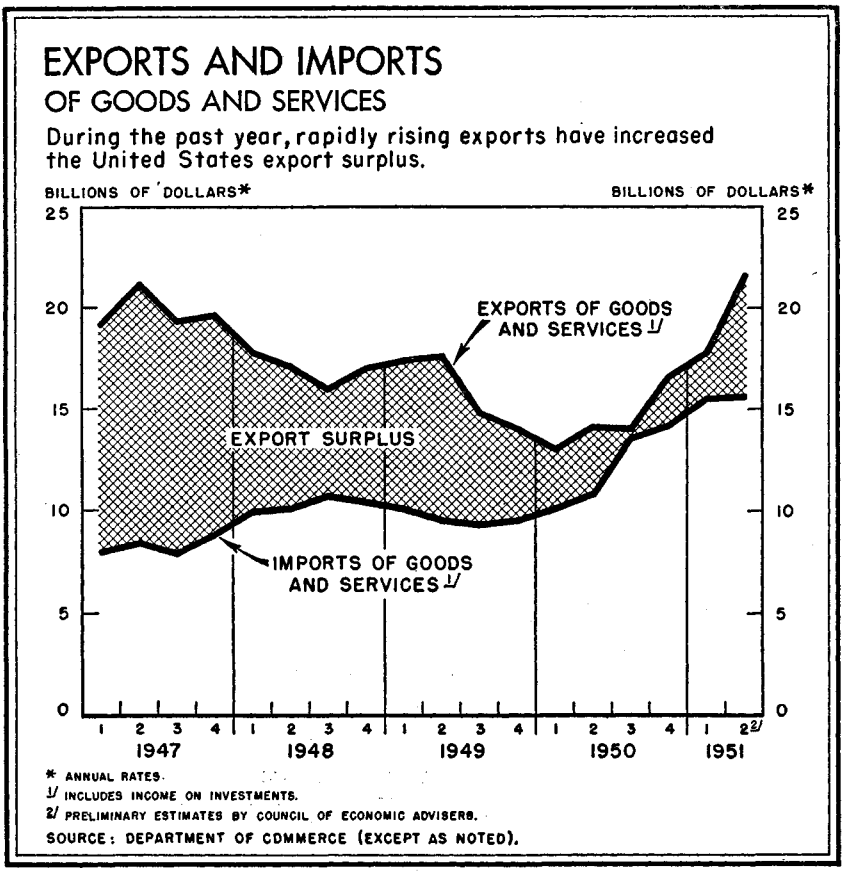
Although corporations did not resort to external financing to the same extent as during the second half of 1950, nonetheless they continued to expand their bank borrowings and trade and mortgage debt substantially. Whereas there is usually some contraction of corporate indebtedness to banks during the first 6 months of the year, this year corporations expanded their borrowings by 2 billion dollars. The expansion of bank loans to cor-

porations during the whole of 1950 was 2.5 billion dollars. The total increase in trade and mortgage debt was more than three times as large as that during the first half of 1950. On the other hand, the volume of funds obtained from the securities markets was only moderately larger than during the first half of 1950.

International Developments

During the late months of 1950 and the first half of 1951, the first worldwide economic impact of the Korean outbreak began to weaken. The rapid increases in the quantity of United States imports of industrial products and in the market prices of raw material imports tapered off, and in some cases there were declines. At the same time, the effects of free world rearmament asserted themselves in other nations. Foreign demand for United States exports increased rapidly; the foreign trade positions of most other countries that are rearming stopped improving and in some cases began to deteriorate; and the extent of price rises in most other coun-

CHART 38



tries surpassed the rise in the United States. (See appendix tables B–40 through B–47 for detailed statistics on international transactions.)

These shifting influences were reflected in the international transactions of the United States, through a rise of about 4.3 billion dollars in the annual rate of exports of goods and services from the second half of 1950 to the first half of 1951, and a moderation of the rise in imports of goods and services. The increase of these imports by an annual rate of 1.7 billion dollars resulted from a large rise in the first quarter of 1951, followed by a leveling off in the second quarter. As a result of these changes, the export surplus rose from an annual rate of 1.5 billion dollars in the second half of 1950 to an estimated 4.1 billion in the first half of 1951. The most significant part of this expansion occurred from the first to the second quarter of 1951, when the surplus rose from an annual rate of 2.3 billion dollars to one estimated at 5.8 billion, the highest level since the widespread tightening of import restrictions and the currency devaluations in 1949. These changes are shown in table 16 and chart 38.

TABLE 16.—*United States exports and imports of goods and services*

[Billions of dollars]

Period	Exports of goods and services [1]	Imports of goods and services [1]	Surplus of exports
1946	14.7	7.0	7.8
1947	19.8	8.3	11.5
1948	17.0	10.3	6.7
1949	16.0	9.6	6.4
1950	14.4	12.1	2.3
Annual rates:			
1950—First half	13.6	10.5	3.1
Second half	15.3	13.8	1.5
1951—First half [2]	19.6	15.5	4.1

[1] Includes income on foreign investments.
[2] Estimates based on incomplete data; by Council of Economic Advisers.

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

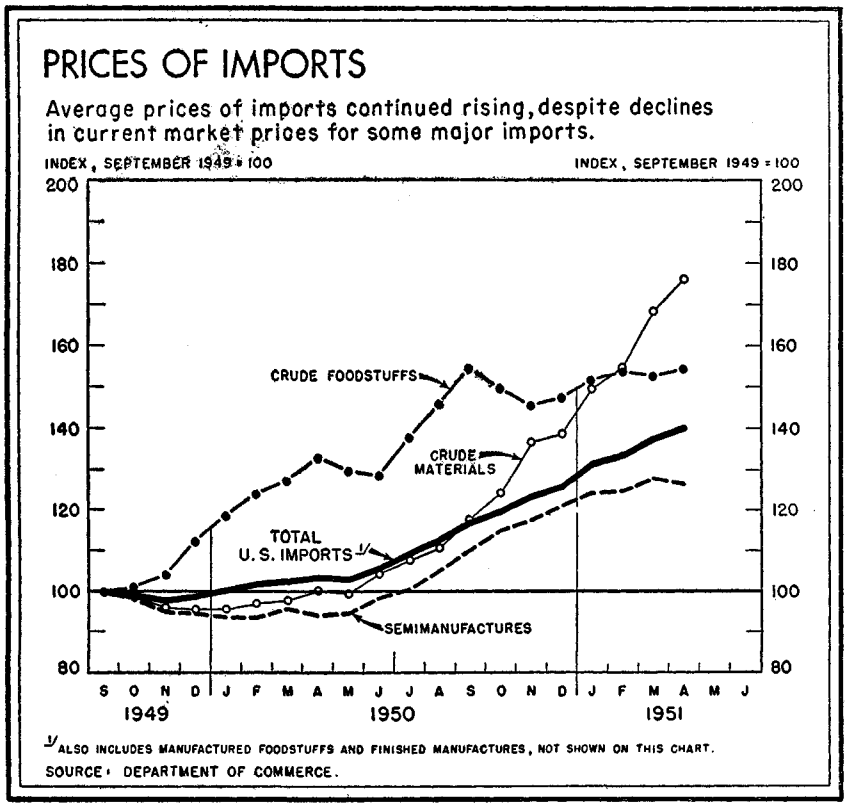
Source: Department of Commerce, except as noted.

These shifts in our international goods and services transactions were almost wholly the result of changed transactions in goods. The rise in the dollar value of merchandise imports, which had begun with our economic recovery well before the outbreak of hostilities in Korea but had been sharply accentuated after it, continued during the first quarter of the year, when both the physical quantity and the dollar value of imports surpassed previous peaks. In the second quarter, however, this rise came to a halt. The halt was the foreign trade counterpart of the leveling off of consumer buying which characterized the United States private economy quite generally during the first half of this year.

Most of the rise in the dollar value of merchandise imports reflected price increases. During the early months of this year, prices of many of

our major imports were stabilized by controls or market forces, and some have declined. Prices of rubber, tin, and wool fell by 19, 40, and 70 percent, respectively, from their post-Korean peaks, although at midyear they were still far above their pre-Korean levels. Despite these declines, however, average prices of imported goods actually received in this country were still rising in April, the latest date for which import price figures are available. (See chart 39.) It was a reduction in the quantity of imports that caused their dollar value to stop rising.

CHART 39



In contrast to the behavior of imports, the dollar value of our merchandise exports rose rapidly in February, March, and April. This rise was more the result of growing physical quantities than of the rise in export prices. Part of the increase in the quantity of exports was attributable to increased shipments of military equipment to Western Europe under the Mutual Defense Assistance Program, but most of it was the result of generally increased demand for United States goods of all kinds on the part of those foreign countries which had higher incomes and more ample supplies of dollar exchange. Partly because of these more ample dollar

supplies and partly because of fear of shortages and price rises, foreign import restrictions have been considerably relaxed since mid-1950, particularly in the Western Hemisphere and Asia, and in some cases imports from the United States have been directly encouraged. Thus, to a considerable extent the rise in foreign demand had the same basic anticipatory character as the post-Korean rise in domestic demand.

The increase in import prices since the first half of 1950 has far exceeded the rise in export prices, as table 17 shows. Although in actual dollar values our merchandise imports in the first half of 1951 were at a rate 55 percent higher than in the first half of 1950, they were only 15 percent higher in terms of average quantity. In the case of exports, the rise in quantity was 28 percent.

TABLE 17.—*Index of average prices in United States foreign trade* [1]

[First half of 1950=100]

Period	Import prices	Export prices	Ratio of import to export prices
1950—Third quarter	110	102	108
Fourth quarter	120	109	109
1951—First quarter	131	115	114
Second quarter [2]	136	119	114

[1] Figures represent average unit values of recorded merchandise trade.
[2] Estimates based on incomplete data; by Council of Economic Advisers.

Source: Department of Commerce, except as noted.

With the stepping up of programs to strengthen national defense, controls over exports in short supply were again imposed. These controls have been intensified in recent months. To limit the drain on domestic resources and to distribute the limited quantities available among the importing countries in accordance with essential needs, quantitative export ceilings have been established for copper, aluminum, zinc, iron and steel scrap, hides and skins, cotton, sugar, inedible molasses, bronze, hard bristles, diamonds, cattle and horse hair, lead, nickel, petroleum oils and greases, iron and steel products, tinplate, wool, and a number of other products.

The strain of our increased domestic demand on free world supplies was considerably alleviated by increased domestic production of several important materials that we import. From the first half of 1950 to the first half of 1951, we doubled our production of synthetic rubber and raised our production of aluminum and crude petroleum by over 20 percent in each case. We also increased exports of coal to Western Europe and increased our shipments of wheat to India from 93,000 long tons in the fourth quarter of 1950 to 152,000 and over 500,000 long tons, respectively, in the first and the second quarters of this year.

Increased exports of military end-items were accompanied by an expansion of military aid to foreign countries. Economic aid to the United Kingdom and to Ireland under the European Recovery Program was suspended early in the year, but economic aid to other countries was

increased slightly. As a result mainly of increased military aid, total net Government financing of foreign transactions rose from an annual rate of 4.0 billion dollars in the second half of 1950 to one of 4.7 billion in the first half of 1951. In the second quarter of 1951 it was less than the total United States export surplus, which, as has already been noted, expanded rapidly from the first to the second quarter. This was a reversal of the relation between aid and the export surplus which had prevailed since mid-1949, when our export surplus was less than our foreign aid.

From mid-1949 to the first quarter of 1951, there was a large outflow of gold and dollar assets from the United States to other countries. The outflow was particularly heavy during the third quarter of 1950 when, in addition to a virtual disappearance of our export surplus, there was a large but short-lived speculative outflow of United States private capital. (See appendix table B–40.) Gold and dollar assets were being accumulated by foreign countries, largely by the sterling area and Canada, but also by a number of countries in Latin America and Southeast Asia, at an annual rate of 4.3 billion dollars in the 9 months after mid-1950. This accumulation abated to a rate of about 3.0 billion dollars in the first quarter of 1951, but at the end of March it was sharply cut, and in the second quarter of the year it amounted to an annual rate of only about 200 million dollars.

While United States demand for imports abated, Western European countries began to feel the effect of free world rearmament and the strain upon their resources which it will involve. Increased import prices were accompanied by purchases of larger quantities of imported goods, partly to replenish reduced inventories and partly in anticipation of increased requirements of their own expanding defense programs. The resulting rapid rise of imports, combined with some reduction of exports, enlarged Western Europe's trade deficit from an annual rate of over 3 billion dollars in the last quarter of 1950 to one of more than 5 billion dollars in the first quarter of this year. As table 18 below indicates, this was a reversal of an improvement which had been occurring since 1949.

TABLE 18.—*Foreign merchandise trade of Western Europe with rest of world* [1]

[Billions of United States dollars]

Period	Imports [2]	Exports	Excess of imports
1948	13.5	6.9	6.6
1949	12.8	7.3	5.5
1950	11.4	7.5	3.9
Annual rates:			
1950—First quarter	10.9	6.5	4.4
Second quarter	11.4	6.8	4.6
Third quarter	10.8	7.5	3.3
Fourth quarter	12.4	9.4	3.0
1951—First quarter	14.4	9.1	5.3

[1] Trade of metropolitan countries participating in European Recovery Program with all nonparticipating countries.

[2] Imports are on a c. i. f. basis.

Source: Economic Cooperation Administration.

An even more dramatic effect of the past year's economic developments and a more universal and potentially dangerous one was the setting off of a world-wide price inflation. The magnitude of the price rises which have occurred in various foreign countries was indicated in table 11, page 160. This table shows that most countries of the world have suffered increases in wholesale prices greater than the United States, in some cases far greater. The actual increases and the annual rates of increase are shown in appendix table B–27. Countries depending largely upon imports for their raw materials and exporting manufactured goods were generally affected by rises in both import and export prices. In most of them import prices rose more, restricting the quantity of goods available for their domestic use. This was the case in most of the countries of Western Europe and in Japan. In the case of the countries exporting primarily raw materials, the main causal factor in their inflations has been the increase of export prices. This has brought about an expansion of incomes which has spread through their whole economies. In contrast to the situation in the raw material importing countries, export prices have risen more rapidly than import prices and there has consequently been a rise of national income in physical as well as money terms. The inflations in some of these cases may nevertheless be disruptive in their internal economic and social effects.

Government Fiscal Operations

Net budget receipts of the Treasury, which exclude the payments of taxes for Federal Old-Age and Survivors' Insurance and refunds of receipts, were 29.7 billion dollars in the first half of 1951. (See table 19.) This was the largest amount ever collected in a 6-month period. Budget expenditures were 25.6 billion, leaving a surplus of 4.1 billion in the first half year. There had been a small deficit in the preceding 6 months, so that the budget surplus for the fiscal year ended June 30, 1951, was 3.5 billion dollars.

Table 19.—*Federal budget receipts and expenditures, the General Fund balance, and the public debt*

[Billions of dollars]

Item	Calendar year 1950			Calendar year 1951, first half
	Total	First half	Second half	
Federal budget accounts:				
Net receipts	37.8	19.4	18.5	29.7
Expenditures	38.3	19.2	19.1	25.6
Surplus (+) or deficit (−)	−.4	+.2	−.6	+4.1
General Fund balance [1]	4.2	5.5	4.2	7.4
Public debt outstanding [1]	256.7	257.4	256.7	255.3

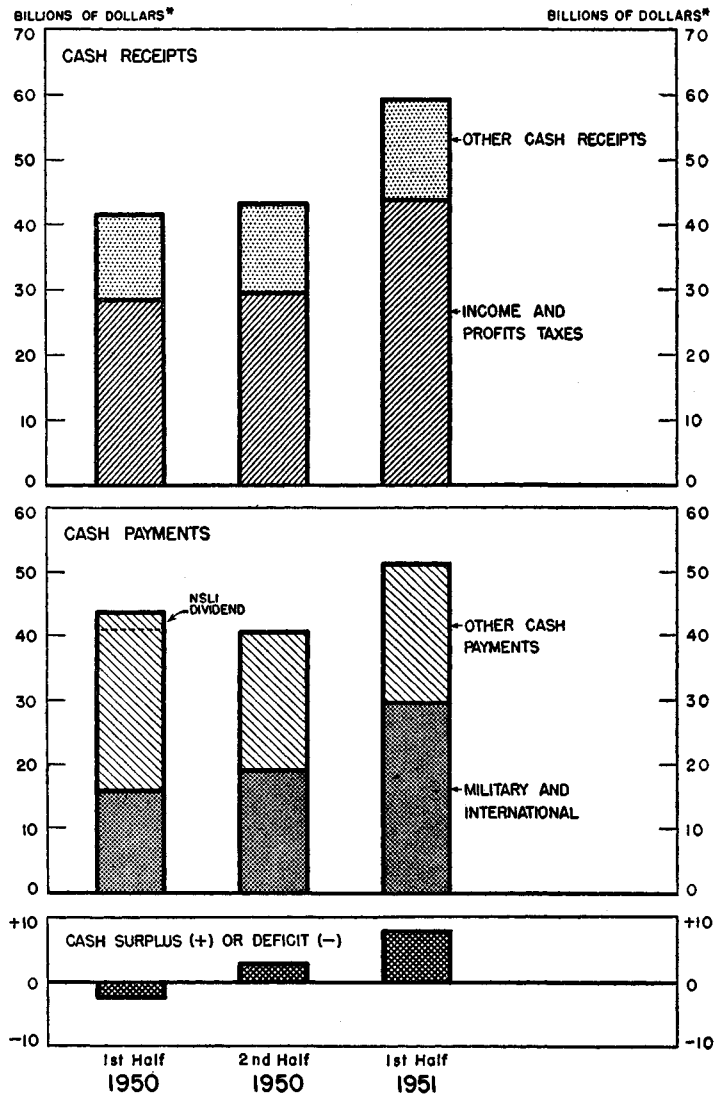
[1] End of period.

Source: Treasury Department.

CHART 40

FEDERAL CASH RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

Total cash receipts were considerably larger than payments during the first half of 1951, resulting in a near-record cash surplus.



*SEASONALLY ADJUSTED ANNUAL RATES.

SOURCES: TREASURY DEPARTMENT AND BUREAU OF THE BUDGET.

The public debt declined from 256.7 billion dollars at the end of December 1950 to 255.3 billion at the end of June 1951. During this same period, there was a substantial increase in the Treasury's General Fund balance from 4.2 billion to 7.4 billion. (See tables B–31 and B–32 for changes in the kinds of Government securities outstanding and in the distribution of ownership.)

There are large amounts of both receipts and expenditures, principally in the Old-Age and Survivors' Insurance and other trust funds, which are not included in the conventional budget accounts. They have an important effect upon the economy because they represent an actual flow of funds being paid into or withdrawn from the Treasury. The consolidated cash totals of receipts and payments are shown in tables 20 and 21. In the first half of 1951, the excess of cash receipts was 6.9 billion dollars, or considerably more than the budget surplus. The cash surplus of 7.6 billion dollars in fiscal 1951 compares with a cash deficit of 2.2 billion dollars in fiscal 1950. Chart 40 shows Federal cash receipts and payments in terms of seasonally adjusted annual rates.

Progress of spending for national security program

The largest changes on the expenditure side of the budget were associated with the national security program. As shown in table 20, cash payments for the military services rose from 7.6 billion dollars in the second half of 1950 to 12.3 billion dollars in the first 6 months of this year. There was also an increase in outlays for international security and foreign relations, mostly due to the rise in expenditures for Mutual Defense Assistance. The national security program includes, in addition, larger expenditures for atomic energy, Defense Production Act activities, and other functions, but these are not shown separately in the table.

TABLE 20.—*Federal cash payments to the public, by function*

[Billions of dollars]

Function	Calendar year 1950			Calendar year 1951, first half [1]
	Total	First half	Second half	
Military services	13.6	6.0	7.6	12.3
International security and foreign relations	3.9	2.1	1.8	2.5
Veterans' services and benefits	8.9	5.9	3.0	3.0
Social security, welfare, and health	3.3	1.5	1.8	2.2
Agriculture and agricultural resources	1.3	1.2	.1	.4
Interest	4.2	2.1	2.1	2.1
Other	7.2	3.6	3.6	3.4
Deduction from Federal employees' salaries for retirement	−.4	−.2	−.2	−.2
Clearing account for outstanding checks and telegraphic reports	−.1	−.3	+.3	(2)
Total Federal cash payments to the public	42.0	21.9	20.1	25.7

[1] Estimates based on incomplete data.
[2] Less than 50 million dollars.

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

Source: Treasury Department and Bureau of the Budget.

Funds obligated by the military services were considerably larger than the actual amount of expenditures. A total of 48 billion dollars was obligated during the fiscal year 1951 for the military functions of the Department of Defense and for Mutual Defense Assistance. Expenditures for these same categories amounted to about 20 billion dollars.

Cash payments by the Federal Government

Total cash payments to the public were 25.7 billion dollars in the first half of this year. This was the highest rate of expenditures since the latter part of 1945, when demobilization and reconversion expenses were heavy.

There have been major declines during the past twelve months in cash expenditures for veterans' benefits, aids to agriculture, and unemployment insurance. The principal increases, apart from the national security programs, have been in certain housing and home finance activities and social security benefits. In the latter case, the increases reflected the liberalization of benefits in accordance with the Social Security Act amendments approved in August 1950.

Cash receipts of the Federal Government

Cash receipts of 53.5 billion dollars in the fiscal year 1951 compare with the previous high of about 50 billion dollars in the fiscal year 1945. This record volume of Federal receipts reflected the increase in incomes and profits, and the increase in tax rates.

TABLE 21.—*Federal cash receipts from the public, by source*

[Billions of dollars]

Source	Calendar year 1950			Calendar year 1951, first half [1]
	Total	First half	Second half	
Direct taxes on individuals	19.2	11.2	8.0	16.4
Direct taxes on corporations	9.9	5.0	5.0	9.1
Employment taxes	3.4	1.7	1.7	2.2
Excises and customs	8.6	3.9	4.8	4.5
Surplus property receipts	.2	.1	.1	.2
Deposits by States, unemployment insurance	1.2	.5	.6	.7
Veterans' life insurance premiums	.5	.2	.2	.3
Other	1.5	.7	.8	.9
Less: Refunds of receipts	−2.2	−1.8	−.3	−1.8
Total Federal cash receipts other than borrowing	42.4	21.5	20.9	32.6

[1] Estimates based on incomplete data.

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

Source: Treasury Department and Bureau of the Budget.

As shown by the estimates in tables 21 and 22, Federal cash receipts were substantially higher in the first half of 1951 than in the last 6 months of 1950, even after adjustment for seasonal factors.

State and local government finances

Both the receipts and payments of the State and local governments increased during the first 6 months of 1951. The estimated rise in receipts was somewhat larger than the rise in payments, with the result that the small deficit incurred by these governments in the previous period was virtually eliminated. These trends are shown in table 22.

TABLE 22.—*Government cash receipts from and payments to the public*

[Billions of dollars, seasonally adjusted annual rates]

Receipt or payment	Calendar year 1950			Calendar year 1951, first half [1]
	Total	First half	Second half	
Cash receipts:				
Federal	42.4	41.7	43.2	59.3
State and local	18.3	17.6	19.1	20.2
Total cash receipts	60.8	59.3	62.3	79.5
Cash payments:				
Federal	42.0	43.7	40.5	51.5
State and local	19.3	19.0	19.7	20.3
Total cash payments	61.4	62.6	60.2	71.8
Surplus (+) or deficit (−):				
Federal	+.3	−2.1	+2.6	+7.8
State and local	−1.0	−1.4	−.6	−.1
Total, surplus (+) or deficit (−)	−.6	−3.4	+2.1	+7.7

[1] Estimates based on incomplete data.

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

Source: See appendix table A–5.

The increase in receipts was chiefly the result of the expansion of the tax base brought about by the general rise in business activity. While a number of new taxes have been adopted by States and localities so far in 1951, and rates of many existing taxes have been raised, relatively few of these changes became effective during the first 6 months of the year. The rise in expenditures, which is due to higher materials costs and wage rates, as well as to a continued growth in regular governmental programs, has caused more and more attention to be given to possible ways of adding to revenues. (Appendix tables A–5 through A–8 give details of government finance.)

THE NATION'S ECONOMIC BUDGET

Table 23, the Nation's Economic Budget, shows the receipts and expenditures of major economic sectors for 1950, by half years, and the first half of this year. All estimates are seasonally adjusted annual rates. As shown in this table, the outstanding economic development of the second half of 1950, compared with the first half, was the growth in private incomes and expenditures, particularly business investment, while government cash payments declined. The most significant single factor was the rise in private

TABLE 23.—*The Nation's Economic Budget, calendar years 1950–51*

[Billions of dollars, seasonally adjusted annual rates]

Economic group	1950, first half			1950, second half			1951, first half [1]		
	Receipts	Expenditures	Excess of receipts (+) or expenditures (−)	Receipts	Expenditures	Excess of receipts (+) or expenditures (−)	Receipts	Expenditures	Excess of receipts (+) or expenditures (−)
CONSUMERS									
Disposable income arising from current production	175.1			195.5			203.8		
Government transfers and net interest payments	*22.3*			*15.8*			*16.4*		
Disposable personal income	*197.4*			*211.2*			*220.2*		
Consumption expenditures		186.7			200.4			205.6	
Personal net saving (+)			*+10.7*			*+10.7*			*+14.6*
BUSINESS									
Retained receipts	29.4			30.0			30.6		
Gross private domestic investment		44.0			53.8			61.8	
Excess of receipts (+) or investment (−)			*−14.6*			*−23.8*			*−31.2*
INTERNATIONAL									
Cash loans abroad	*−.2*			*.1*			*.3*		
Net foreign investment		−1.6			−3.0			−.9	
Excess of receipts (+) or investment (−)			*+1.4*			*+3.1*			*+1.2*
GOVERNMENT									
Tax payments or liabilities	64.4			75.1			88.4		
Adjustment to cash basis	*−5.1*			*−12.8*			*−8.9*		
Cash receipts from the public [2]	*59.3*			*62.3*			*79.5*		
Purchases of goods and services		40.7			44.3			57.2	
Government transfers		*21.9*			*15.9*			*14.6*	
Cash payments to the public [2]		*62.6*			*60.2*			*71.8*	
Excess of receipts (+) or payments (−)			*−3.4*			*+2.1*			+7.7
ADJUSTMENTS									
For receipts relating to gross national product	+1.0		+1.0	−5.0		−5.0	+1.0		+1.0
Other adjustments	*+4.9*		*+4.9*	*+12.9*		*+12.9*	*+6.7*		*+6.7*
Gross national product	269.7	269.7		295.6	295.6		323.8	323.8	

[1] Estimates based on incomplete data; second quarter by Council of Economic Advisers.
[2] Consolidated cash statement (including trust accounts) for Federal, State, and local governments.

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

Source: See appendix A.

business investment, which increased by 10 billion dollars over the level of the first half of the year. Consumer expenditures increased by more than 13 billion dollars, about equal to the rise in disposable income.

From the second half of 1950 to the first half of 1951, the expansion in government expenditures was almost as large as that of business and consumers combined. Consumer expenditures rose by less than income,

which raised personal saving to the highest level for any half-year since the war. Business investment continued to rise from the last half of 1950, but at a more moderate rate than last year. A large part of the increase was in inventories, a substantial portion of the increment reflecting an unexpected decline in demand on the part of consumers. Business receipts did not change greatly, since higher taxes more than offset gains in corporate profits before tax. Consequently, the excess of business expenditures over receipts rose from the already exceptional levels of 1950.

While the rise in personal saving offset in part the increase in funds needed by business to finance increased investment expenditures, there was a net inflationary impetus arising from the private sectors of the economy in the first half of this year. However, the rise in the government surplus helped to restrain inflationary tendencies. Cash receipts rose from a seasonally adjusted annual rate of 62 billion dollars to almost 80 billion from the second half of 1950 to the first half of 1951, and the cash surplus expanded from 2 billion to 8 billion. While this change resulted in part from higher corporate and personal incomes, it also reflected higher taxes, and for that reason helped to restrain inflationary forces.