

The Annual Economic Review

January 1952

A Report to the President

By the

COUNCIL OF ECONOMIC ADVISERS

LETTER OF TRANSMITTAL

COUNCIL OF ECONOMIC ADVISERS,
Washington, D. C., January 11, 1952.

The PRESIDENT:

SIR: The Council of Economic Advisers herewith submits a report, the Annual Economic Review: January 1952, in accordance with section 4 (c) (2) of the Employment Act of 1946.

Respectfully,

Leon Keyserling

Chairman.

John D. Clark

Roy Blough

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I. The Economic Strategy of the Defense Program

THE United States has undertaken an economic strategy—and supported it with a program—to achieve national security, and that degree of general well-being essential to security throughout a dangerous period of indefinite duration. We must be prepared either for a sudden shift to total war if others force the issue, or for a gradual transition to the more peaceful conditions for which we strive. Meanwhile, this generation must deal with something new in American experience, a prolonged neither-peace-nor-war existence in which this Nation has a major responsibility for world leadership.

National economic policies—both private and public—must serve our ultimate goals of security, peace, and a sound economy. But we need to view in broad perspective the basic purposes of current economic policy, before turning to a more detailed review of 1951, the objectives and problems of 1952, and policy issues raised thereby.

The basic purposes of economic policy listed in the next few pages are not new in January 1952. Our approach to these purposes in the past, however, too often has been of a piece-meal character, with inadequate attention to the meaning of the whole pattern of our national effort.

Under current conditions, economic policy must cope with more unpredictable factors than would beset the country in either a total war or a completely peaceful situation. But the unavoidable presence of many uncertainties does not mean that all policy actions should be kept fluid. True, some policies must be kept more flexible than would be necessary under other circumstances. Nonetheless, we must seek a course of policy which is sufficiently far-sighted and firm to elicit general understanding and support.

The great effort now under way clusters around these central purposes, toward which the operations of the whole mobilization effort are being vigorously directed:

(1) A clear definition and prompt execution of the basic defense program

Since the aggregate demand for resources is expected greatly to exceed their supply, achievement of the goals of national economic policy requires that resources be allocated and used as efficiently as possible. If this is to be accomplished, it is of major importance that the definition of the military program—whatever its substance—be as clear and firm as feasible.

Otherwise, with such a considerable portion of the total economic effort going to basic defense, it would be virtually impossible to keep the other components of the effort consistent with the military program and among themselves. It would be impossible to determine the portion of resources that would be available for the expansion of basic productive facilities, or to design policies needed to restrict private consumption and less essential private and public investment.

From the viewpoint of general economic policy, the speed of the military build-up is of similar interest. If the rest of the economy is to keep in step with basic defense and serve it properly, it is necessary both to know what the schedule of the defense program is and to achieve the goal on schedule.

In thus stressing the need for clearly defining the military program and achieving it on schedule, the Council is passing no judgment on the defense program as such. The Council has the responsibility of seeking to throw light on the implications for the economy of all Government programs, including the defense program. There is always the necessity of appraising the economic costs of different programs, and of developing the information and analysis that will make it possible for the ultimate decisions to reflect a correct balancing of costs against expected benefits. However, the Council does not claim any special competence to make recommendations regarding the size, composition, or timing of the basic defense program that may be required by the international situation—except in the event that the program became so large that there was real doubt about the adequacy of the Nation's economic resources to meet it. The program for this emergency, promising at the most to involve about half the relative burden shouldered at the peak of World War II, has not, in the Council's judgment, reached that size.

(2) Expansion of output

General economic growth is one of our primary objectives in peacetime. It has properly been regarded as the main avenue to an increasing abundance more generally enjoyed throughout the Nation. For this growth, we have relied mainly upon the enterprise of producers, coupled with the voluntary expression of popular wants.

In the early stages of a defense emergency, when our resources are clearly not adequate to support all types of expansion at once, the emphasis upon economic growth must be selective. Currently, this involves concentration upon munitions production, basic materials-providing and energy-producing industries, such as agriculture, steel, aluminum, electric power, and oil, and such basic economic services as our transportation system. To achieve this concentration, and to restrain types of expansion which would interfere with it, requires public policies for the guidance of production to which the Nation would not resort in more normal times.

However, the rapid expansion of these vital types of production has desirable consequences besides serving our immediate defense needs. The capacity now being built up would go a long way toward meeting the needs of full mobilization, should events suddenly thrust that upon us. Moreover, productive growth in these fields (except munitions) will provide a base for further growth in civilian supplies and in civilian-serving industries later on, even if defense outlays remain high. As this process continues, it hastens the time when the relative portions of defense and non-defense output can move closer toward their pre-emergency patterns. Thus the expansion programs now under way, if skillfully adjusted and timed, will in the longer run ease the relative burden and the relative inflationary pressures of the defense program.

Provided that the expansion of output is conducted on this balanced basis, it can make a highly important contribution toward carrying whatever burdens the Nation may have to bear. Toward this end, we should draw fully upon our still incompletely utilized resources of technology, manpower, and managerial skills.

(3) *The maintenance of a strong civilian economy*

A strong civilian economy is a foundation of military power. We must maintain civilian strength, first, with respect to private consumption. Much has been said about "guns and butter." No one in a responsible position has claimed that we can have as much "butter," while the basic defense program grows, as we could have if our supply of "guns" were not being increased. The defense program during the coming year will affect many civilian durable commodities. The cutbacks will be real. Unless demand in particular markets behaves in an unexpected fashion, some shortages as measured by market demand also are to be expected. But there is every reason to believe that Americans will continue to have *enough* "butter," in terms of ordinary standards of consumer well-being, if the distribution of goods and services is not badly distorted by further inflation. There will be adequate civilian supplies to maintain the indispensable public support upon which execution of the defense program depends, if stabilization is effective, and if the people and the Government join in a clear understanding of the nature of the program and its urgency.

But "guns and butter" is deficient terminology. It is much too categorical in its assumption of a sharp line between the factors that are essential for security and those that are not. In a race which promises to be more a marathon than a sprint, good diets, health, shelter, education, recreation, and the good morale that depends upon all of these, are essential for endurance in our national security effort. Striking a balance between our needs in these respects and for primary defense is a vital problem.

Striking this balance also requires a judicious comparison of services rendered through the private economy and those rendered by government. Undoubtedly, at all levels of government, there are peacetime pro-

grams which must be cut. True economy and efficiency in public operations, desirable at all times, is imperative at a time when our resources face a persisting strain and when public financial burdens are unavoidably heavy. Yet there can be no general presumption that public outlays are wasteful or nonessential compared with private outlays. The building of a highway or a school may be far more essential to the conservation and advancement of our national strength than the building of a motion picture house or the production of luxuries. In an emergency, a sense of priority is highly important, and while many desirable public services need to be restrained until we can afford more of them, it would be false economy to strip them excessively in order to preserve materials and manpower for nonessential or wasteful private investment and consumption.

We should also seek to preserve civilian strength by avoiding unnecessary inequities and dislocations. The very essence of a rapid shift toward defense production is a substantial reallocation of economic resources. Some consequent dislocations are unavoidable. But it is an important objective of economic policy to avoid unnecessary dislocations, and to minimize the inequities among different producer and income groups. The worst potential inequities, of course, are those that would arise from serious inflation. Beyond this, however, it is highly desirable to minimize the dislocation of both employment and enterprise resulting from materials curtailment, with particular attention to the problems of small business.

(4) Maintenance of economic stability

The curbing of inflation is necessary to facilitate the defense production program, to prevent inequities, to maintain public support for the defense effort by moderating conflicts among economic groups, to minimize the financial burden of defense, and to avoid unnecessary burdens upon our allies. Consequently, the prevention of inflation is a vital element in the success of all our efforts.

For this very reason, it is important to recognize that the problem of inflation does not exist in isolation, and that stabilization measures cannot be effectively administered in a vacuum. Stabilization, in large measure, is a means to other ends. Stabilization policies are constantly being tested, not only by their immediate effect in reducing inflationary pressures, but also by their longer-range effect upon production and the utilization of our resources. Stabilization policies which are desirable for a presumably long period of partial mobilization are different from those which would be necessary in the more acute situation of total war. The programs now under way are intended to reconcile the application of controls adequate to the current situation, with allowance of sufficient play in the workings of our enterprise system for it to function more productively and more efficiently year by year.

(5) Integrating our efforts with those of our allies

In all of its economic endeavors, the United States needs to strive for a free-world-wide perspective. This is not only a matter of calculated self-interest, but is dictated by our basic concern for improving the economic and social underpinnings of democratic institutions throughout the world. As a logical consequence of processing and consuming a major share of the free world's resources, the United States must make available to others some of its resources, including its productive techniques and skills.

(6) Unity of programs and policies

There is no question that this Nation has the over-all resources to do the job, if it uses them wisely. In governmental operations under emergency conditions, the basic principles to guide the wise use of resources are similar, in some respects, to those in a business organization. A business feels that it is using its resources well when it appraises accurately the whole situation with which it has to deal, decides upon its objectives, and determines how much of its total resources it can afford to allot to various purposes. From the viewpoint of the economist, the same criteria should be applied to the immense array of complex undertakings which the Government is now performing in the mobilization effort. It would be no answer to say that the job is too big and difficult to be brought within any such vigilance. The very size of the job, and its impact upon the whole Nation, make the cost of avoidable inconsistencies or mistakes beyond the limit of what we can afford.

There are necessary limitations in this matter, arising from the very nature of our system, and from the fact that we are not now engaged in a total war. Confidence cannot be placed safely in any overrefined or overdeveloped "master planning" concept which seeks to blueprint every detail and to cover every contingency. The capacity and desire to think for ourselves is one of our greatest assets. Nonetheless, it is of the essence in defense mobilization that the decisions made at various points within the Government be interrelated. Thus, if the defense program proper is not reasonably firm and clear, the civilian programs are left in the dark. For example, a specialized agency may best determine how much housing or schools the localities need. But while supplying these needs in full would be desirable under other circumstances, the specialized agency needs guidance when a defense program and an industrial expansion program must be given some priority because of the pressure of large total demands upon limited total supplies.

The Council has called this necessary process during the current emergency "programming." In our Midyear Economic Review last July, we broke down this "programming" process into four main parts:

- (1) The clear definition of major goals—military, international, industrial, and civilian—and continuous testing of their feasibility one against the other to keep them in balance. The desired balance, of course, may change with changes in the international situation.

(2) A continuing determination of the relative part to be played, in achieving these goals, through the expansion of some supplies on the one hand and the reduction of some demand on the other. This means an integration of all major economic policies toward a common purpose.

(3) A continuous scheduling and timing of specific major program objectives.

(4) A reasonably complete and continuous synthesis or inventory at *one central point* of all the vitally 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.

With all the sizable gains which have been made, the Council believes that for ensuing stages of the mobilization effort the "programming" process should be further advanced. As the impact of the defense effort upon the economy increases, the importance of over-all policy integration will increase correspondingly.

(7) *The enlistment of public support*

In a democratic nation, particularly during a defense emergency, one cannot draw a sharp line between the exertions of the government and the exertions of the people whose government it is. What the Federal Government does is only a fractional part of our total national effort; most of the planning and work are carried forward by industry, agriculture, labor, and the other major elements in our enterprise system.

The great danger that we face, in the long run, is not an inadequacy of our combined private and public resources. The great danger is rather that, faced with problems so different from any confronting us before, we might get an admixture of private and public action not best suited to our native genius and not compatible with advancing the strength of our free institutions. The emergency indeed requires that the Government do more things than in normal peacetime, and influence the economy in more ways. But this fact does not diminish the force of the proposition that the Government should do only what is essential and what others cannot do as well.

But whatever may evolve as a proper dividing line between private action and public action, the scope of public action will remain large during the emergency. Consequently, the sharing of responsibility for public action should be upon a broader base than in normal peacetime. While progress in this direction has been made during the past year, the Nation has not yet found an adequate formula for welding together the brains and experience of our enterprise system with that of our public service in dealing with problems at the national level. This is not simply a matter of recruiting people from private enterprise into government jobs, although that too is important. The leadership of our great economic

groups, while functioning as such, must be brought into a sympathetic relationship to some of the great decisions of national economic policy.

It is no answer to this need to recite the old *cliché* about avoiding conflicts of interest. The conflicts of interest are there, whether we see them or not, and the only question is whether they are allowed to mount to the point where they could imperil our security and impair our whole economy, or whether some way can be found to reduce these conflicts to manageable proportions. And the only way to reduce such conflicts, in a democracy, is for people to find ways of working together.

The active and integral participation by major group leaders in the shaping of national economic policy, through the channels of their organizations, carries a keener sense of active responsibility for the defense effort to great numbers of our people. In addition, there is need for efforts to increase the effectiveness of broad-scale citizen participation in the over-all defense program through local and regional activities. The success of these attempts will depend heavily upon the extent to which those at the center of the effort are able to convey to the Nation at large a comprehensive picture of national policies and problems.

These problems arise out of the essential nature of our economic system—a system in which freedom and flexibility are held precious; a system in which command can never take the place of assent; but a system in which, nonetheless, group interests have become so strong that their apathy or defiance could imperil the whole national effort.

Many steps have been taken, during the past year, to face up to this problem of unity as it arises out of the relationship between a free people, a free enterprise system, and a free government in a time of emergency. No one would claim that the solutions thus far attempted have yet been entirely satisfactory. But in this connection, the National Advisory Board on Mobilization Policy represents a prime vehicle and a great forward step. This Board has made a good beginning, and may become even more effective with further improved staffing and agenda.

But this problem cannot be solved simply by the creation of more machinery; it requires that the *will* to solve it exist in the minds and hearts of men both inside government and outside government. It depends upon the common consciousness that we are confronted by world dangers which make the things that can hold us together infinitely more important than those that might tear us apart.

II. Detailed Developments During 1951

LIKE March in the old adage, the economic year 1951 came in a lion and went out a lamb. The inflation that raged at the beginning of 1951 was replaced near the end of the first quarter by stability of such persistence that the causes and probable duration of "the lull" became a foremost topic of speculation among economists and businessmen.

Broadly speaking, the dominant trends of the year were the rise in Government buying for the security program and the change in the pace of consumer buying, which surged to a crest in the first quarter, then abated, and remained relatively stable during the rest of the year. In the first months of 1951, private demand for goods reinforced an ascending Government demand to bring inflation; later, it counteracted an expanding Government demand to help bring stability.

The bad news from Korea in the first weeks following the intervention by China caused consumers to continue buying at a high rate after the close of the Christmas season. Though retail sales dropped from 14.8 billion dollars in December 1950 to 12.2 billion in January and to 11.2 billion in February, this was less than the usual seasonal decline. At seasonally adjusted annual rates, retail sales rose 8.5 percent from the fourth quarter of 1950 to the first quarter of 1951. Manufacturers and merchants took an exceedingly optimistic view of prospective market demand, and the former expanded their output while the latter flooded their suppliers with new orders. The increase in Government purchases for national security programs combined with the heavier buying in civilian markets to extend and in some cases to speed the rapid rise in prices that had begun in 1950.

The situation was reversed in the second quarter. Retail sales were 3 percent greater than in the first quarter, but this was much less than the normal increase for those months. On a seasonally adjusted basis, retail sales were 6.5 percent lower in the second quarter than in the first quarter. The inflow of many kinds of merchandise ordered in the optimistic mood of the first quarter piled up in the inventories of merchants and in the warehouses of manufacturers, to hang over the market for the remainder of the year.

During the second half of 1951, retail sales (seasonally adjusted) were not much above the second quarter level. National security expenditures continued to rise, though more slowly than in the first half of the year, but private investment fell off, principally because of a lower rate of inventory

accumulation. Prices remained fairly stable and total output, after remaining steady in the third quarter, rose moderately in the fourth. The lull that had begun near the end of the first quarter persisted through the second half of the year.

The first months of active inflation were marked by some financial factors which are believed by many people to reduce inflationary pressures, while the 9 months of relative quiet were characterized by several factors which similarly are believed to generate inflationary pressures. There was a record Government cash surplus in the first quarter of 1951 and an accompanying decline in the privately-held money supply. Outstanding consumer credit, after rising rapidly through December, fell to a lesser degree in the first quarter of 1951. On the other hand, during the months of stability, there was a Government cash deficit which rose steeply from quarter to quarter, the money supply climbed more sharply than in the same period of 1950, and, after midyear, consumer credit and loans of commercial banks resumed their expansion. In the case of these series, the year 1951 demonstrated the hazards of interpreting short-range developments in the economy as a whole, through the use of a limited number of indicators, many of which are likely to reflect seasonal movements.

Some important financial factors showed a different pattern. Total bank loans increased more than twice as much during the 9 months from July 1, 1950, to March 31, 1951, as during the following 9 months. During the former period, long-term Government securities found a ready market without risk of loss in the Federal Reserve banks, which was not true during the latter period. Heavy tax increases passed in 1950 became fully effective in 1951, and further increases were hanging over the heads of consumers and businesses through most of 1951. The Revenue Act of 1951, passed in October, applied higher rates to 1951 corporate income, and imposed increased withholding and excise tax rates which became effective November 1, 1951. Moreover, the lags in the impact of the financial factors must not be overlooked in interpreting their effects on inflationary pressure.

In general, 1951 was a year of some surprises and, in a sense, of some paradoxes. We shall try in this Part to set down the facts of the year's economic record. In Part III, we shall consider the principal economic problems which will confront the Nation in the year ahead as a result of the combination of these facts and of our broad policy objectives.

THE BASIC SECURITY BUILD-UP

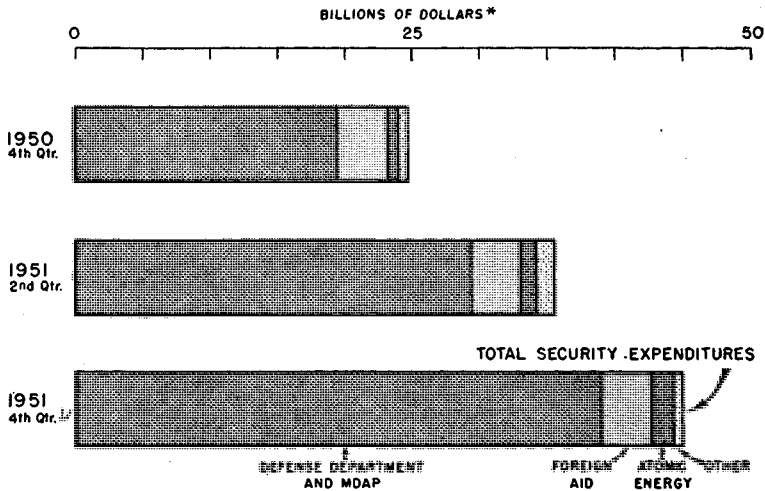
During the past 12 months, the annual rate of expenditure for the major national security programs—both domestic and international—increased by more than 20 billion dollars, reaching a rate of 45 billion dollars in the fourth quarter. Currently, the national security programs are taking about 14 percent of gross national product, compared with 8 percent a year ago. (See chart 6.)

CHART 6

NATIONAL SECURITY EXPENDITURES

FOR GOODS AND SERVICES IN 1951 PRICES

During 1951, the annual rate of national security expenditures increased by about 20 billion dollars. The build-up of our military establishment and military aid to other countries accounted for more than 85 percent of total security expenditures.



* SEASONALLY ADJUSTED ANNUAL RATES.

1/ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCES: DEPARTMENT OF COMMERCE AND COUNCIL OF ECONOMIC ADVISERS.

The rate of expansion of the security programs slackened toward the end of 1951. During the last quarter, security expenditures are estimated to have increased only 3 billion dollars, at an annual rate, compared with an average increase of 6 billion dollars in each of the previous three quarters. Since the middle of the year, foreign economic aid expenditures have not increased, and there has been a considerable reduction in stockpiling expenditures. The decline in stockpiling expenditures reflected not only a general reduction in purchases for the stockpile, but also an actual suspension of purchases of some strategic materials, a reduction in the availability of some that come from foreign areas, and sharply rising domestic requirements for defense production and expansion of industrial capacity.

During the first half of last year, military expenditures, including expenditures for foreign military aid, increased steadily and rapidly, partly as a result of the large increases in military pay and purchases of soft goods associated with rapid expansion in the size of the armed forces. In the second half, as the composition of the program shifted more towards expenditures on hard goods and military construction, expansion in total spending was necessarily slower. At the present time, about half of total military outlays are for hard goods and military construction.

While deliveries of military hard goods and military construction put in place increased by about 250 percent from the fourth quarter of 1950 to the fourth quarter of 1951, the increase in actual military production during the period was somewhat greater. It was to be expected that, during the earlier phase of the program, expansion of military production pipelines would be larger than the increase in actual deliveries. Deliveries of types of military equipment which are easier to produce—like ammunition, weapons, and vehicles—increased enormously over the levels of the autumn of 1950. On the other hand, the gain in aircraft deliveries, which will account for about 25 percent of the military production program, was more moderate.

As will be indicated in Part III, future increases in security expenditures will be very largely for military hard goods, especially for items which are more difficult to produce.

PRODUCTION AND EMPLOYMENT

Production

Total output of the economy, measured by gross national product adjusted for changes in prices, rose about 5 percent from the fourth quarter of 1950 to the fourth quarter of 1951. The bulk of the increase occurred in the first half of the year; in the second half, aggregate output was nearly stable. For the year as a whole, total national output was 8 percent above 1950, and the rise in the private sector of the economy was 7 percent. (See chart 7 and appendix tables B-2 and B-3.)

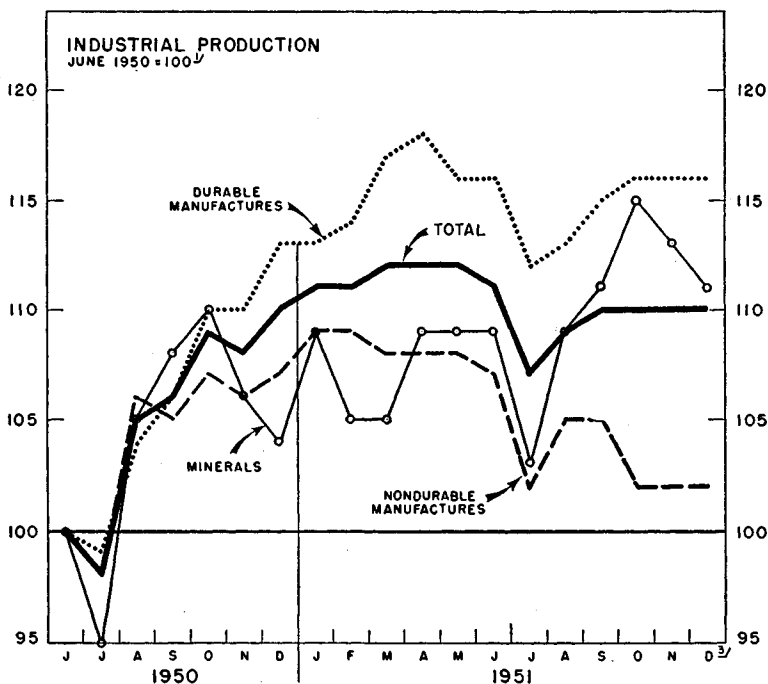
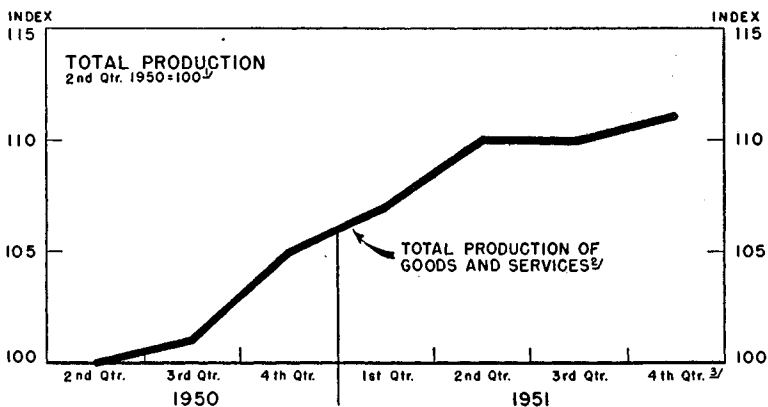
Industrial production. Industrial production fluctuated within a narrow range through most of 1951. The index, estimated at 218 in December 1951, was at about the same level as a year earlier. (See chart 7 and appendix table B-16.) This relative stability of total industrial production for the past year resulted from differing trends in the defense and consumer goods sectors of the economy. Defense and munitions output continued to increase. Aircraft manufacture, railroad equipment production, and ship-building activity rose on the average by about 50 percent from January to November. Machinery output climbed during most of 1951, and by November was 7 percent above the beginning of the year.

Output of both durable and nondurable consumer goods decreased after the first quarter of the year. Consumer durable goods output dropped by about one-third from March to November, partly in response to cutbacks in materials, partly in response to the decline in consumer demand. Passenger car production fell from an annual rate of 6.4 million units in the first quarter to a rate of 4.4 million in the last quarter. The rate had been 6.7 million in the fourth quarter of 1950, and 4.6 million in the same quarter of 1949. Output of major appliances, such as washing machines, refrigerators,

CHART 7

PRODUCTION

Total output of goods and services continued to climb in the first half of 1951, but leveled off in the second half. Total industrial production was somewhat lower in the second half as the continued advance of producers' durable equipment and munitions was more than offset by declines in the consumers' sector of durable and nondurable manufactures.



^{1/} INDEXES BASED ON SEASONALLY ADJUSTED DATA.

^{2/} INDEX BASED ON GROSS NATIONAL PRODUCT IN 1951 PRICES.

^{3/} PRELIMINARY ESTIMATES.

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

stoves, and vacuum cleaners, suffered particularly sharp declines, and the production of radios and television sets fell steeply after February.

Total production of nondurable goods industries declined gradually during most of the year. By November, production was 7 percent below January. The textile industry, in particular, greatly curtailed output during the second half of the year. Even the production of chemical products, which had risen continuously since early 1950, reached a plateau toward the end of 1951.

Minerals output moved irregularly higher during the year to a new record in October, largely because of the rising production of crude petroleum. The latter was at an all-time high in October, and then tapered off somewhat as production allowed in the Texas fields was cut. Bituminous coal output rose substantially in the latter part of the year, as exports to Europe increased.

Production of electric power, which is not included in the industrial production index, reached record levels in 1951, and averaged 13 percent above the previous year.

The year's developments in the construction industry are summarized in the discussion of investment activity during 1951.

Agricultural production. Despite adverse developments in the fall months in the outturn of some crops, notably cotton and corn, agricultural production in 1951 maintained the high level of recent years. (See appendix table B-16.) High-level agricultural output enabled us to meet the expanded demands for food and fiber of a military force which more than doubled in the past year, to increase shipments of food to friendly foreign countries, and to raise average food consumption in this country slightly above the pre-Korean level.

The 1951 production record is all the more impressive in view of the handicaps of drought and floods, and a continuation of the long-run decline in agricultural employment, as some farm workers shifted to defense industries. There were also shortages of some materials, particularly fertilizers.

Current estimates for cotton indicate a crop of 15.3 million bales in 1951, 53 percent larger than in 1950. Expected domestic and foreign demand for cotton in relation to total available supplies point to little, if any, buildup in the present relatively low cotton stocks. Record supplies of fats and oils are available. But production of feed grains and concentrates indicates that supplies for the 1951-52 feeding year will be about 5 percent smaller than for 1950-51, when carryover stocks were being reduced.

Poultry and egg production in 1951 was nearly 7 percent higher than in 1950, and hog slaughter was up about 8 percent. Cattle slaughter was relatively small in 1951, partly because producers expanded their breeding herds. The number of cattle on farms in early 1952 was at record levels, several million head above a year earlier. Reduced feed supplies and a

continued high output of livestock and livestock products point to a further cut in reserve stocks of feed grains during the 1951-52 feeding year.

Services. Personal expenditures for services, in constant prices, rose about 3 percent above 1950, a smaller increase than that recorded in any other recent year. (See appendix tables B-2 and B-3.)

Employment

The total labor force, civilian and military, increased from about 64.7 million in December 1950 to more than 66 million in December 1951. But because of the growth in the armed forces, the civilian labor force increased only slightly during the same period—from 62.5 million to 62.7 million. Total civilian employment rose from 60.3 million in December 1950 to 61.0 million in December 1951. Over the year, total civilian employment averaged about 1 million higher in 1951 than in 1950. (See chart 8 and appendix table B-11.)

While the long-run decline in agricultural employment continued, non-agricultural employment during 1951 averaged about 1.5 million above 1950, with each month of the year outstripping the same month of the previous year; but the margin became generally smaller as the year progressed. December employment in nonagricultural activities was 54.6 million, compared with 54.1 million a year earlier.

The number of employees in manufacturing in 1951 averaged 15.9 million, the highest since World War II. The shifting pattern toward increased defense activity was evidenced by the fact that employment in durable goods industries was 280,000 higher in November 1951 than a year earlier, while employment in the nondurable goods field was about 180,000 lower. (See appendix table B-12.) The increase since Korea of about 3.5 million persons engaged directly or indirectly in defense work was made possible primarily through the shifting of workers from nondefense work, and also through a considerable absorption of unemployed persons.

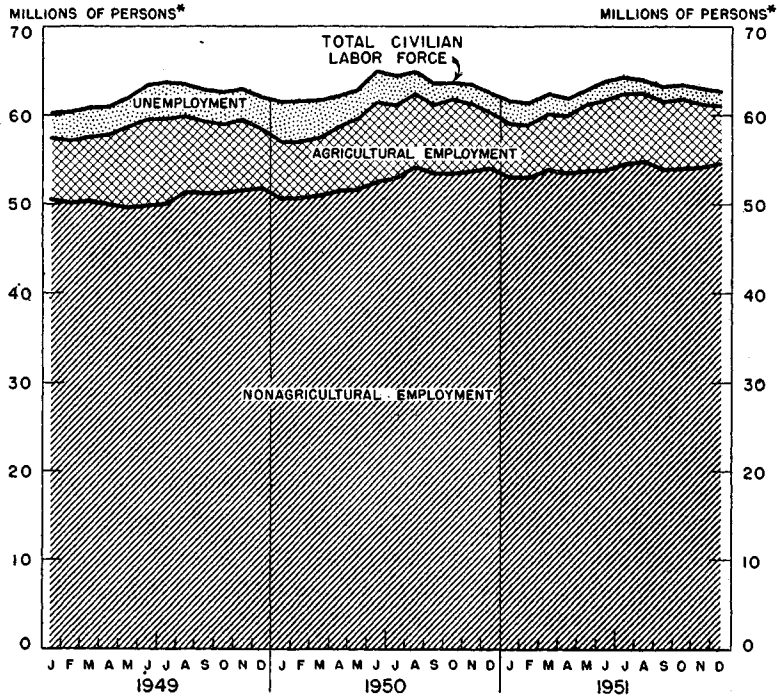
About 5.5 million persons are now engaged directly or indirectly in defense production, excluding work on privately-financed facilities construction. Of this total about 750,000 are in aircraft, private shipyards, and ordnance; the rest are employed in Federal defense agencies, or work in mining, in the production or transportation of metals, machine tools, machinery, scientific instruments, chemicals, or rubber products, or in other activities needed for supplying the armed forces. These adjustments in employment were made while we continued to maintain our civilian economy at a high level. Material shortages have, in some instances, restricted the output of certain specific goods, but so far, lack of manpower has not played a significant part in holding down civilian output. In fact, layoffs in many consumer goods industries in the latter part of 1951 were the highest recorded for that time of the year since 1945.

The workweek, which had averaged more than 41 hours for total manufacturing in the last half of 1950, dropped slightly during the first half of

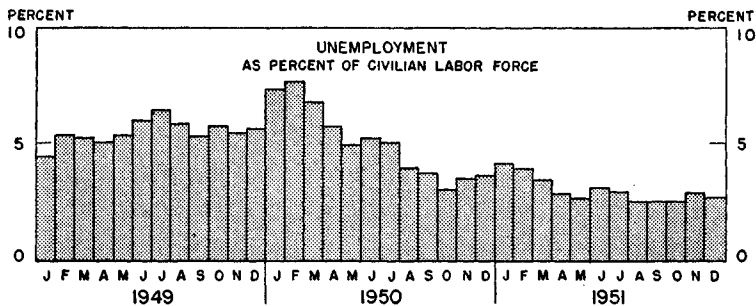
CHART 8

CIVILIAN LABOR FORCE

The civilian labor force in 1951 was almost as large as in 1950, despite the growth of the armed forces. Total employment averaged 61 million, or an increase of 1 million compared with the previous year. Agricultural employment, continuing its long-run decline, decreased about $\frac{1}{2}$ million, while nonagricultural employment rose by $1\frac{1}{2}$ million.



Unemployment for the year averaged about 2 million — a decrease of about $1\frac{1}{4}$ million, or 40 percent, from the 1950 average.



*14 YEARS OF AGE AND OVER

SOURCE: DEPARTMENT OF COMMERCE

1951, and, after the vacation months, leveled off at about 40½ hours. For the year as a whole, the workweek averaged slightly higher in 1951 than in 1950. Many plants in the durable goods area, particularly in the machinery and metalworking groups, were on a 48-hour week. Curtailment in nondurable goods production reduced the workweek in that sector slightly more than 1 hour from November 1950 to November 1951. (See appendix table B-13.)

Unemployment. Unemployment decreased from about 2.2 million persons, or 3.6 percent of the civilian labor force, at the end of 1950 to 1.7 million, or about 2.7 percent, at the close of 1951. (See chart 8 and appendix table B-11.)

Important changes have occurred in the duration of unemployment. Over the year the number who had been seeking work 15 weeks or more declined more than 40 percent, from 410,000 to 230,000.

The national averages obscure somewhat the unemployment which has developed in some areas as a result of the shift from civilian to defense production. In some geographical areas, the increase in defense output has failed to provide enough employment to offset the declines resulting from the defense program. In Michigan, for example, the number of persons drawing unemployment compensation in November 1951 was nearly 2½ times that in November 1950. In Detroit, the impact of material and production regulations and a slackening in automobile demand have carried to the point where, in the Nation's largest durable goods producing center, somewhat more than 100,000 people are reported out of jobs.

In November 1951, despite the low level of unemployment nationally, there were 15 major labor market areas, as well as 5 minor ones, which were characterized as areas of substantial labor surpluses. Some of our larger metropolitan centers such as New York and Providence are included in this group. Few, if any, of these 15 areas have been pushed into this surplus labor category by the controls required by the defense program; many, in fact, are communities in which unemployment has been a problem for some time. Defense production in these places is either relatively unimportant or has been insufficient to absorb the labor surpluses which have developed as a result of long-standing economic problems.

Among the States where unemployment has been growing are Michigan, Wisconsin, Massachusetts, Tennessee, Georgia, North Carolina, and Rhode Island. Cutbacks in orders for such consumers' goods as textiles, apparel, shoes, and jewelry aggravated the persisting unemployment problems in such local areas as Lawrence, Lowell, Manchester, Providence, and Brockton.

Work stoppages. During 1951, less than one-quarter of one percent of total estimated working time was lost by strikes. Total man-days of labor lost through work stoppages during this period were lower than in any other postwar year.

A work stoppage on major railroads of the country began near the end of January when several hundred yard workers took "sick leave". Eventually the stoppage involved about 70,000 workers in the industry. The last workers returned to work about February 10. Steel production was affected by a work stoppage at various locations of the Tennessee Coal, Iron and Railroad Company in Alabama, which lasted from February 22 to March 6, and idled 18,000 workers at its peak.

Another significant labor stoppage in the first part of 1951 was in the textile industry. Between mid-February and late April, 70,000 members of the Textile Workers Union (CIO) engaged in strikes of varying durations at some 160 woolen and worsted mills, mostly in New England and the Middle Atlantic states.

On August 27, there was a serious work stoppage curtailing copper production. It involved an estimated 40,000 workers, mostly members of the Mine, Mill, and Smelter Workers Union. On August 31, about 10,000 of these workers returned to their jobs after a settlement was reached with the Kennecott Copper Corporation. Following an injunction issued under Federal labor laws ordering a return to work and a resumption of collective bargaining, settlements also took place with three other major copper producers.

PRICES, WAGES, AND PROFITS

Prices

During most of 1951, prices were relatively stable, with wholesale prices showing a moderate decline, and consumers' prices rising slowly. This pattern of price movements was in striking contrast to the violent waves of general price increases which marked the second half of 1950 and early 1951, and which were finally curbed only after the imposition of the general price and wage freeze late in January.

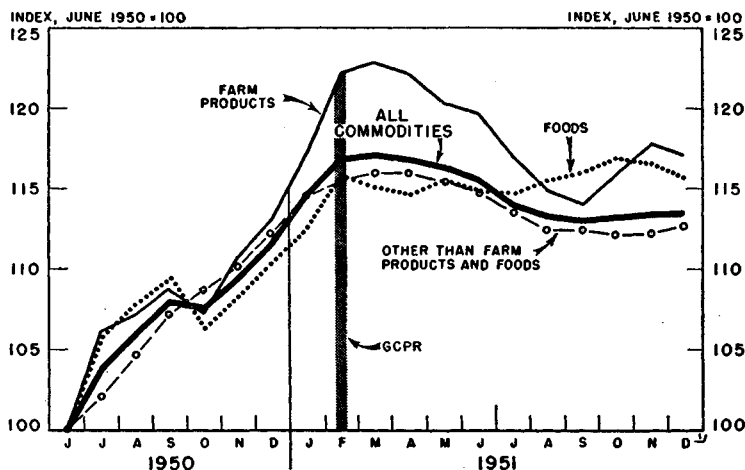
Since the General Ceiling Price Regulation was issued, consumers' prices have advanced 2.6 percent; wholesale prices have declined 2.9 percent; and the index of 28 "sensitive" primary market commodities has shown a large drop of 15.7 percent. But consumers' prices are 10.8 percent higher than at the Korean outbreak, wholesale prices are 13.4 percent higher, and the prices of primary commodities, 23.2 percent higher. (See charts 9 and 11, also appendix tables B-22 and B-23.)

Wholesale prices under controls. Wholesale prices have gone through three periods since the general freeze. (See table 1.) First, they continued to rise for a short time after price controls were imposed, but much more moderately than in the period immediately preceding control. The rise was primarily concentrated among those agricultural and food prices left uncontrolled for legal or technical reasons. The rise in these prices virtually ended in February.

CHART 9

WHOLESALE PRICES

Average wholesale prices declined during the spring and summer of 1951 and at the end of the year were moderately lower than at the time of the general price freeze.



¹PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF LABOR (EXCEPT AS NOTED).

In the middle of the second quarter, as excessive inventories developed, a selective drop began in wholesale prices which continued until autumn. The markets particularly affected were those closely tied to consumer demand, notably textiles, hides and leathers, and some farm products. Inflationary pressures continued heavy in markets where the expanding security program exerted a strong pull. (See chart 10 and appendix table B-23.)

By the beginning of the fourth quarter, the period of major price declines was over, as inventories had been brought more closely in line with sales. Subsequently, there was only a moderate stiffening in price trends.

In December, wholesale farm prices were 4.1 percent lower than at the time of the general freeze. The declines began in late spring and continued through the summer. They were caused by the expectations of very good crops, the sagging demand for such commodities as cotton and wool, seasonal declines in fresh fruits and vegetables, and the relaxation of general inflationary pressures. But by early autumn, farm prices began to strengthen again as crops proved to be smaller than expected. Particularly noteworthy was the recovery of cotton prices, which brought them at times close to the ceilings. The lagging demand for textiles, however, prevented a full return to ceiling levels.

TABLE 1. *Changes in wholesale prices*

Commodity group	Percentage change		
	Korean out- break to General Ceiling Price Regulation ¹	General Ceiling Price Regula- tion to December 1951 ¹	Korean out- break to December 1951 ¹
All commodities.....	+16.7	-2.9	+13.4
Farm products.....	+22.1	-4.1	+17.1
Grains.....	+13.4	+2.9	+16.7
Livestock.....	+20.5	-11.7	+6.4
Foods.....	+15.7	-1	+15.7
Meats.....	+13.8	-3.2	+10.2
Other than farm products and foods.....	+15.5	-2.6	+12.6
Hides and leather products.....	+30.4	-18.4	+6.5
Textile products.....	+32.4	-11.3	+17.5
Fuel and lighting materials.....	+4.1	+8	+5.0
Metals and metal products.....	+9.4	+1.8	+11.4
Building materials.....	+12.9	-1.4	+11.2
Chemicals and allied products.....	+28.6	-6.5	+20.3
Housefurnishing goods.....	+19.4	-1.9	+17.1
Miscellaneous.....	+24.4	+5	+25.0

¹ June 1950 data used for computing changes since the Korean outbreak and February 1951 data for changes since the General Ceiling Price Regulation. The latter most nearly reflect the level at the time of the general price freeze in late January.

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

Beef cattle prices continued strong through most of the period. The abolition of slaughtering quotas created considerable difficulty for the control of beef prices during late summer and early fall when marketings continued small as farmers further built up their cattle herds. There was great pressure for the elimination of all controls on beef, which may have contributed to the unusually small marketings of beef cattle. Prices of some grades of cattle rose at times to levels considerably above those which reflected the retail beef ceilings. However, by November the seasonal increase in marketings became heavier than usual, leading to alleviation of the supply situation and to a moderate decline in cattle prices.

Hog prices, which were strong during the first half of 1951, became weaker beginning in late summer as marketings increased seasonally. However, the total decline in the autumn was a little less than usual in percentage terms, and prices at their seasonal low in December were about the same as a year before.

The parity ratio reached a post-Korean peak of 113 in February, and then declined to a 1951 low of 103 in September. This drop reflected primarily changes in prices received by farmers, as prices paid by farmers fluctuated within a very narrow range after April. The ensuing strengthening of farm prices resulted in a rise in the parity ratio to 107 in December, which was slightly lower than a year earlier. In June 1950, the ratio was .97. (See appendix table B-24.)

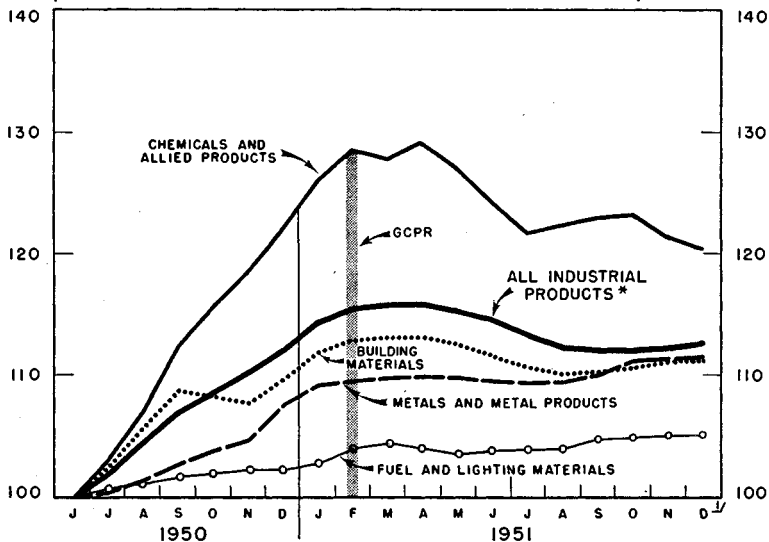
CHART 10

WHOLESALE PRICES OF INDUSTRIAL PRODUCTS

Industrial prices showed mixed trends in 1951. Metals and metal products were strong because of the impact of the growing security program. Sagging consumer demand and excessive inventories caused declines, particularly in soft goods.

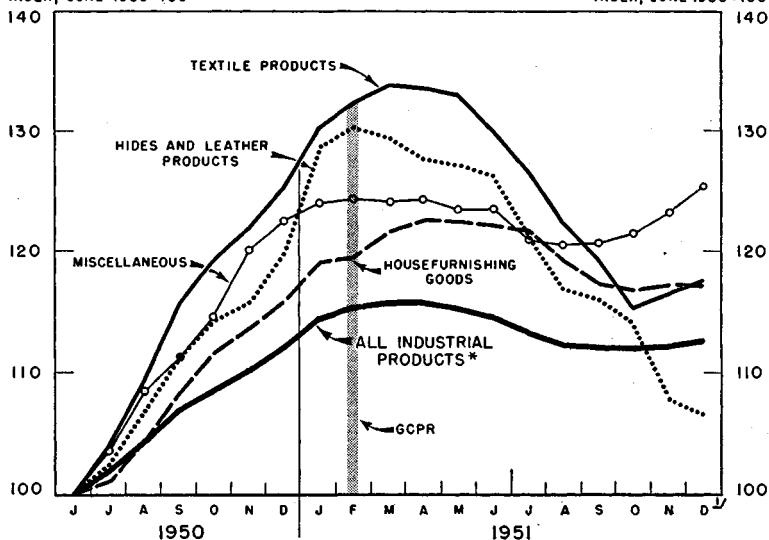
INDEX, JUNE 1950=100

INDEX, JUNE 1950=100



INDEX, JUNE 1950=100

INDEX, JUNE 1950=100



* ALL COMMODITIES OTHER THAN FARM PRODUCTS AND FOODS.

⌋ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF LABOR (EXCEPT AS NOTED).

Unlike farm and industrial prices, wholesale food prices were virtually unchanged at the end of the year, compared with their level at the time of the general freeze. After mid-February they fluctuated irregularly within a narrow range, with compensating price movements, largely seasonal, in different groups of foods. (See chart 9.)

During the same period, industrial prices declined 2.6 percent. (See chart 10.) The drop was highly selective. Many prices fell below ceilings, some drastically, while at the same time many other prices strained at the ceilings. The declines affected large areas where problems of "excessive" inventories developed in the spring. The sharpest declines were in commodities like cotton, hides, rubber, tin, wool, and tallow, in which there had been great speculative price increases immediately after Korea. The price decline in most commodities in this group was concentrated in the spring and summer. By autumn, the downward movement had more or less spent itself and some minor upturns in prices took place.

The textile and the hides and leather products groups showed the largest average declines from the general freeze to the end of 1951, the former dropping 11.3 percent and the latter, 18.4 percent. Within these subgroups, the declines, like the earlier rises, were greatest at the raw material levels, and least at the final stages of fabrication. Thus, hides registered the largest decline and shoes the least; cotton grey goods the most, and cotton clothing the least.

Other industrial products in which there were substantial price declines were chemicals, which fell 6.5 percent after the general freeze, mainly as a result of a sharp drop in the prices of fats and oils following steep rises prior to the freeze. Prices of industrial chemicals, fertilizer materials, and drugs and pharmaceuticals were firm, or advanced.

Both metals and metal products, and fuels and lighting, accounting for more than 40 percent of the industrial products group, advanced after the general freeze, the former by 1.8 percent and the latter by 0.8 percent. The metals and metal products group is particularly subject to the impact of the expanding security program. The large demand for fuel contributed to strength in the prices of petroleum and other fuels. Since these groups are subject to price control, little upward movement was recorded, except to reflect permitted adjustments in ceiling prices, as in the cases of automobiles, and lead and zinc. (See appendix table B-23.)

Consumers' prices under controls. The trend of consumers' prices following the general freeze was quite unlike that of wholesale prices. After the general freeze, the consumers' price index continued to rise until May, then leveled off, and remained virtually unchanged until September, when it began a new rise.

The greater strength of consumers' prices during this period, compared with wholesale prices, is accounted for by a number of factors. For many commodities, winter clothing, for example, it normally takes a considerable

TABLE 2. *Changes in consumers' prices*

Item	Percentage change		
	Korean outbreak to General Ceiling Price Regulation ¹	General Ceiling Price Regulation to November 1951 ¹	Korean outbreak to November 1951 ¹
All items.....	+8.0	+2.6	+10.8
Food.....	+11.3	² +2.4	² +13.9
Apparel.....	+9.4	+2.8	+12.5
Rent.....	+2.4	+3.7	+6.1
Fuel, electricity, and refrigeration.....	+3.5	+6	+4.1
Housefurnishings.....	+13.5	+5	+14.1
Miscellaneous.....	+5.6	+3.2	+8.9

¹ June 1950 data used for computing changes since the Korean outbreak and February 1951 data for changes since the General Ceiling Price Regulation. The latter most nearly reflect the level at the time of the general price freeze in late January.

² A preliminary survey indicates that food prices advanced by 0.2 percent from November 15 to December 15.

Source: Department of Labor. (See appendix table B-22.)

time for price increases at wholesale to show up at retail. Part of the strength of the index was due to the rise in food prices, as consumers maintained a high demand for what are basically nonpostponable purchases. The consumers' price index includes many items over which controls are lacking or are only partial, thus permitting further price increases. In addition, part of the increase in the index was due to the new excise taxes.

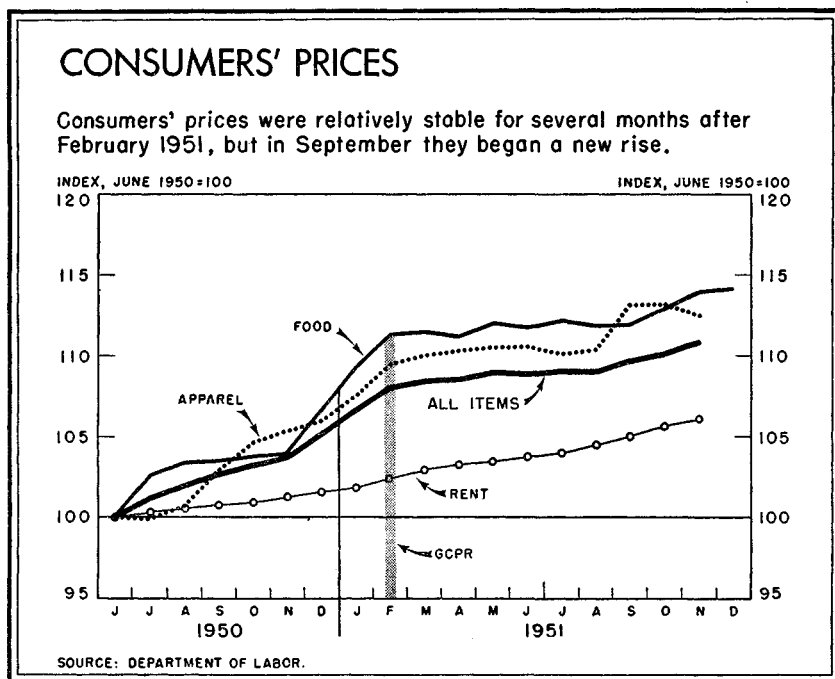
All major components in the index have continued to advance since the inauguration of price controls, with the largest increase, 3.7 percent, occurring in rents, which are subject only to partial control. (See table 2 and chart 11.) The tempo of increases in rents, which have been rising steadily during the postwar period, has been sharply stepped up in the last year and a half, as more and more areas have been exempted from controls, and more liberal rent adjustments have been required by law. In addition, the increased demand for housing under the impetus of the defense program has played an important role in many areas. Progress has been made, however, in returning areas to rent control under the new law.

Prices of the miscellaneous group of goods and services have increased 3.2 percent since the imposition of the General Ceiling Price Regulation. More than 1 percent of the rise came in November, following the imposition of increased Federal excise taxes which became effective in that month.

The 2.8 percent rise in apparel prices—the major part of which occurred in September—reflected the accumulated effect of the cost increases since the year before in the pricing of the new lines of fall merchandise.

Retail food prices have been generally strong throughout the period February to November 1951, with only minor dips. The rise in retail meat prices has been slightly greater than the average rise in food prices, amount-

CHART 11



ing to 2.7 percent, compared with 2.4 percent for all foods, and 2.6 percent for the consumers' price index.

Wages

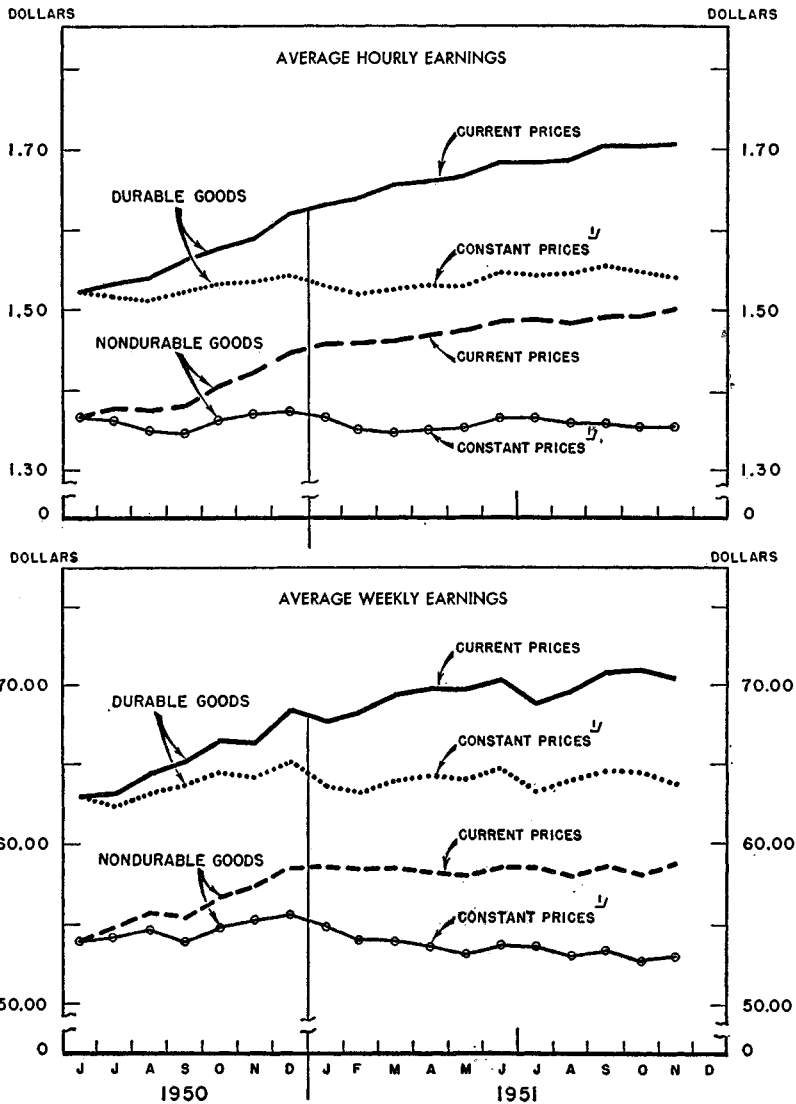
The upward creep in wage rates was one of the most important factors responsible for the increased total labor income in 1951. In manufacturing industries, average hourly earnings rose 11 cents, from \$1.51 in November 1950 to \$1.62 in November 1951. Workers in the durable goods manufacturing industries received average hourly wages of \$1.70 in November 1951, an increase of 12 cents, or about 7 percent, from November 1950. The rise in the nondurable goods sector was smaller, from \$1.42 in November 1950 to \$1.50 in November 1951. (See chart 12 and appendix table B-14.)

Hourly earnings in manufacturing exclusive of overtime pay rose 10 cents or about 7 percent from November 1950 to November 1951, somewhat less than the rise in gross pay. From February 1951, the first month of operation of the wage stabilization program, to November, gross hourly earnings rose 6 cents, or 4 percent. Straight-time hourly rates also increased by 6 cents, or 4 percent.

Average weekly earnings in manufacturing rose by less than hourly rates, since average hours of work were lower in November 1951 than in the

AVERAGE EARNINGS IN MANUFACTURING INDUSTRIES

Average hourly earnings rose slowly throughout 1951, but when adjusted for price changes were fairly constant. There was a smaller rise in average weekly earnings, due to a slight decline during the year in the workweek.



^{1/2} EARNINGS IN CURRENT PRICES DIVIDED BY CONSUMERS' PRICE INDEX ON BASE JUNE 1950=100.

SOURCES: DEPARTMENT OF LABOR AND COUNCIL OF ECONOMIC ADVISERS.

same month of 1950. In all manufacturing industries, average weekly wages rose by about \$3.02, or 5 percent, to a level of \$65.25 in the 12 months beginning November 1950. In the durable goods sector, weekly earnings advanced by \$4.08, while the rise in nondurable goods industries was \$1.50. (See appendix table B-15.) It has been estimated that average weekly earnings of clerical and professional workers, as distinct from wage earners, rose around 6 percent in the 12-month period.

Wage negotiations. During the year, wage negotiations were conditioned by the wage stabilization program, which affected practically every contract signed in 1951.

As a necessary prelude to the development of a wage stabilization program, the Wage Stabilization Board froze wages on January 26, 1951. Just prior to this freeze an unusually large number of settlements took place. Many new contracts were negotiated at that time through mutual consent, since the terms of existing contracts did not contain wage reopening provisions effective in January. Many deferred increases negotiated in 1950 also became effective in that month. In addition, there were numerous instances of consent to the immediate payment of increases which were scheduled to become effective later in 1951.

The freeze was relaxed on January 30, by a regulation which authorized increases that were to become effective before February 10, when called for by agreements antedating the freeze. The bituminous coal and anthracite agreements, which raised wages \$1.60 a day, fell within this category. In the 4 or 5 weeks following the freeze order, wage settlements were few.

With the removal of the freeze and the initial development of Board policy, wage settlements became more numerous. These settlements represented mainly a completion of pre-stabilization wage movements and negotiations interrupted by the freeze. As a result, wage increases were agreed upon or put into effect for more workers during March than in any of the preceding 12 months. A wage settlement, which contained a cost-of-living escalator clause, and which affected about 1 million railroad workers, was reached on March 1. Announcement of the BLS consumers' price index for January brought cost-of-living wage increases for more than a million workers covered by contracts with automatic escalator clauses. Many of the settlements negotiated during this period, particularly in the textile industry, provided for general increases and supplementary benefits in excess of the limit allowable without prior approval of the Wage Stabilization Board. In other instances, employers voluntarily raised wage rates of large groups of workers to the maximum permitted without specific Government authorization.

In May, the Wage Stabilization Board, in a decision that was the forerunner of the Board policy of gearing wage stabilization to changes in the

cost of living, allowed the meat packing workers, who had received an increase of 11 cents in 1950, an additional increase of 9 cents. The Board held that it would not be fair to penalize the parties because, in their previous contract, they had decided to use a reopening clause rather than a formalized escalator clause as a protection against higher living costs. Later an additional amount averaging 2 cents an hour was allowed, to increase the differentials among job classes. In June, a wage increase of 15 cents was approved for the Atlantic Coast shipbuilding workers, on the ground that wage rates in shipbuilding were abnormally low in the base period which WSB had included in its general adjustment formula.

Many settlements later in the year provided for wage increases to offset the rise in the cost of living, as well as for fringe benefits. Among the more noteworthy settlements in the second half of the year were those in the paper, glass, electrical, rubber, nonferrous mining and smelting, and food industries. Contracts also were signed covering many workers in transportation, communications, and construction. In addition, wage increases were granted most Federal Government workers and many State and local government employees.

At the year's end, a most significant contract negotiation was taking place between the steel industry employers and the steelworkers union. The CIO Steelworkers Wage Policy Committee presented a 22-point set of proposals covering some 1 million workers. Key bargaining points included a "substantial wage increase, a guaranteed annual wage, a union shop, a 'drastic' revision of the incentive system, time and one-half for Saturday work and double time for Sunday, as such, 8 paid holidays and a more liberal vacation program." On December 22, after the parties had failed to reach an agreement, the case was referred by the President to the Wage Stabilization Board.

Profits

Corporate book profits before taxes in 1951 were the highest on record, reaching an estimated total of 44.8 billion dollars. In 1950, the previous peak year, corporate book profits before taxes amounted to 41.4 billion. (See chart 13 and appendix table B-32.)

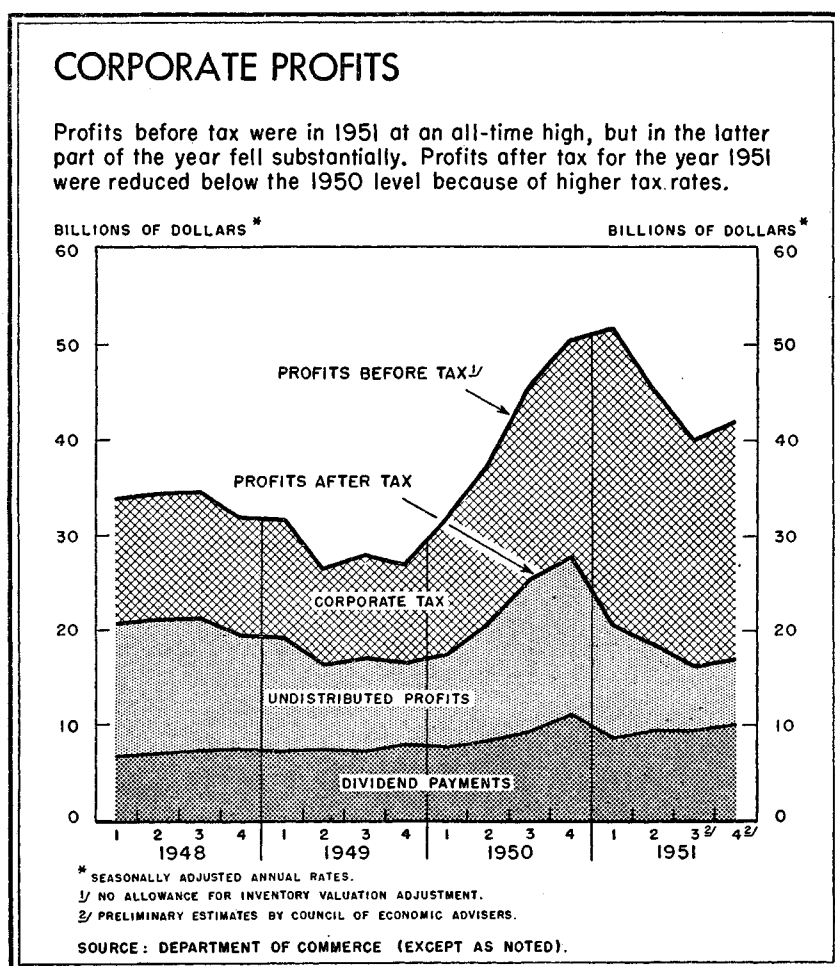
The profits trend, however, changed drastically in the course of 1951. After reaching a postwar peak of 51.8 billion (annual rate) in the first quarter of 1951, corporate profits before taxes declined sharply, reaching a level of 40 billion in the third quarter. Lower levels of sales and prices in many industries, as well as the upcreep of costs, accounted for the change. In the fourth quarter, as sales increased somewhat and prices firmed slightly, corporate profits before taxes, according to preliminary indications, rose to an annual rate of approximately 42 billion dollars.

Corporate profits after taxes were an estimated 18.1 billion dollars in 1951, compared with 22.8 billion in 1950, most of the reduction being a result of higher tax rates. In 1951, the combined Federal, State, and local

taxes on profits took about 60 percent of profits before taxes, compared with about 45 percent in 1950. The level of corporate profits after taxes was exceeded in only 3 previous years, 1947, 1948, and 1950.

Although corporate profits as a whole were substantially lower at the end of 1951 than at the beginning, there were significant differences among industries. (See appendix tables B-33 through B-36.) Petroleum refining, and printing and publishing (except newspapers) showed, before taxes, a higher rate of return on sales in the third quarter than in the first. Profits of the following industries dropped moderately during the same period: food, tobacco, furniture, chemicals, leather and leather products, stone, clay and glass, nonferrous metals, iron and steel, machinery (except electrical), transportation equipment, instruments, and motor vehicles and parts.

CHART 13



Steep declines were reported by corporations producing textiles, apparel, and lumber and wood products, where inventories were particularly excessive.

The decline in profits during 1951 affected both large and small firms. However, the largest manufacturing firms, those with assets of 100 million dollars or more, reported a smaller decline in their profit-sales ratio (before taxes) than did those with assets of \$250,000 or less.

CREDIT AND MONEY SUPPLY

Credit

Most forms of private credit expanded during 1951, though at a lower rate than in 1950. Total loans of commercial banks, which had jumped 9.2 billion dollars or 21 percent in 1950, rose about 6 billion or 12 percent during the past 12 months. The difference was largely accounted for by the behavior of nonbusiness loans. While commercial and industrial loans of banks rose close to 5 billion dollars during 1951, about the same as in 1950, loans of all other kinds, such as consumer and real estate loans, expanded approximately 1.5 billion in 1951, compared with 4.4 billion the year before. (See chart 14 and appendix table B-27.) A major factor that sustained the growth of commercial and industrial loans, while the expansion of most other classes of bank loans slowed down considerably, was the rising demand for credit to finance defense-supporting activities. Approximately 40 percent of the increase in outstanding business loans during the second half of 1951, as reported by banks in leading cities, represented borrowing by firms engaged in defense or defense-related production. Much of the rest of the increase in commercial and industrial loans during this period was seasonal.

Commercial bank holdings of U. S. Government securities showed little change during 1951, while the drop during 1950 had been 5.0 billion. Investments in other securities rose by nearly 1 billion during 1951, compared with 2.2 billion in 1950. The combined effect of changes in the three major components of commercial bank earning assets was to lift total loans and investments about 7 billion dollars or 6 percent during 1951. The rise in total earning assets of banks in 1950 had been 6.5 billion or 5.3 percent.

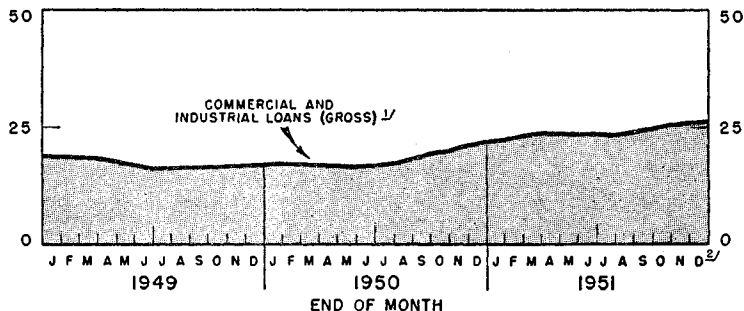
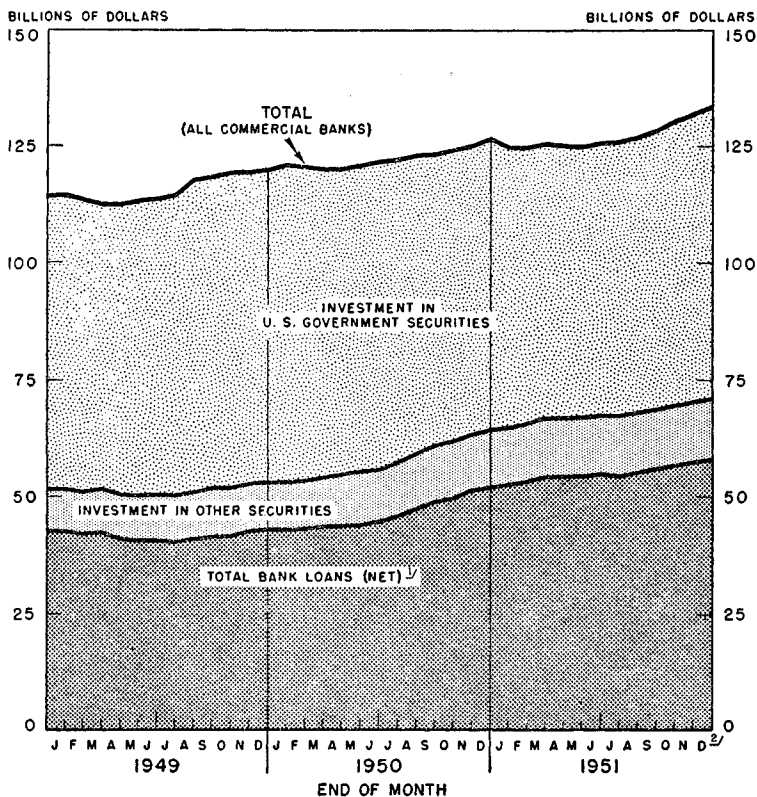
Outstanding consumer instalment credit declined 0.6 billion dollars during the first 4 months of 1951, and then rose slowly, but at the end of the year it was still below the December 1950 level. During 1950, consumer instalment credit had grown by 2.6 billion or 24 percent, with nearly half of the increase occurring in the third quarter. (See appendix table B-26.)

Farm mortgages held by all groups of investors rose approximately 0.5 billion dollars or 8 percent during 1951, which was about as much as in 1950, while total nonfarm mortgages of \$20,000 or less increased about

CHART 14

BANK LOANS AND INVESTMENTS

The increase in total bank loans was only about two-thirds of the 1950 increase, although commercial and industrial loans expanded nearly as much in 1951 as in the previous year.



1/ VALUATION RESERVES INCLUDED IN GROSS LOANS; EXCLUDED FROM NET.

2/ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (EXCEPT AS NOTED).

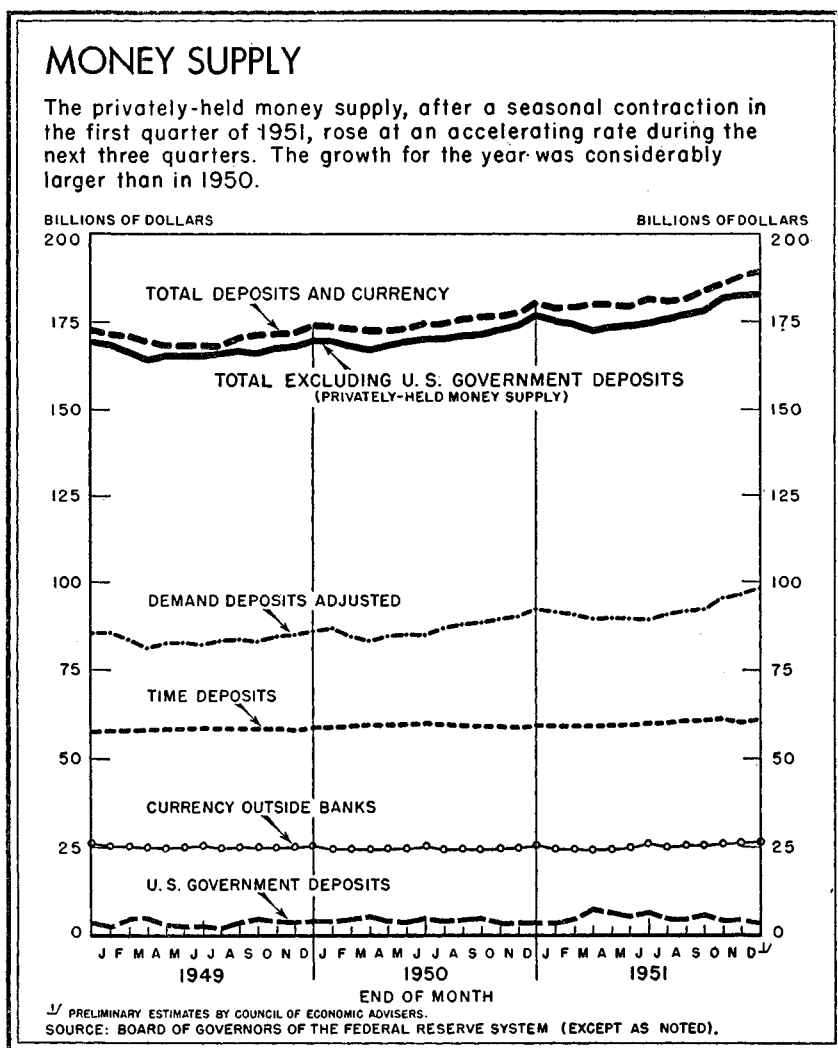
6.5 billion dollars or 15 percent during 1951, compared with 7.8 billion or 20 percent in 1950.

Money supply

The privately-held money supply (deposits adjusted and currency) expanded nearly 9 billion dollars or about 5 percent during 1951, compared with 7.1 billion or 4.2 percent in 1950. (See table 3.) The rise in the last three quarters of 1951 exceeded substantially that of the comparable period in the previous year. (See chart 15 and appendix table B-28.)

After declining 4.4 billion dollars in the first quarter of 1951, or more than half again as much as in the same months of 1950, largely because

CHART 15



of the surplus of Treasury cash receipts, the money supply moved upward in each succeeding month.

TABLE 3.—*Factors changing the volume of the privately-held money supply*¹

[Billions of dollars]

Factors	1949 total	1950			1951		
		Total	First half	Second half	Total ²	First half	Second half ²
Loans of commercial and mutual savings banks.....	+1.4	+10.8	+2.5	+8.4	+7.9	+3.5	+4.4
Securities of U. S. Government held by banking system ³	-.1	-3.6	-1.7	-2.0	+1.8	-2.0	+3.8
Securities of State and local governments held by commercial and mutual savings banks.....	+1.2	+2.1	+1.0	+1.1	+1.0	+.4	+.6
Treasury deposits ⁴	-.5	+.4	-.7	+1.1	-.2	-3.0	+2.8
Monetary gold stock.....	+.2	-1.7	-.2	-1.5	-.1	-1.0	+.9
Other factors, net.....	-1.5	-.9	-.7	-.1	-1.6	-.1	-1.5
Net change in privately-held deposits and currency ⁵	+7.7	+7.1	+2	+7.0	+8.8	-2.2	+11.0

¹ Includes State and local government deposits.

² Estimates based on incomplete data; second half by Council of Economic Advisers.

³ Includes commercial banks, mutual savings banks, and Federal Reserve banks.

⁴ A decrease in Treasury deposits is denoted by a positive figure, and an increase by a negative figure. In the case of other specific factors the reverse is true.

⁵ See appendix table B-29 for aggregate money supply and its components.

NOTE.—Detail will not necessarily add to totals because of rounding. Signs preceding figures in columns indicate effect on the money supply.

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

The monetary expansion of more than 13 billion dollars in the past 9 months reflected (1) the growth of the loans and investments of the banking system, including mutual savings banks, (2) the drawing down of U. S. Government deposits to meet part of the cash deficit, and (3) to a lesser extent, the reappearance, beginning in the third quarter, of net gold imports after more than a year and a half during which the United States had lost gold to other nations.

THE FLOW OF GOODS AND PURCHASING POWER

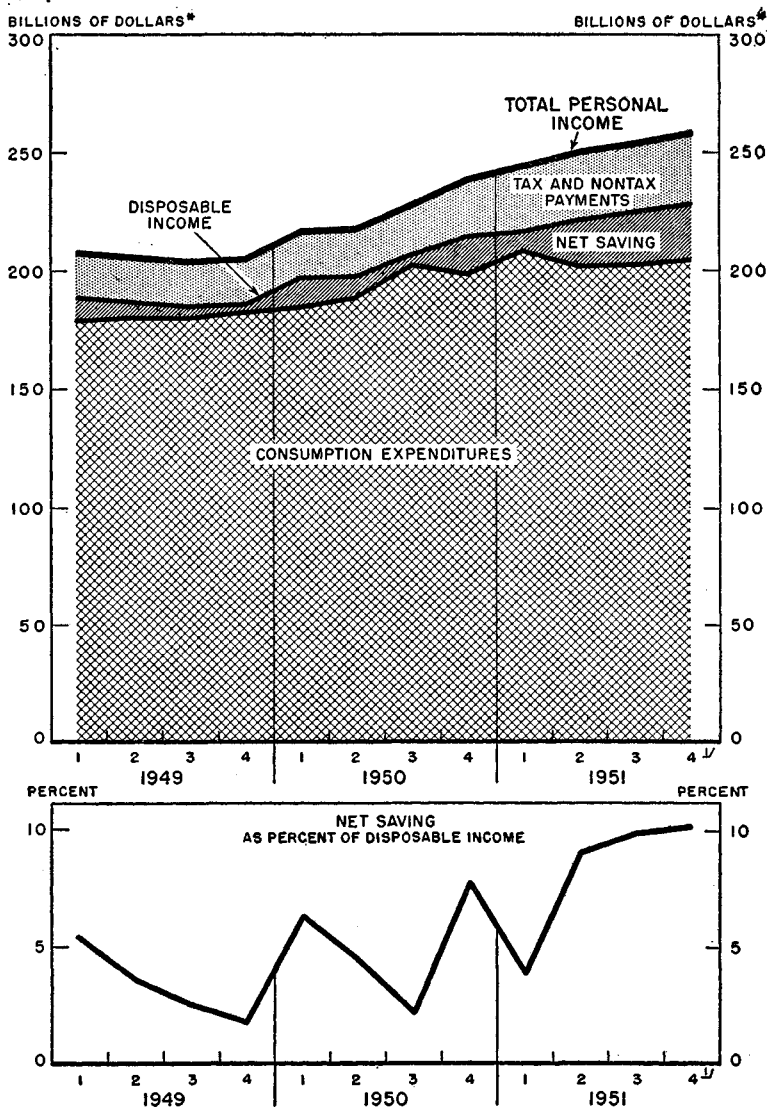
Personal income, consumption expenditures, and saving

Personal income. Personal income has gained quarter by quarter since Korea, but the rate of increase was slower in 1951. (See chart 16 and appendix table B-7.) One important component of consumer income, unincorporated business and professional income, reached a peak in the first quarter of last year. Labor income advanced less and less rapidly as the momentum of increases in wage rates slackened, the average factory work-week was reduced, and employment gains were only moderate. Farm income, which declined sharply from 1948 to 1950, continued upward from the postwar low reached in the second quarter of 1950. In the fourth quarter of 1951, personal income attained an annual rate of 258 billion dollars. This was more than 40 billion above the pre-Korean level; but

CHART 16

PERSONAL INCOME, SPENDING, AND SAVING

Consumption expenditures in the second half of 1951 remained below the first quarter peak despite the continued rise in income. Saving rose to 10 percent of disposable income.



*SEASONALLY ADJUSTED ANNUAL RATES.

⌋ PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

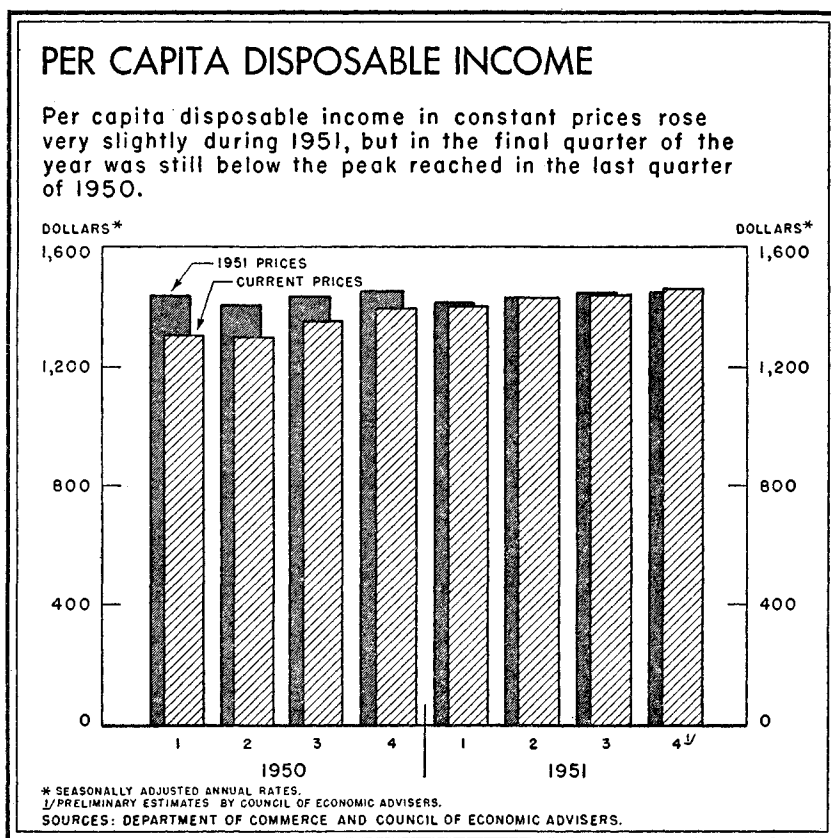
SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED).

only 14 billion of the increase took place in the second half of the 18-month period.

Tax increases since Korea have slowed down gains in spendable income. Personal tax liabilities rose from 19.5 billion (annual rate) in the second quarter of 1950 to about 30 billion in the fourth quarter of 1951. Nevertheless, personal disposal income rose by more than 30 billion dollars or 15 percent over the period. Total disposable incomes in real terms have gained by about 5 percent since Korea, but the sharp price rises in December 1950 and January 1951 caused a temporary drop in real income. It was not until the third quarter of 1951 that total consumer purchasing power regained the level of the fourth quarter of 1950. On a per capita basis, real disposable income did not regain the level of the fourth quarter of 1950. (See chart 17 and appendix table B-10.)

Although, in general, gains in income have more than kept pace with the cost of living, they have been unevenly distributed throughout the population. Since Korea, farm incomes have risen somewhat more than those of other groups, compensating for the decline that extended through the

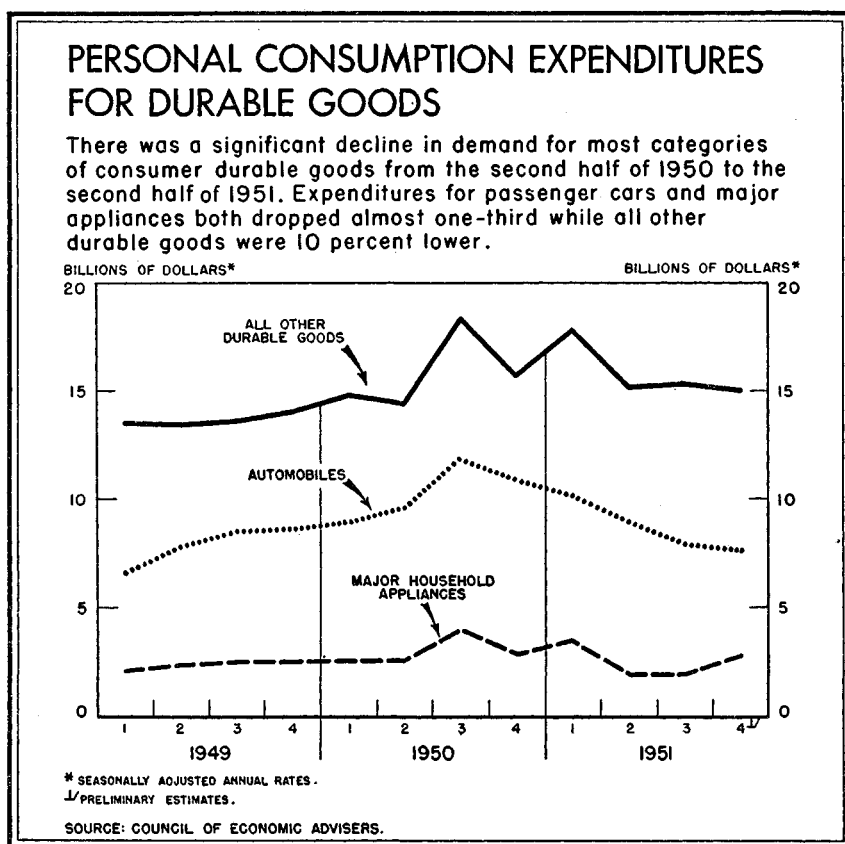
CHART 17



first half of 1950, while annuitants and other fixed-income recipients have, of course, become worse off. Average hourly earnings of workers in durable goods manufacturing industries increased by 18 cents between June 1950 and November 1951, compared with 14 cents in nondurable goods industries. After adjustment for price increases and trends in average weekly hours (but not allowing for higher taxes), real earnings of workers in nondurable goods manufacturing in November 1951 were slightly below June 1950, while real earnings of workers in durable goods manufacturing were moderately above. Average weekly earnings in the construction industry rose more than those in manufacturing, while those in trade and services rose much less and fell behind the rise in living costs. The gains in income of a large proportion of Government workers were commensurate with those of workers in private industry.

Consumption expenditures. After the December 1950–February 1951 buying wave, total consumption expenditures declined abruptly, falling at the seasonally adjusted annual rate of 6.5 billion dollars, or 3 percent, from the first to the second quarter. Since then they have moved up slightly, but

CHART 18



have not regained the first quarter level. The decline in demand was concentrated in durable goods purchases, which fell from the almost unprecedented annual rate of 31.5 billion dollars in the first quarter (compared with 29 billion dollars in 1950 as a whole) to 26 billion dollars in the second quarter, and remained somewhat below that level for the rest of the year. Sales of automobiles and major appliances declined substantially, as is shown in chart 18. Purchases of nondurable goods, which had moved up as prices rose in 1950, remained fairly constant in 1951, while expenditures for services continued to expand slowly. (See appendix table B-4.)

The extent of the decline in consumer demand is indicated by the fact that the volume of consumer purchases in the second half of 1951, after adjustment for price changes, was below the level of the second quarter of 1950, despite an increase of 5 percent in real income. In terms of 1951 prices, expenditures for durable goods were lower by 3.5 billion dollars, while outlays for services increased by a somewhat smaller amount. Expenditures for nondurable goods remained at about the level of the second quarter of 1950 despite a population increase of 3 million. (See appendix table B-3.)

Personal saving. The drop in spending in the second quarter was associated with a rise in the rate of saving from 4 percent of disposable income in the first quarter—a rate not far below the postwar average—to 9 percent. Later in the year, as incomes continued to increase, saving rose to an even higher rate. (See chart 16 and appendix table B-9.)

This rate of saving, the highest reached since World War II, undoubtedly reflected a combination of factors, some temporary and some of a more permanent character. The rate appears unusually high in contrast with that of the rest of the postwar period, during which special reasons, ranging from the backlog of demand and purchasing power built up during the war to scare buying following Korea, tended to raise spending, especially for durable and semidurable goods.

The increase in the rate of saving in 1951 may have represented primarily the disappearance of backlog demands, particularly for automobiles, the temporary saturation of some other markets for durable goods, and the desire to replenish liquid reserves. Other factors, such as restraints on consumer credit and resistance to high prices, were also undoubtedly among those contributing to this development. Moreover, the price calm of the last three quarters of 1951 probably helped to moderate the previously high level of spending that had been initiated in part by the anticipation of rising prices.

In recent years, there has been a marked preference for tangible forms of personal saving, such as investments in homes and in the assets of unincorporated businesses, compared with more liquid types of saving. The buying of durable goods, which has many of the characteristics of saving, has also been at a high rate. In fact, in the period 1947 through 1950, the in-

crease in mortgage, consumer, and personal business debt, in connection with investment in tangible forms of saving and consumer durable goods, was greater than the increase in the ownership of such assets as deposits, stocks and bonds, and insurance equities. This tendency was reversed in 1951, when total saving expanded. As shown in table 4, the high level of saving in the second and third quarters of 1951, compared with the corresponding period of 1950, largely reflected a rise in liquid saving. Estimates of the change in personal business debt are not yet available, but consumer debt rose much less rapidly than in the previous year, while additions to currency, deposits, and corporate and other securities were greater.

TABLE 4.—*Liquid and total personal saving*

[Billions of dollars]

Type of saving	1950		1951	
	Second quarter	Thrd quarter	Second quarter	Thrd quarter ¹
Liquid saving:				
Currency, deposits, and savings and loan shares.....	+0.7	+2.3	+1.1	+4.5
Private insurance reserves.....	+9	+1.0	+9	+1.0
Securities:				
U. S. Government.....	+5	—4	—	—1
State and local government.....	—1	—2	+4	—
Corporate and other.....	+4	+5	+1.1	+6
Debt liquidation:				
Mortgage.....	—1.7	—1.9	—1.7	—1.4
Consumer.....	—1.3	—1.7	+2	—1
Total liquid saving.....	—5	—3	+2.0	+4.7
Total personal saving ²	+3.5	+2.0	+6.8	+7.0

¹ Estimates based on incomplete data.

² Includes liquid saving, and personal tangible investment less depreciation, and the increase in farm and business debt; not adjusted for seasonal variation and therefore cannot be computed from saving data in appendix table B-9.

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

Sources: Securities and Exchange Commission, and Department of Commerce.

Investment and finance

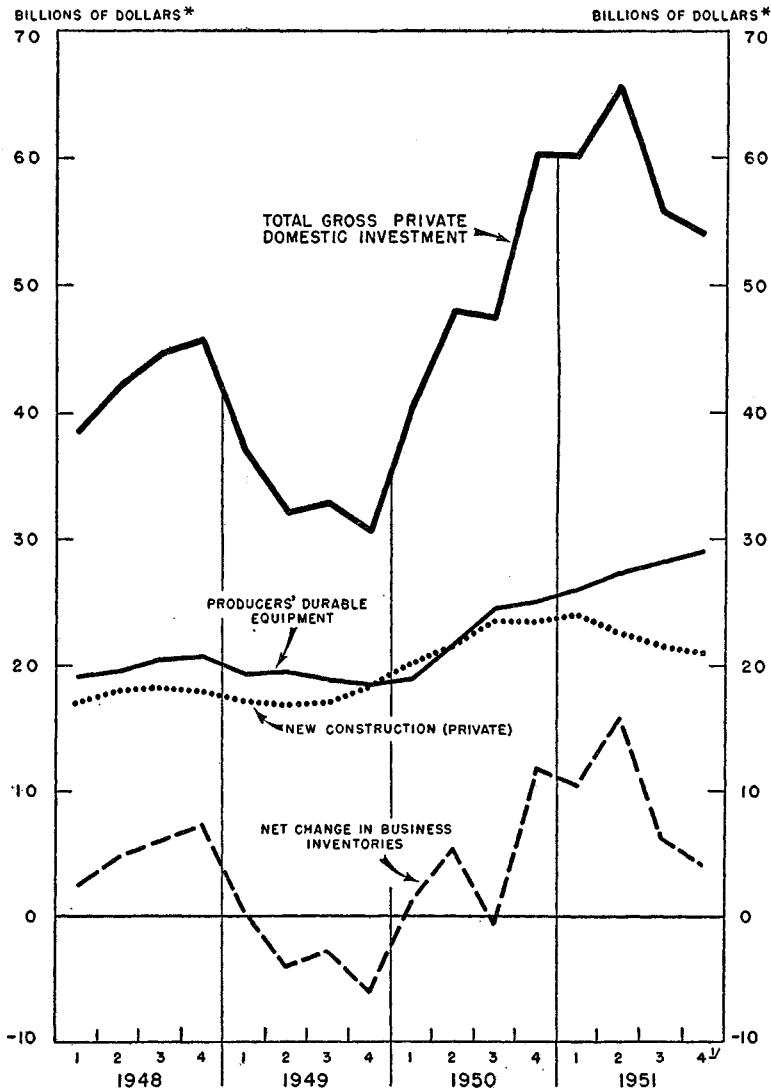
There were wide swings in the movement of business investment during 1951, reflecting in more extreme form the same mixture of strength and weakness which characterized economic events generally. After reaching a peak annual rate of 65.6 billion dollars, or 20 percent of total output in the second quarter of 1951, gross private domestic investment declined 18 percent to 54 billion, or 16 percent of total output, in the fourth quarter. (See chart 19 and appendix table B-5.) Even at this lower level, investment was taking about the same proportion of total output as in such previous peak years as 1948. In spite of the downward trend in the second half, the 59-billion-dollar level of business investment for 1951 as a whole was higher than for any previous year, both in real and money terms and as a proportion of total output.

The peaking of total investment in the second quarter of 1951 reflected an extremely high rate of inventory accumulation, and a continued rise in the rate of outlays for producers' equipment and nonresidential construc-

CHART 19

BUSINESS INVESTMENT

Investment in producers' durable equipment continued to rise rapidly through 1951, but private construction and inventory accumulation both dropped in the second half of the year.



* SEASONALLY ADJUSTED ANNUAL RATES.

1/2 PRELIMINARY ESTIMATES BY COUNCIL OF ECONOMIC ADVISERS.

SOURCE: DEPARTMENT OF COMMERCE (EXCEPT AS NOTED).

tion. Residential construction meanwhile was receding from the record level reached in the latter part of 1950. (See chart 22.)

The decline in total business investment during the second half of 1951 was due primarily to two factors. The more important was the extremely sharp drop in the rate of inventory accumulation, as many industries took steps to bring production and inventories in line with the decline in consumer demand which developed early in the spring. The second factor, which was becoming increasingly significant toward the end of the year, was cutbacks in commercial and some other categories of construction, effected primarily by controls over materials.

Plant and equipment. During 1951, business investment in plant and equipment rose to record levels, placing a major strain on the supply of scarce materials. (See appendix table B-19.) The expansion in basic areas was stimulated and encouraged by Government action to ensure a productive capacity capable of meeting a growing demand for defense and related output. As the year progressed, it became necessary and possible to shift the emphasis toward the more urgently needed types of expansion, and to reach decisions on specific goals for the expansion of key industries.

Through most of 1951, business expenditures for new plant and equipment continued the rapid rise that had begun in the spring of 1950. By the fourth quarter of 1951, private nonfarm plant and equipment outlays were running 18 percent higher than in the same quarter of 1950, and 17 percent above the pre-1951 peak reached in the fourth quarter of 1948. (See appendix table B-19.) In terms of physical volume, the increase from the fourth quarter of 1948 was probably about half that much.

This unprecedented surge of investment in new productive facilities reflected in some measure the stimulus of defense buying, and Government inducements such as accelerated tax amortization. The largest increases during 1951 were in the industrial and utility fields, and particularly in the aircraft and primary metals industries. (See charts 20 and 21.)

But it is noteworthy that the investment boom of 1950-51 was too broad, and began too early, to be explained wholly or even primarily as the direct result of military procurement or Government aids. The basic factors were the growth in civilian demand until near the end of the first quarter of 1951, the general absence of surplus productive capacity even before Korea, ready availability of funds during most of the period, an outlook for increasing demands and shortages of materials and equipment, and the encouragement given by excess profits tax provisions to the debt financing of new investment.

In the latter part of 1951, increasing demands on scarce materials and equipment for military goods and top-priority industrial expansion programs made it impossible to continue other types of business construction and equipment investment at the record rates which had been attained. By the fourth quarter, plant and equipment outlays in the commercial, communications, and miscellaneous field were 13 percent below the level of a year

earlier. The decline was 7 percent in the textile industries, and 14 percent in the food and beverage industries. (See chart 21 and appendix table B-19.)

The more urgent types of expansion were given the right of way by priorities on the necessary materials and equipment; by various forms of Government financial assistance; by allocations of several critical materials; and in some instances by controlled scheduling of output and distribution of key component items. Financial aids or inducements have been supplied where necessary, in the form of Government loans, loan guarantees, purchase contracts, and certificates of rapid amortization of facilities for tax purposes.

The accomplishments of 1951, in terms of expansion of productive capacity, were impressive by any standard. In a private survey made late in 1950, manufacturers reported plans for a 9 percent expansion in total capacity in 1951, and a considerably greater expansion in certain defense-related lines such as machinery, transport equipment, and chemicals. The actual plant and equipment outlays of 1951 suggest that these anticipations were probably not wide of the mark.

The expansion achieved in certain types of basic industrial facilities related to defense is shown in table 5.

TABLE 5.—*Expansion of capacity or output of selected industries*

Industry or product	Percent- age increase	Industry or product	Percent- age increase
Capacity expansion during 1951:		Capacity expansion during 1951—Con.	
Electric utilities.....	10	Cotton duck.....	45
Petroleum refining.....	4	Output expansion, 1950 to 1951:	
Steel ingots.....	4	Aluminum ³	16
Pig iron.....	2	Chlorine.....	18
Coke (byproduct ovens).....	2	Zinc ⁴	8
Motor trucks and tractors ¹	6	Newsprint.....	8
Railroad freight cars ²	2	Molybdenum ³	34
Railroad locomotives ²	2		

¹ Excludes vehicles for military use.

² Based on increase in number of units; does not take account of increased average ton-mile capability per unit.

³ Domestic primary production.

⁴ Domestic primary production plus secondary recovery.

Source: Defense Production Administration.

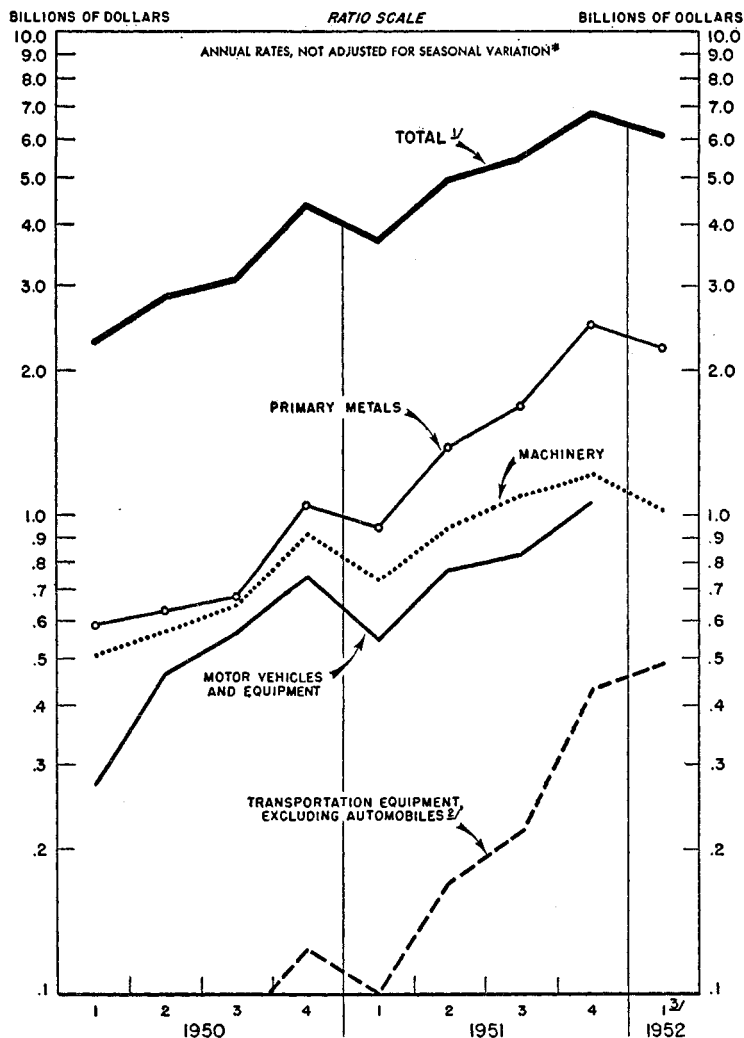
Since a large part of the facilities investment of 1951 went into projects not completed within the year, value of work put in place is a better criterion of accomplishment during the year. Table 6 measures in those terms the progress made on the major programs covered by tax amortization.

For projects assisted by tax amortization, which will entail in all about 11.5 billion dollars of investment on the basis of the certificates already approved, work was about 35 percent in place at the end of September, and at that time was expected to be about 46 percent in place by the end of

CHART 20

NEW PLANT AND EQUIPMENT OUTLAYS IN SELECTED DURABLE MANUFACTURING INDUSTRIES

The major durable goods industries invested in plant and equipment at a rising rate through 1950 and 1951.



* SEASONAL INFLUENCES TEND TO RAISE OUTLAYS IN THE FOURTH QUARTER AND LOWER THEM IN THE FIRST.

1/ INCLUDES FABRICATED METALS; STONE, CLAY, AND GLASS; PROFESSIONAL AND SCIENTIFIC INSTRUMENTS; LUMBER, FURNITURE, ORDNANCE, AND MISCELLANEOUS MANUFACTURES, NOT SHOWN ON CHART.

2/ POINTS FOR FIRST THREE QUARTERS OF 1950 ARE AS FOLLOWS: .048, .072, .084.

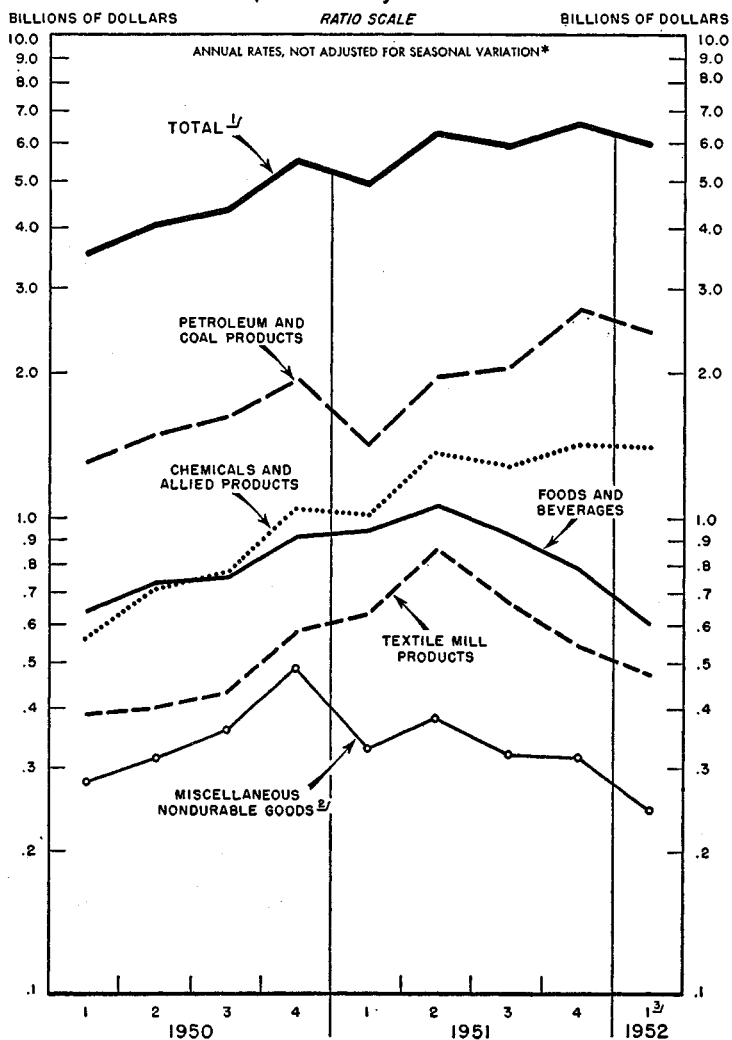
3/ ANTICIPATED EXPENDITURES REPORTED BY BUSINESS DURING LATE OCTOBER AND NOVEMBER 1951.

SOURCES: DEPARTMENT OF COMMERCE AND SECURITIES AND EXCHANGE COMMISSION.

CHART 21

NEW PLANT AND EQUIPMENT OUTLAYS IN SELECTED NONDURABLE MANUFACTURING INDUSTRIES

The chemicals and petroleum and coal products industries continued to invest in plant and equipment at a rising rate through 1951. In other major nondurable lines, investment declined in the latter part of the year.



*SEASONAL INFLUENCES TEND TO RAISE OUTLAYS IN THE FOURTH QUARTER AND LOWER THEM IN THE FIRST.

¹INCLUDES PAPER AND RUBBER, NOT SHOWN ON CHART.

²INCLUDES TOBACCO, APPAREL, LEATHER, PRINTING AND PUBLISHING.

³ANTICIPATED EXPENDITURES REPORTED BY BUSINESS DURING LATE OCTOBER AND NOVEMBER 1951.

SOURCES: DEPARTMENT OF COMMERCE AND SECURITIES AND EXCHANGE COMMISSION.

the year. The actual year-end figure, however, may have been somewhat lower in view of the severe shortage of structural steel and some other vital construction materials and equipment items in the fourth quarter. Work put in place during the third quarter was, for similar reasons, about 17 percent less than had been anticipated at midyear.

In the case of some expansion programs, such as iron and steel and synthetic fibers, the "proposed investment" shown in table 6 comprises the bulk of that now planned over the next 2 years. Other important private investment programs are covered only to a minor extent or not at all by tax amortization. This applies, for example, to oil and gas wells and pipe lines, electric power, agricultural equipment, and mining facilities generally. Moreover, in both electric power and the munitions industries, direct public investment plays an important part in addition to private investment.

TABLE 6.—Progress on facilities projects aided by tax amortization

Industry	Necessity certificates approved through November 30, 1951	Tax amortization (millions of dollars)	Status of projects (percentage of proposed investment in place at date shown). ¹	
			Sept. 30, 1951	Dec. 31, 1951 ²
All industries.....	10,768	6,945	35	46
Iron and steel.....	2,430	1,700	28	38
Railroads.....	1,143	810	67	83
Chemicals (excluding synthetic fibers).....	1,098	631	30	41
Petroleum refining.....	872	575	32	38
Aircraft, ordnance, and accessories.....	750	514	34	49
Electric light and power.....	693	306	41	50
Aluminum (primary refining).....	615	421	16	27
Machinery.....	568	371	37	52
Pulp, paper, and allied products.....	514	271	26	34
Welded and heavy riveted pipe.....	185	113	21	28
Synthetic fibers.....	130	66	11	19
Great Lakes transportation.....	108	79	28	40
Coke and byproducts.....	98	76	26	35
All other.....	1,564	1,012	41	54

¹ Status reports cover only projects approved through September 30, 1951.

² Figures are in most cases not directly comparable with those shown in table 14, partly on account of differences in industry classification and partly because (as noted in the text) not all projects are covered by tax amortization certificates.

³ Advance estimates reported as of September 30.

⁴ In addition to this total amount, certificates, for which the amount of tax amortization to be allowed was still undetermined, were issued on projects entailing 715 million dollars of proposed investment, distributed by major industry groups as follows (in millions of dollars): railroads 196, chemicals (including synthetic fibers) 126, primary metals 85, mining 81, machinery 67, pulp, paper, etc., 38, and all other 122.

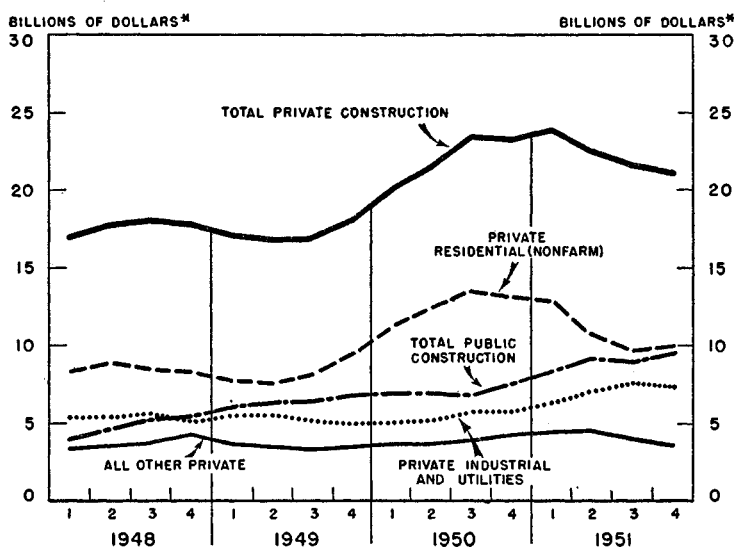
Source: Defense Production Administration.

Construction. A record value of total new construction was put in place in 1951—29.9 billion dollars. Although this was 7 percent more than in 1950, the physical volume of construction was about the same in the 2 years. (See chart 22 and appendix table B-18.) Less essential construction, especially recreational, commercial, and private residential, was cut back, while defense, industrial, and public utility construction increased

CHART 22

CONSTRUCTION

Expenditures for private nonfarm residential construction dropped sharply in 1951, while private industrial and utility rose. Total private construction outlays in 1951 were about the same as in 1950, while public construction increased 27 percent.



* SEASONALLY ADJUSTED ANNUAL RATES.
SOURCE: DEPARTMENT OF COMMERCE.

sharply during the year. Beginning in September, the value of total new construction on a seasonally adjusted basis has been less than in corresponding months of 1950.

The shift to military, industrial, and defense-related construction in general continued during 1951. Construction projects of these types received priority in the allotment of controlled materials under the Controlled Materials Plan. From December 1950 to December 1951, military and naval construction increased by more than six times on a seasonally adjusted basis, while private industrial construction increased 12 percent. For 1951 as a whole, however, private industrial construction was about 85 percent above 1950.

The largest and most consistently sustained decreases in construction expenditures, on a seasonally adjusted basis, were for new private residential, commercial, and recreational building. Partly as a result of credit controls, private nonfarm residential construction fell after September 1950, with only two significant interruptions. From a 1951 high in February of 13.0

billion dollars (seasonally adjusted annual rate), residential construction had declined almost one-quarter by December, to 9.9 billion. The number of new nonfarm housing units started in 1951, including about 71,000 public housing units, amounted to about 1.1 million, a drop of about 22 percent from the all-time high of close to 1.4 million in 1950. Although seasonal declines followed a temporary upturn in September, a relatively high level of starts was maintained through the last quarter, caused partly by the easing of credit regulations. Sustained demand, and a generally adequate supply of materials, were also factors of importance.

Significant decreases were effected in less essential construction categories such as warehouses, office and loft buildings, stores, restaurants, and garages, and other nonresidential buildings. This reduction was achieved by a variety of specific limitation orders and by credit restraints, and, beginning in the fourth quarter of 1951, by drastic cutbacks in allotments of controlled materials.

Total public construction, seasonally adjusted, though higher for each month in 1951 compared with the corresponding month of 1950, showed a slight upward trend during most of the year, with increases in military and naval, residential, and industrial construction more than offsetting decreases, principally in highways and conservation and development projects. (See discussion under Government Fiscal Operations.) In November, the volume of public construction turned up significantly, lifting the year's total to about 27 percent above 1950.

Nonfarm inventories. The year 1951 was a period of unprecedented inventory accumulation. (See appendix tables B-3 and B-5.) But even more noteworthy were the tremendous fluctuations within the year, with an unusually high rate of accumulation being reached in the first half of 1951. By the end of the year, the rate of inventory accumulation had dropped drastically. On the other hand, the needs of the expanding security program led to a continuous build-up of inventories in the industries primarily concerned with defense activity.

During 1951, the accumulation of nonfarm inventories was about 8 billion dollars, the highest rate on record. This compares with 3.6 billion in 1950 and 6.3 billion in 1946, the previous record. The rate of inventory accumulation, on a seasonally adjusted annual basis, was 9 billion dollars in the first quarter of 1951, then soared to the unprecedented level of 14.8 billion in the second quarter, dropped to around 5 billion in the third quarter, and declined further to 3 billion in the fourth quarter.

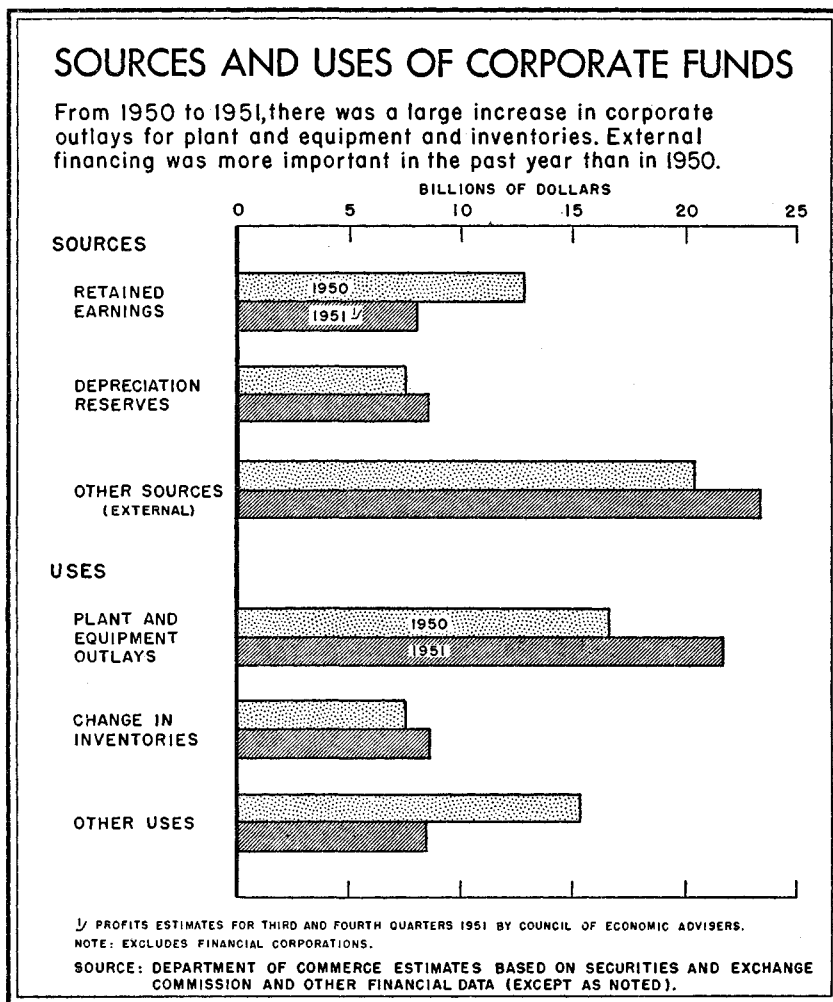
The rapid rise of total inventories in the first half of 1951, and the even more rapid fall in the rate of accumulation in the second half, represented basically the over-anticipation by manufacturers and sellers of the level of consumer demand and the subsequent steps taken to adjust to actual sales levels.

There was, after midyear, a major divergence in trend between retail inventories and those in manufacturing. (See appendix tables B-20 and

B-21.) Retail inventories, after rising in the first half of 1951, began to turn down, and by the end of the year were at about the same level as at the beginning. The problem of "excess" inventories was particularly acute in the case of retailers' stocks of durable goods and apparel, where very heavy ordering by retailers had taken place to avoid anticipated shortages which did not materialize.

Manufacturers' inventories, on the other hand, continued to rise during the second half of the year, but at a much slower rate than during the first half. The increase in manufacturers' inventories occurred primarily in the expanding defense industries. Inventories of nondurable goods remained stable during the second half of the year, while inventories of durable goods continued to expand.

CHART 23



At the end of 1951, the inventory-sales ratio was at about the levels prevailing during 1949, the previous postwar high, but it was below prewar levels. In manufacturing, the ratio expanded through the first three quarters and then declined slightly. In retailing, the rise was concentrated in the first half of the year. The ratio declined in the second half, as retailers were successful in reducing their inventories.

Corporate finance. The financing of business expansion did not give rise to major problems during 1951. As already noted, Government inducements through tax amortization, loans, and aids such as loan guarantees, helped to expedite some more urgently needed projects, but covered in all only a minor fraction of capital investment requirements.

Despite a large decline in their earnings after taxes, nonfinancial corporations' total use of funds in 1951 for fixed and working capital was about 40 billion dollars, as large as during 1950, and 10 billion dollars larger than in any other postwar year. (See chart 23 and appendix table B-37.) Corporate outlays for plant and equipment were about 6 billion dollars greater than in 1950. There were sharp declines in the rate of increase in customer accounts and acquisitions of liquid assets. For the year as a whole, the book value of corporate inventories showed a slightly greater increase than during 1950, but by the end of the year inventory accumulation had become very small.

About 40 percent of total uses of funds was internally financed, a smaller proportion than in any of the other postwar years. As a result of high corporate taxes and large dividend disbursements, retained corporate earnings declined to about two-thirds of the level of 1950. Approximately 60 percent of total corporate profits was accounted for by tax liabilities, and about 50 percent of profits after taxes was paid out in dividends. Corporate depreciation allowances expanded about 1.2 billion dollars above 1950, increased somewhat by rapid amortization as an inducement to certain types of expansion.

A record total of 24 billion dollars was obtained from external sources of funds, including the corporations' own reserves of about 8.5 billion for Federal income taxes. Increases in bank loans and mortgage loans were moderately larger than during 1950; net new issues of stocks and bonds exceeded the 1950 total by 60 percent. The huge increase in bond issues, which occurred despite significant increases in interest rates, was mainly for the financing of capacity expansion in the utilities, and in the iron and steel, nonferrous metals, machinery, and chemical industries.

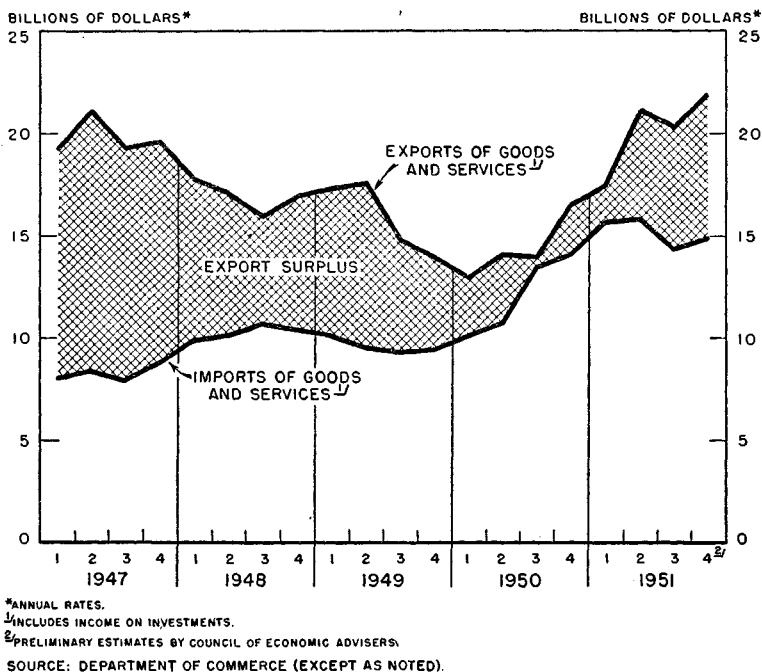
International transactions

In 1951, the expansion of defense and private demand in other countries of the free world, supported by increased military aid from the United States, brought about an expansion of United States exports of goods and

CHART 24

EXPORTS AND IMPORTS OF GOODS AND SERVICES

Since early 1951, rising exports and slackening imports have increased the United States export surplus.



services to a peacetime record of more than 20 billion dollars. Imports of goods and services reached a new high during the year, despite a large decline in the quantity of commodity imports during the second and third quarters which accompanied the lull in private demand. The rise in exports of goods and services during the year exceeded that in imports, and the United States export surplus, which had fallen to an annual rate of 1.5 billion dollars in the second half of 1950 under the impact of the sharp post-Korean rise of merchandise imports, increased to one of approximately 6.5 billion dollars in the second half of 1951. (See chart 24 and table 7.)

United States exports. Total exports of goods and services in 1951 were about 40 percent above the 1950 level, with commodity and service items both running higher. (See appendix tables B-38 and B-39.) The large volume of commodity exports in 1951 reflected the high demand for goods in virtually all foreign countries resulting from the rearmament programs abroad, the high incomes of the raw-material-producing countries, and

TABLE 7. *United States exports and imports of goods and services*

[Billions of dollars]

Period	Exports of goods and services ¹	Imports of goods and services ¹	Surplus of exports
1950.....	14.4	12.1	2.3
1951 ²	20.2	15.2	5.0
Annual rates:			
1950—First half.....	13.6	10.5	3.1
Second half.....	15.3	13.8	1.5
1951—First quarter.....	17.5	15.7	1.8
Second quarter.....	21.1	15.8	5.4
Third quarter.....	20.3	14.3	6.0
Fourth quarter ²	21.9	14.9	7.0

¹ Includes income on foreign investments.² Estimates based on incomplete data; fourth quarter by Council of Economic Advisers.

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

Source: Department of Commerce (except as noted).

accelerated programs of economic expansion in underdeveloped areas. Recorded commodity exports reached a peak value of 14.9 billion dollars, compared with 10.3 billion dollars in 1950, as a result mainly of increased quantities of goods shipped and, to a lesser extent, higher prices for exports. (See appendix tables B-41 and B-42.) Exports financed under the Mutual Defense Assistance Program in 1951 nearly tripled their 1950 level of 500 million dollars, and exports excluding MDAP shipments rose from 9.7 billion dollars to approximately 13.8 billion dollars.

All economic classes of exports increased above their 1950 levels in dollar value, with exports of coal and wheat, for example, doubling not only in value, but in quantity as well. Exports of semi-manufactured goods and finished manufactures were more than 50 percent above their 1950 dollar values, judging from data for the first 10 months of 1951. Approximately three-fourths of the increase in the value of exports of finished manufactures represented larger quantities; the remainder represented higher prices. Despite domestic scarcities, exports of machinery in 1951 were more than 30 percent greater in dollar value than in the previous year. The value of agricultural machinery exports was 29 percent above the 1950 level, construction machinery 40 percent higher, and mining equipment exports were up by more than 38 percent.

United States imports. Purchases of both goods and services abroad increased above their 1950 levels, despite a large decline in commodity imports in the second and third quarters of 1951. (See appendix tables B-38, B-43, and B-44.) These imports in the year as a whole were 11.2 billion dollars, compared with 8.9 billion in 1950. There was also an increase in Government purchases of goods and services abroad in connection with the defense program and the war in Korea, with Government expenditures for services abroad rising rapidly.

The impact of the Korean outbreak on United States commodity imports began to weaken after the first quarter of 1951. Total commodity im-

ports, after rising to an all-time high in March, declined steeply from April through September, and increased somewhat in the final quarter. The decline was almost entirely due to smaller quantities of goods entering the country. Average unit values of imports continued to rise through June, and have since declined only slightly. Although spot prices of world-traded materials had begun to slip after the first quarter, the decline was not reflected in unit values until the third quarter because of the lag between the placing of orders and deliveries. In addition to seasonal movements, the fall in imports reflected in part the leveling off of general consumer and business buying which characterized the United States economy, and in part the availability of ample inventories of imported commodities which had been accumulated during the second half of 1950 and the first quarter of 1951 in a wave of anticipatory buying. Although the decline in imports occurred in all commodity categories and from all areas, it was largest both in dollars and in percentage terms in crude foodstuffs, imports of which dropped 48 percent. Imports of crude materials declined 24 percent during the same period.

This substantial 6-month decline in total imports illustrates, among other things, the extreme short-run sensitivity of our imports to domestic business activity and to the level of inventories of imported commodities.

Imports in 1951 of certain scarce basic materials, including tin, lead, and zinc, were considerably below their 1950 levels, as table 8 shows. In the cases of lead and zinc, the decline was due mainly to foreign prices being higher than the domestic ceilings. The decline in tin imports began in late 1950, but its continuation in 1951 reflected the decision of the Government early in March, when prices were about \$1.80 a pound, to suspend tin purchases until prices were more reasonable. After the United States withdrew from the market, tin prices fell; but since July, when they were as low as \$1.00 on the London market, they have gradually risen. Despite the decline of imports during 1951, tin consumption in the United States was maintained at about its 1950 level. As a result, industrial stocks were reduced, and by the end of the year they were at very low levels.

TABLE 8.—*United States imports of selected metals*
[Thousands of short tons, annual rates]

Period	Copper	Lead	Tin	Zinc
1949.....	569	409	110	285
1950—First half.....	701	429	113	342
Second half.....	510	677	129	470
1951—First half.....	532	215	77	368
Second half ¹	582	215	59	314

¹ Estimates based on data available through October.

Source: Department of Commerce.

Imports of copper in 1951, although at a lower level than during the first half of 1950, were fairly well maintained in the face of tremendous world demand.

Foreign aid and other financing of export surplus. In 1950, the United States export surplus of goods and services was smaller than foreign aid expenditures, and foreign countries were able to accumulate gold and dollar reserves. In 1951, aggregate foreign aid rose only slightly above 1950 levels and, at approximately 4.6 billion dollars, was less than the export surplus. (See appendix table B-40.) Foreign countries as a whole accumulated gold and dollar assets in the first part of the year, but in the second half, losses by the United Kingdom, France, and a few other countries outweighed continued accumulation elsewhere.

Although private capital exports declined below their level in 1950, when they had been inflated by a speculative movement in the third quarter, reinvestment of undistributed earnings from direct investments abroad, which are not counted as part of capital outflow, probably increased in 1951. Direct investment of United States capital abroad, which had declined in 1950, dropped further in 1951. Much of the decline in direct investment is accounted for by reduced investment in foreign petroleum properties, resulting from the fact that facilities necessary to meet the estimated requirements of the near future have been completed. Despite the measures to encourage foreign investment noted in Part III of this Review, there has been little reduction of the basic obstacles to United States investment abroad.

Government fiscal operations

There was a marked shift in the budgetary position of the Federal Government during calendar 1951. Early in the year, at the time of the heavy income tax payments, a large surplus was accumulated in the conventional budget accounts. Thereafter, the seasonal decline in receipts and the steadily rising trend of expenditures for national security programs caused a sizable budget deficit.

For the year as a whole, Federal expenditures aggregated 56.8 billion dollars, and net budget receipts 53.5 billion. Both totals represented substantial increases above the preceding year. Only in the wartime years 1942-1945 were expenditures higher than in 1951, while last year's budget receipts were by far the highest in the Nation's history.

The budget deficit of 3.4 billion dollars in calendar 1951 compares with the deficit of 400 million dollars in 1950. The increase in the public debt was from 256.7 billion dollars at the end of 1950 to 259.4 billion at the close of 1951. A reconciliation of these changes with trust accounts and other transactions, and with changes in the General Fund balance is shown in table 9.

The trend of the total Federal debt is illustrated in chart 25. The rise in budget receipts permitted some debt retirement in late 1950 and early 1951. In fact, not until October 1951 did the total public debt rise significantly above the amount outstanding at the end of June 1950. Exclusive of the amounts held by U. S. Government agencies and trust funds,

TABLE 9.—Summary of Federal fiscal operations

[Billions of dollars]

Item	Calendar year 1950	Calendar year 1951		
		Total	First half	Second half
Budget accounts:				
Net receipts ¹	37.8	53.5	29.7	23.8
Expenditures	38.3	56.8	25.6	31.3
Surplus, or deficit (—)	— .4	—3.4	4.1	—7.5
Trust accounts, clearing account, and other transactions, excess of receipts, or expenditures (—)	.4	4.1	2.5	1.6
Investments of Government agencies and trust accounts in public debt securities (net), excess of investments (—)	(?)	—3.4	—2.0	—1.4
Total	—	—2.6	4.6	—7.3
Net increase, or decrease (—) in public debt	— .4	2.7	—1.5	4.2
Net increase (—) or decrease in General Fund balance	.4	—1	—3.1	3.1
Total	—	2.6	—4.6	7.3
Public debt ²	256.7	259.4	255.2	259.4
General Fund balance ³	4.2	4.3	7.4	4.3

¹ Gross receipts less appropriations to Federal Old-Age and Survivors Insurance Trust Fund and refunds of receipts.

² Less than 50 million dollars.

³ End of period.

Note:—Public debt excludes guaranteed obligations, which total less than 50 million dollars.

Source: Treasury Department.

the debt was lower at the end of 1951 than at mid-1950. (See appendix tables B-29 and B-30.)

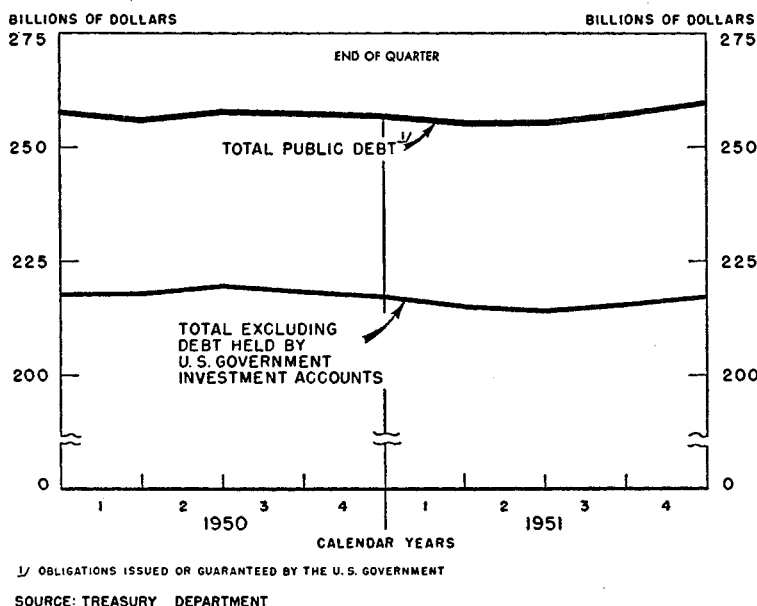
Public debt operations. In addition to a moderate amount of new borrowing during 1951, the Treasury engaged in a substantial volume of refinancing, the greater part of both operations falling within the second half of the calendar year. All new marketable issues were short-term, as were the marketable issues offered in exchange for maturing or called marketable obligations. New money was obtained from the public by increasing the volume of 3-month Treasury bills, by floating two issues of a new type of Treasury bill, the tax anticipation series, and by issuing a new series of nonmarketable Treasury savings notes, made more attractive by interest rates in line with those on other short-term issues.

Public debt transactions of special significance in furthering the policy of keeping the debt outside the banking system were the offer in March of long-term nonmarketable convertible bonds in exchange for two series of long-term marketable bonds, and the optional extension of maturing Series E savings bonds. Of the 19.7 billion dollars long-term bonds to which the exchange offer applied, 13.6 billion were turned in for the new nonmarketables. Under legislation approved in March, holders of maturing Series E bonds were given the privilege of holding the bonds another 10 years, during which they would earn an over-all rate of return equal to that of the first period of ownership, or of exchanging them for Series G

CHART 25

THE PUBLIC DEBT

At the end of 1951, Government debt held outside Government investment accounts was unchanged from a year ago. The increase in the holdings of these accounts equaled the rise in the total debt.



bonds. These options were made available in order to minimize the volume of cash redemptions.

Most new Treasury borrowing during 1951 was at rising rates of interest. For example, the average yield on new issues of 3-month Treasury bills, which had been 1.22 percent for 1950 as a whole, was 1.40 percent in the first quarter of 1951 and climbed to 1.65 percent by the fourth quarter. The approximate yield to maturity on the new Treasury savings notes was raised to 1.88 percent, compared with 1.40 percent on the previous series. (See appendix table B-31.)

Consolidated cash accounts. On a consolidated cash basis, there was a surplus of 1.2 billion dollars in the calendar year 1951. As shown in chart 26, which is in terms of seasonally adjusted annual rates, the large excess of cash receipts over cash payments in the first half of the year was replaced by a cash deficit in the second half.

The difference between the surplus in the consolidated cash accounts summarized in table 10, and the calendar year deficit in the conventional budget accounts given in table 9, is largely accounted for by net cash receipts in the Federal Old-Age and Survivors Insurance and

TABLE 10.—*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		
		Total ¹	First half	Second half ¹
Federal Government:				
Cash receipts.....	42.4	59.3	58.6	60.0
Cash payments.....	42.0	58.0	51.4	64.7
Federal cash surplus, or deficit (—).....	.4	1.2	7.2	—4.7
State and local governments:				
Cash receipts.....	18.4	20.0	19.7	20.2
Cash payments.....	19.3	20.4	20.2	20.6
State and local cash surplus, or deficit (—).....	— .9	— .4	— .5	— .4
Total government:				
Cash receipts.....	60.8	79.3	78.3	80.2
Cash payments.....	61.3	78.4	71.6	85.3
Total cash surplus, or deficit (—).....	— .5	.8	6.7	—5.1

¹ Estimates based on incomplete data.

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

Source: See appendix table A-5.

other trust funds. Most of the payroll taxes, for example, are appropriated directly to the OASI Trust Fund and are excluded from net budget receipts.

All of the important sources of receipts shared in the rise from 1950 to 1951. Not only has the tax base grown, as a result of the marked business expansion and the price rise, but substantially higher tax rates have become effective. Three major revenue bills, estimated to yield a combined total of about 15 billion dollars in a full year of operation, were enacted between September 1950 and October 1951. In addition, the tax base for OASI was broadened as of January 1, 1951.

TABLE 11.—*Federal cash payments to the public by function*

[Billions of dollars, seasonally adjusted annual rates]

Function	Calendar year 1950	Calendar year 1951		
		Total ¹	First half	Second half ¹
Total cash payments.....	42.0	58.0	51.4	64.7
Military services.....	13.5	30.6	25.4	35.8
International security and foreign relations.....	4.0	4.8	5.0	4.6
Veterans' services and benefits.....	8.9	6.0	5.9	6.1
Social security, welfare, and health.....	3.3	4.4	4.3	4.5
Agriculture and agricultural resources.....	1.3	.9	.7	1.0
Interest.....	4.3	4.2	4.1	4.3
Other.....	7.1	7.4	6.3	8.5
Deductions from Federal employees' salaries for retirement.....	— .4	— .4	— .4	— .4
Clearing account for outstanding checks and telegraphic reports.....	— .1	.1	— .1	.3

¹ Estimates based on incomplete data.

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

Source: See appendix table A-7.

A functional breakdown of Federal cash payments is presented in table 11, in terms of seasonally adjusted annual rates. Apart from the increases for the military services and the international programs, which are discussed below, the major changes in expenditures from 1950 to 1951 were the reductions of about one-third in payments for veterans' services and benefits and of more than one-third in agricultural programs, and the increase of about one-third in social security and related programs. The latter increase was associated in large part with the liberalization of benefits provided by the 1950 amendments to the Social Security Act. The "other" category in the table includes such programs as atomic energy and Defense Production Act activities, which expanded in 1951.

In the special classification of Federal cash payments by type of recipient and transaction, presented in table 12, the major change from 1950 to 1951

TABLE 12.—*Federal cash payments to the public by type of recipient and transaction*
(Billions of dollars, seasonally adjusted annual rates)

Classification of payment	Calendar year 1950	Calendar year 1951		
		Total ¹	First half	Second half ¹
Direct cash payments for goods and services, excluding military services:				
To individuals for services rendered.....	3.5	3.7	3.5	3.9
To business and foreign countries for goods and services.....	3.3	3.4	2.8	4.0
Loans and transfer payments to individuals.....	13.5	11.3	10.7	11.9
Loans, investments, subsidies, and other transfers to business and agriculture.....	4.8	4.6	4.3	4.9
Loans and transfer payments to foreign countries and international institutions.....	3.8	4.6	4.8	4.3
Military services, cash payments for goods and services.....	13.2	30.3	25.2	35.4
Clearing account for outstanding checks and telegraphic reports.....	-.1	.1	-.1	.3
Total Federal cash payments to the public.....	42.0	58.0	51.4	64.7

¹ Estimates based on incomplete data.

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

Source: See appendix table A-8.

is shown to be in payments for goods and services for the military. Loans and transfer payments to individuals declined, largely because of lower dividend payments to veterans holding National Service Life Insurance, while loans and transfers to foreign countries and international institutions increased.

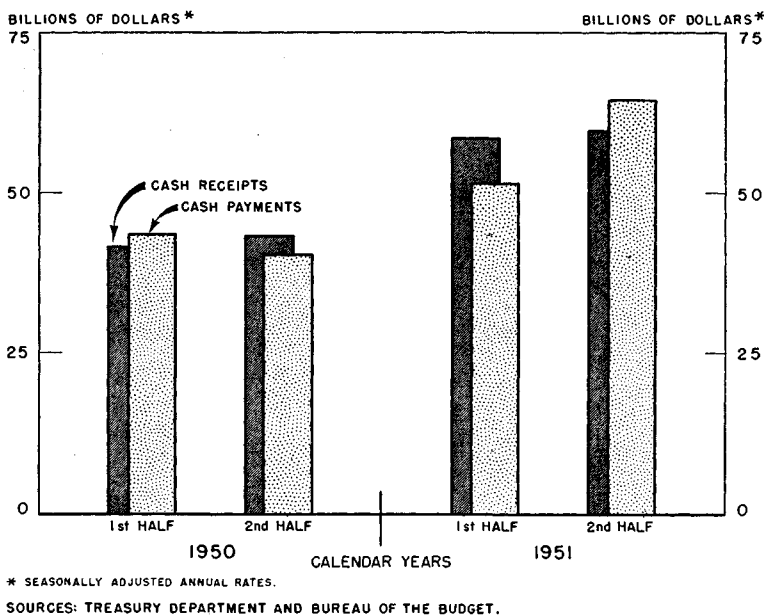
Further tabulations of Government financial transactions will be found in appendix A, in connection with the supporting tables for the Nation's Economic Budget.

Major national security programs. Cash expenditures for the military services advanced from 13.5 billion dollars in 1950 to 30.6 billion dollars in 1951. This increase was larger than the rise in total cash payments in this period. In the second half of 1951, payments for the military services were about 40 percent larger than in the first half. Outlays for the international programs increased to 4.8 billion dollars in 1951, but they were somewhat lower in the second half of the year than in the first half.

CHART 26

FEDERAL CASH RECEIPTS FROM AND PAYMENTS TO THE PUBLIC

Steadily rising cash payments in 1951 turned the surplus in the first half of the year into a deficit in the second half.



The category of "major security programs" includes, in addition to the programs mentioned above, these other programs which are not shown separately in table 11; atomic energy, maritime, civil defense, economic stabilization, and Defense Production Act activities. In the aggregate, these programs came to 1.9 billion dollars in 1951, bringing the total for all of the major security programs to 37.3 billion dollars.

These expenditure data are somewhat different from the estimates in the national income and product accounts of the value of current production being absorbed by the security programs. (See appendix table B-1.) The difference is explainable partly by the lag of Federal payments behind deliveries of goods and services, and partly by the fact that Federal expenditures are not always for currently produced goods and services but sometimes instead represent transfer payments or purchases of land or of existing facilities or equipment.

Major nonmilitary construction programs. Movements in total seasonally adjusted expenditures for public construction (excluding military and naval construction, but including State and local as well as other Federal con-

struction) showed mixed tendencies during 1951; in contrast, total private construction expenditures fell continuously after the first quarter. This contrast partly reflected greater inherent difficulties in reversing the trend of many large-scale public projects, and partly the important role which some of these public programs must play in sustaining the economy's strength in the "long pull" defense period. Table 13, which shows specified types of new public construction expenditures in 1951 prices for selected years since 1939, sets the 1951 record in better perspective.

During the past 2 years, public construction of the developmental type has increased, but by less than would have occurred had there been no mobilization program. The increases from 1950 to 1951 were for school construction and for housing, much of it in defense areas. Both were

TABLE 13.—*New public construction expenditures for major development programs*
[Millions of dollars, 1951 prices]

Program	1939	1943	1948	1950	1951
Total.....	1 5, 637	2, 752	3, 773	5, 728	5, 771
Education.....	1 1, 184	130	653	1, 205	1, 486
Health.....	335	90	240	504	496
Development of natural resources.....	1 1, 093	530	743	960	884
Transportation.....	1 2, 871	584	1, 964	2, 688	2, 305
Housing.....	154	1, 418	173	371	600

¹ Includes Works Progress Administration projects, adjusted for probable lower productivity.

NOTE.—Construction expenditures by Federal, State, and local governments are included.

Source: Department of Labor.

almost entirely State and local programs. Decreases took place in transportation (principally highways) and in natural resources development. It is significant that for neither of these did the postwar peak of expenditures in 1950 reach the 1939 level in real terms.

State and local finance. Receipts of State and local governments increased by about 1.6 billion dollars, or 9 percent, from 1950 to 1951. Most of the major sources of revenue shared in the increase which, while reflecting in some degree recent adoptions of new taxes or higher rates, was attributable for the most part to the prevailing high level of economic activity. The increase in the total spending of these governmental units from 1950 to 1951 was less than the growth in receipts. The combined State-local deficit was reduced from 900 million dollars to 400 million in 1951. (See table 10.)

Despite record revenues, increases in tax rates were more general than reductions among State and local governments in 1951. Caution was also shown in undertaking programs which would involve new expenditures, although the increase of population, creation of new suburban areas, population shifts associated with defense activities, and other factors placed State and local authorities under strong pressure to extend and improve governmental services. To some extent, of course, the higher level of expenditures in 1951 merely reflects increases in prices and wage rates.

III. Central Problems for 1952

ADVANCING THE SECURITY BUILD-UP

AN over-all measure of progress in the security program is the virtual doubling, from the end of 1950 to the end of 1951, of total security expenditures for goods and services, which reached an annual rate of 45 billion dollars in the fourth quarter of 1951. Military expenditures during the past 6 months have increased by the amount contemplated in the fiscal 1952 budget. We are still a long way, however, from achieving our basic security objectives of building up the military and economic strength of the free world as a whole. Major difficulties have been encountered, for example, in getting our military production program under way. These difficulties involve chiefly the machine tool and other bottle-necks, and design, engineering and production problems associated with the decision to produce exceedingly complex equipment of the most advanced design, rather than to concentrate on large-scale production of types already in use.

The proposed build-up

The security program now being submitted by the President calls for a further increase in total security expenditures for goods and services from the present annual rate of 45 billion dollars to a rate of almost 65 billion dollars by the end of 1952. Under present plans, the maximum rate of expenditures under this program would be slightly higher, and would probably be reached late in 1953. Besides a large further increase in expenditures for the military production programs which will supply United States forces and meet our North Atlantic Treaty commitments, an increase is planned in the atomic energy and civil defense programs. Economic assistance to other free nations—needed to help some of them carry out their mobilization programs and to help them strengthen their economies—is expected to be continued at approximately the present reduced levels of expenditure. More than 85 percent of total security expenditures in 1952 will be spent on the military establishment of this country and on military goods for our Allies.

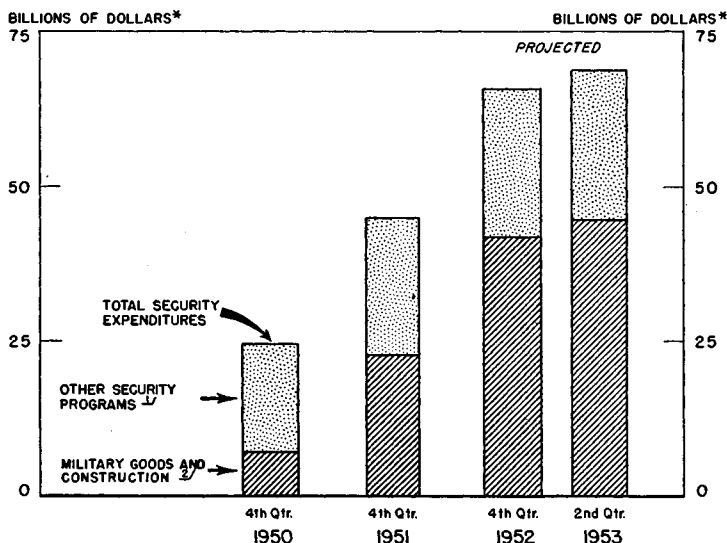
Although the 20-billion-dollar increase in the annual rate of security expenditures expected during the next 12 months is about equal to the increase achieved from the fourth quarter of 1950 to the fourth quarter of 1951, its character will be substantially different. (See chart 27.) Nearly all of the projected increase is represented by expenditures on military hard goods and military construction, while about three-fifths

CHART 27

THE SECURITY PROGRAM

EXPENDITURES FOR GOODS AND SERVICES IN 1951 PRICES

During 1952, the annual rate of security expenditures is expected to increase to a level about 20 billion dollars above the fourth quarter of 1951. Most of the increase will be for military goods and construction.



* SEASONALLY ADJUSTED ANNUAL RATES.

1/ INCLUDES MILITARY PERSONNEL COSTS AND OTHER SALARY EXPENDITURES OF THE DEPARTMENT OF DEFENSE, ATOMIC ENERGY PROGRAM, STOCKPILING, AND FOREIGN ECONOMIC (NONMILITARY) AID.

2/ HARD AND SOFT GOODS AND CONSTRUCTION FOR U.S. AND NATO FORCES.

SOURCES: DEPARTMENT OF DEFENSE, BUREAU OF THE BUDGET, AND COUNCIL OF ECONOMIC ADVISERS.

of the increase during the past 12 months occurred in these categories. The military production program calls for a doubling of hard goods deliveries and military construction within a year, with an increasing portion represented by aircraft and other relatively hard-to-produce types of military equipment. Equipping the military forces as now planned will require some further increase in deliveries of military equipment in 1953, and maintenance of a high rate of deliveries for a year or more. Deliveries of some items will begin to decline fairly soon, as requirements are met, while deliveries of other items will continue to increase through the period.

Achievement of this expansion would increase the proportion of the total national output taken for security purposes from nearly 14 percent in the fourth quarter of 1951 to more than 18 percent in the corresponding period of this year. For the year 1952 as a whole, between 17 and 18 percent of total output would be devoted to security. Indicative of the concen-

trated impact of the program, more than half of the national security output of goods and services will come from the metalworking and construction industries, though they account for only a little more than a quarter of the national output as a whole.

Plans for the security program in the longer run are necessarily flexible. The size and composition of forces, the extent of the build-up of war reserves, and the rates of replacement of matériel all affect the longer-run cost of the program. As a rough guide, however, it has been assumed that the total maintenance cost of forces now planned, plus the atomic energy program, would be in the general range of 40 to 50 billion dollars annually, until a firmer outlook for peace is established. In the perspective of the probable size of the economy of the middle 1950's, a program of this general magnitude would not place us under an intolerable economic strain. Such a program would take roughly one-eighth of the total national output we could expect to have, with reasonably full use of our resources. With success in meeting current objectives for capacity expansion, most of the now serious materials problems would become relatively unimportant. The expected steel capacity of over 120 million tons, and an aluminum supply of over 2 million tons, would take care of sustained defense requirements and reasonably satisfy other needs associated with a maximum employment economy. In the case of copper and some alloy metals, our needs would have to be met in part by further development of substitutes.

Speed of the build-up

The question has frequently been raised whether economic policy decisions have interfered with the defense program, by providing too much civilian production at the expense of munitions and military equipment. Some confusion has been introduced into this question by the failure to distinguish between (a) the intended size of the defense program and (b) the difficulties which arise in trying to carry out a program of given size on schedule. On the score of intended size, the Council does not believe that the current defense program has been or should be determined primarily by consideration of how much is left over for civilian uses, though the effect of the program on our ability to become economically stronger deserves important consideration. As we have many times said, a security program even larger than that now under way—if found to be necessary on other grounds—would be well within the economic capacity of the country, even though it would raise economic problems of substantial import.

It does not appear that the security program thus far undertaken has been slowed down by insufficient cutbacks in civilian use. It seems clear that, for the most part, materials and manpower have been available for military production when needed. It also appears that there have been certain bottlenecks and shortages which could not have been appreciably alleviated by earlier or more drastic civilian cutbacks. The mobiliza-

tion officials have been wise in avoiding unnecessary dislocations by not reducing civilian utilization of productive resources before the defense program was ready to take up the slack.

Moreover, it may have been entirely wise not to have carried the military program forward substantially faster by sacrificing the opportunity of constantly improving the quality of fighting equipment. The Council does not attempt to evaluate such issues of military strategy. We can only point out that, if a faster military build-up becomes necessary on security grounds, its accomplishment would be impossible without more extensive civilian cutbacks closely synchronized with the defense program.

In any event, strenuous efforts will be required to achieve the objectives now set for 1952. Hard work is now under way to overcome the shortage of machine tools, which will affect the aircraft production program for some time to come, and to relieve the shortage of ferro-alloys, in part through the development of substitutes. There is urgent need for firming up military production schedules and translating over-all requirements into bills of particulars for materials, manpower, and tools.

ALLOCATING SCARCE MATERIALS

The availability of metals

To carry out the security program as now planned, while achieving present objectives for expansion of basic capacity, and maintaining other activities on a basis consistent with an extended mobilization effort, will require some major shifts in the utilization of resources. These shifts are imposed by the shortage of metals, and involve mainly the durable goods sector of the economy, which accounts for about one-quarter of total national output. In the nondurable goods and services sector, the mobilization program will not require major resource adjustments. The impact on that sector is discussed at a later point in this Review, mainly in terms of labor availability and inflationary pressures.

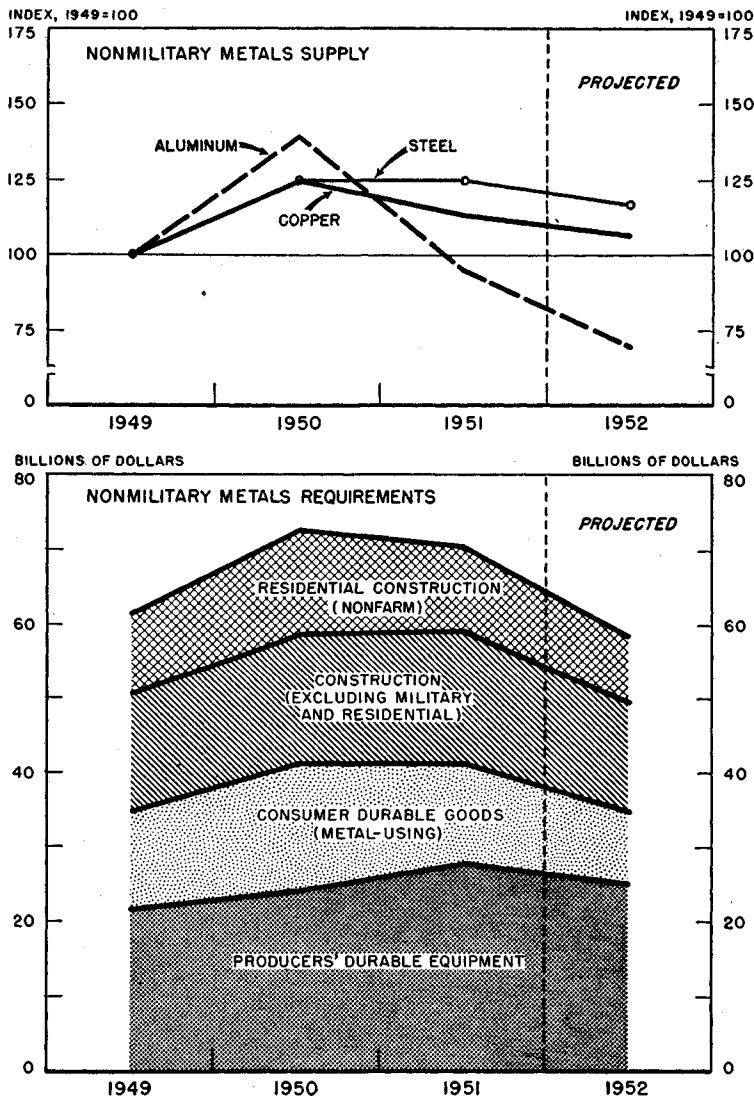
Military requirements for the major metals will increase through most of 1952, and at their peak will absorb roughly one-fifth of the steel supply, one-third of the copper supply, and about half the supply of aluminum. It is probable, however, that with large increases in supplies, these proportions will fall substantially in 1953. Thus the main materials impact, and the main economic impact, of the military production program probably will come during the next 12 months.

The upper panel of chart 28 indicates historical and prospective changes in the supplies of copper, steel, and aluminum available, after deducting military and stockpile requirements, for the output of investment goods, consumer durable goods, public and private construction, and other non-military uses. Comparison of 1952 with 1951 indicates a moderate reduction in the availability of steel and copper, and very sharp reductions in the availability of aluminum, owing to rapidly rising military requirements.

CHART 28

METALS SUPPLY AND REQUIREMENTS FOR CIVILIAN USE

In 1952, there will be moderately less steel and substantially less aluminum and copper available for civilian use. This will impose curtailments in nonmilitary construction, producers' durable equipment, and metal-using consumer goods.



These reductions would leave the steel supply available for nonmilitary uses some 15 percent above the 1949 level, and not much under the level of the last 2 years. However, military requirements will impinge much more severely on particular types of steel, notably high-alloy steels.

Comparing 1952 with 1951, supplies of copper available for civilian users will be reduced by about 5 to 10 percent, and of aluminum about 25 percent; the exact reductions depending in part on whether it is decided that stockpiling can be resumed and, if so, at what rate. Available supplies of copper will be reduced nearly to the 1949 level, while aluminum supplies for civilian use will decline about one-third below the 1949 level. Part of these reductions, however, had already occurred by the fourth quarter of 1951. It must be emphasized that, although these figures are based on the best current estimates of total supplies and military requirements, any of a number of factors could alter them appreciably.

Beginning in 1953, continuing large increases in supplies are expected to result in a moderate increase in the availability of steel for nonmilitary uses, and a substantial increase in aluminum. Some improvement in the copper position also appears possible. A major factor in determining how rapidly consumer durable goods and other types of restricted output can rise will be the extent to which steel and aluminum are substituted for copper. For the near term, the very tight aluminum supply will limit the latter type of substitution.

Major required adjustments

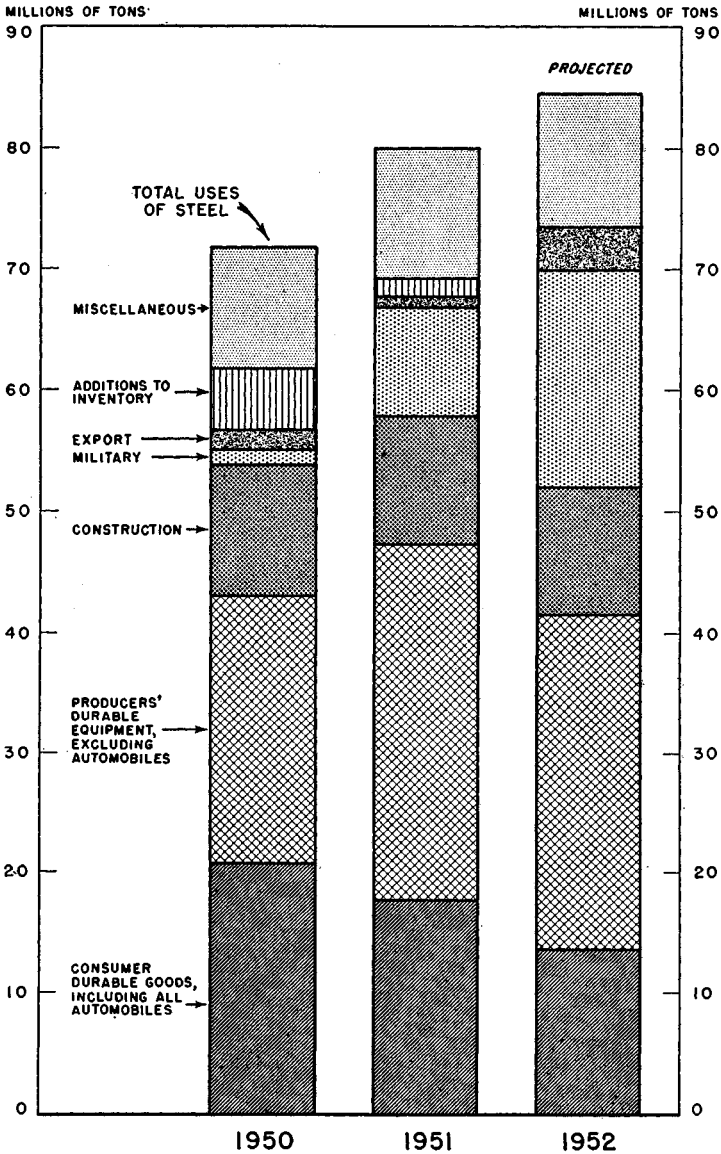
There is no one formula for apportioning limited material supplies. Even after military production objectives have been determined, there is wide range for judgment in determining a rational pattern of metals use. If the maintenance of short-term economic stability were to be given overriding priority, materials allocations policy would attempt to maximize the availability of metals for consumer output at the expense of their use for investment. This policy would probably prolong the period of metals shortages and comprehensive direct controls. On the other hand, the attempt to overcome basic shortages of materials, power and transport at the earliest possible date would require drastic reductions in the use of metals for consumer output and for the construction of schools, hospitals, and other types of investment of high utility.

Although it is not possible to present in detail the adjustments which the reduced availability of materials will impose, their general nature and implications may be indicated. The lower panel of chart 28 indicates the changes that have occurred since 1949 and the change in prospect for 1952 in the dollar volume (measured in terms of constant prices) of the major nonmilitary metal-using activities. Chart 29 compares the estimated distribution of steel uses in 1952 with the actual distribution in 1950 and 1951. The projected estimates in these charts are consistent with the

CHART 29

USES OF STEEL

Less steel will be available for nonmilitary use in 1952. The reduction will mainly affect automobiles, household appliances, and some types of construction.



SOURCE: DEFENSE PRODUCTION ADMINISTRATION.

materials supply picture, as described above, and with present allocation policies.

These charts indicate that between 1950—the peak year of nonmilitary uses in metals—and 1951, there was only a moderate reduction in nonmilitary uses of metals, concentrated mainly in consumer durable goods and in residential construction. The decline in residential construction has saved copper, but not an important amount of steel. Steel used in consumer durable goods, including automobiles, declined about 15 percent, while other major uses were maintained or expanded. Steel used in producers' durable equipment increased by about a third. This expanded use and the maintenance of total construction, despite cuts in particular types of construction, were in part associated with increasing investment in the major industrial expansion programs.

The much larger decline in the availability of metals in prospect for 1952 will force curtailments in all these metal-using activities. A reduction of more than 20 percent in total output of consumer supplies—housing, automobiles, and appliances—from the 1951 level is indicated by the materials allocations for the first quarter of 1952. Some further reduction in these metal allocations is planned for the second quarter. This makes allowance for considerable conservation and change in types of goods bought, since the percentage reduction in the permitted use of copper and aluminum is greater than the projected cut in consumer outlays. In view of the expected increase in programmed investment, discussed in the next section, the maximum reduction in expenditures on producers' durable equipment may be not more than 10 to 15 percent. In addition, it will be necessary to reduce total private and public nondefense construction (other than residential) about 15 percent below the 1951 level, and some types by much more, even if copper is used sparingly. Steel used in nonmilitary construction will not decline by as much as the over-all dollar volume of such construction, because of the shift toward industrial construction which uses relatively more steel. Sufficient steel supplies should be available to permit an increase in steel used for maintenance and repair. The much more restricted availability of copper and aluminum might even operate to prevent a full utilization of steel capacity in 1952.

Major problems in materials allocation

The allocation process moved ahead on schedule in the second half of 1951, to the stage of comprehensive quarterly allocation of steel, copper, and aluminum under the Controlled Materials Plan; and additional materials, components, and equipment items were subjected to other forms of allocation or use restriction. The use of this machinery for the achievement of a highly selective pattern of materials use raises some problems.

The Controlled Materials Plan, as originally instituted, provided no way to insure that the producers of common-use products and components, having gotten their allotments of materials, would supply defense con-

tractors and subcontractors in preference to less essential users. Throughout the latter part of 1951, there was increasing difficulty in getting essential components and equipment for military production and high priority investment projects, despite the fact that components and equipment manufacturers were producing at record rates. The National Production Authority is now attacking this problem, primarily by spot expediting actions to move urgently needed component and equipment orders to the front of the producers' production and delivery schedules. For some types of equipment, where necessary and feasible, this approach will eventually involve complete control over producers' schedules.

This line of action can usefully supplement the basic operation of advance planning for production of equipment and components to meet the needs of scheduled military and industrial expansion programs, so that allotments of materials can be geared to the future rather than the past.

Effective control of inventory accumulation is another problem. There is evidence that many producers' inventories of scarce materials are substantially in excess of operating needs. The necessary control techniques for dealing with this problem are available, and the problem is one of enforcement. The production agencies are taking action to locate and redistribute excess inventories. Continual screening of military requirements also is necessary to insure that inventories are kept to a minimum.

INCREASING PRODUCTION

Production and inflation

It is often taken for granted that increasing production is the natural economic remedy for the inflationary pressure which the defense program produces. The relation between production and inflation is, however, not a simple one.

The central task in halting inflation is to bring supply and demand into balance at the prevailing price level. Whether an increase of output actually will tend to bring demand and supply into balance at the current price level depends on a number of factors.

An increase of production in the form of highly specialized munitions and military equipment may widen the gap between the demand and supply of other goods. The reason for this possible result is that workers and businesses receive increases in income, as a result of expanded munitions production. These increases in income normally result in a rise in consumer and business demand for civilian goods, the supply of which has not been increased.

A very different case is one in which the increase reflects increased efficiency in the production of widely used civilian goods, for example agricultural products, which could result in a decline in the price per unit of output. In this case, the increased production may tend to narrow the gap between demand and supply, because the supply is increased while private money incomes may not rise correspondingly.

Another case is one in which the increase in the production of goods (other than specialized military goods) is achieved by increased employment. This has the result of increasing both the market supply of goods available for civilian purchase, and the incomes of consumers and businesses. If not all of the added income is reflected in increased spending, such an increase in production may be expected to have a net effect of narrowing the gap between demand and supply, although by only a fraction of the amount by which production is increased. If, however, the additional production is achieved only by a substantial increase in unit cost, for example through the payment of premium compensation to workers for overtime, the income added in connection with the production might have a net inflationary effect.

One of the chief methods of increasing future production is investment in new productive facilities, and in the modernization of existing facilities. If such investment is made in those industries where plant capacity and efficiency limit the increase of production and of productivity, the effect after the new facilities come into use is to increase supply and narrow the gap between demand and supply. During the period when the investment is being made, however, materials and other resources are diverted from producing consumer goods into the production of capital goods, which of course cannot be consumed, while income payments continue to be made to workers and other producers. An expansion of production that takes the form of increased investment thus would increase inflationary pressure during the period before the new facilities were brought into productive use.

The fact that some kinds of increases in production create inflationary pressures should not be interpreted as indicating that such increases must therefore be postponed or abandoned. Certain types of output must be expanded despite the fact that they add to inflationary pressures. Thus, military production is undertaken for imperative reasons which do not permit its abandonment for the sake of lessening inflationary pressures. Similarly, the expansion of the industrial mobilization base may be so important that any immediate inflationary pressures which might be produced may have to be accepted. The inflationary impact of such programs, nonetheless, is a reason for subjecting them to controls which will guide the expansion of production into the most essential lines, and for adopting other stabilization measures to limit demand. An expanding supply of consumer goods is likely to improve consumer acceptance of such restrictions as are needed. Clearly, an expansion of total production, if it is well balanced, makes a major contribution toward the expansion of our economic strength.

Factors limiting increase of total production

Given adequate demand for goods, the problem of increasing production is essentially one of overcoming certain physical limiting factors. With respect to most nondurable goods and services, actual output during the

coming year undoubtedly will depend mainly on the intensity of demand. In several of the soft goods industries, the available labor force, plant capacity, and materials would permit increases of production. With respect to many consumer and producer durable goods, however, the availability of raw materials—especially metals—is the limiting factor determining possible increases in output. Expanding metals output is largely a problem of productive capacity, including electric generating capacity. Limitations on the supply of manpower, with a few special exceptions, have not interfered with the growth of production, and the prospect is that the supply of labor can be increased to meet the expanding need, at least over the next 12 months.

Increasing the supply of raw materials

The most immediate restraint on production, both in the United States and throughout the free world, continues to be the limited supply of certain raw materials. Comparing 1951 with 1950, the free world output of many important raw materials showed large gains. (See appendix table B-17.) Increasing the free world supply of certain raw materials, however, continues to be a major problem.

Encouragement of private investment in raw materials production abroad requires reasonable protection of such investment and of fair profits realizable in dollars. Conversely, countries that engage in needed expansion want assurance that neither shortages nor price inflation in the United States will undercut their own efforts to expand production. In some instances, investments are needed in such ancillary facilities as a transportation system. For example, the effective exploitation of Labrador and Quebec iron ore will depend largely on the early completion of the St. Lawrence seaway project.

Pricing and related devices for encouraging production of essential metals and minerals deserve continued judicious use. First, guaranteed floor prices in long-term procurement contracts are now being used, and can be extended where necessary. Floor price guarantees help to increase domestic and foreign supplies of raw materials, by eliminating the risk of a post-emergency price decline to levels which would make additional production and investment unprofitable. Second, where the costs of domestic or foreign marginal mines producing essential scarce minerals exceed United States price ceilings, the use of premium prices or their equivalent would be desirable in cases where protection from abuses can be assured. Premiums should be limited in time and amount, and should apply only to the high-cost portion of output. The same policy is appropriate to encourage new development projects. Third, a program to increase supplies of certain minerals and metals by adjusting price ceilings is appropriate where other methods less likely to impair price stabilization objectives are not effective. Recent ceiling price changes for lead and zinc represented an increase to domestic producers, and should tend to increase domestic sup-

plies. These price changes, however, have not yet resulted in significant improvements in imports. Fourth, removal of the existing United States tariff on lead, zinc, and certain other metals would be desirable, where this action would encourage imports or would ease the pressure on domestic prices.

Technological research and related efforts to conserve materials in short supply by simplifying designs, using more plentiful substitutes, or salvaging and re-using materials, can help in increasing total production, and in easing allocation and production problems. Specific suggestions have already been worked out in the construction industry for effecting substantial savings in the use of structural steel, through the substitution of reinforced concrete and masonry or wood construction. Substantial savings of copper are planned in the electrical, automotive, and other industries by the substitution of aluminum as it becomes more plentiful.

Longer-range requirements for raw materials, and the best methods of meeting them from sources in the United States and the free world generally, have been under intensive study by the President's Materials Policy Commission for the past year. The report of this Commission will soon be completed.

Enlarging the labor supply

Availability of raw materials is the limiting factor in determining the possible increase of output in the durable goods sector of the economy. The manpower needs for this sector, involving the defense program, constitute a priority which should be met. Defense and defense-related production will require about $2\frac{1}{3}$ million more workers in the fourth quarter of 1952 than in the fourth quarter of 1951.

Some of these essential workers will be provided by cutbacks in the output of civilian durable goods and nondefense construction. Allowing also for some lengthening of working hours, and a modest increase in productivity, it seems that an increase in total civilian employment of about $1\frac{1}{3}$ million would be required to service the primary defense effort, and to provide an adequate labor force for such increases in production in other sectors of the economy as might be expected in the light of probable increases in incomes and demand. The small possible addition of workers through further reducing unemployment is about counterbalanced by the probable withdrawal of manpower to enlarge the armed forces.

Judging from previous experience, a net increase of about $1\frac{1}{3}$ million in total civilian employment during 1952 is well within our capabilities. An annual increase in the labor force of about 1 million has been usual since the war, even without such active recruitment as will occur, at least in a few industries, during the coming year.

Though there is no general manpower shortage nor any near-term prospect of one, some localized labor shortages do exist. In November 1951, 6 of the 174 major labor market areas in the United States either had, or were

expected shortly to have, labor shortages which threatened to impede essential activities. Another 60 areas were listed as having a "balanced" labor supply; in some of these, the labor market will tighten as the pace of defense production is stepped up.

In addition to localized manpower shortages, there are some urgent problems arising from scarcities of workers with particular skills, such as those in the fields of engineering, design, and machinery operation, which require considerable training to develop. The Government is stressing the importance of more adequate training programs, and is assisting employers, schools, and labor to improve and expand such programs. When shortages of highly skilled metal workers threatened seriously to hamper machine tool production, the industry was given priority in recruitment of labor through the Employment Service. Special consideration also was given to machine tool workers who were liable to call by Selective Service or as reserves by the Department of Defense. The Department of Labor and the Selective Service System are developing a joint policy which will provide more deferments for apprentices in skilled trades. In addition, every effort should be made to expand the number of "on-the-job" trainees. Full use should also be made of vocational education in public schools, which contributes importantly to the supply of skilled and semi-skilled workers.

Preventable illnesses and accidents, on and off the job, can be reduced by strengthening public health, medical care, safety, and related programs. Strengthening of the existing Federal-State vocational rehabilitation system could, over the years, return to the labor force hundreds of thousands of workers who are already trained and experienced.

In addition to specific labor shortages in industry, there are increasing evidences of farm labor shortage. The steps being taken to meet this shortage include more extensive use of persons not normally in the labor force, community participation in emergency situations, fuller exchange of labor between farmers and between States, better housing facilities, and improved informational, health, and welfare services for migrant workers.

Part of the solution for manpower problems lies in placing facilities expansions and contracts in areas where there are ample labor supplies, thus reducing the need for migration. To ensure that manpower considerations are given adequate attention in placing defense contracts, the Department of Defense has developed a plan under which no such contract will be placed in a labor shortage area without prior consultation with the Employment Service.

But not all defense operations can be carried on in areas of adequate labor supply. The lack of housing and community facilities is the greatest obstacle to recruiting sufficient workers where it is necessary to bring them in from other localities. By mid-January 1952, some 140 local areas had been classified as critical from the point of view of insufficient housing and community facilities and services to accommodate persons migrating to

military installations and defense plants. The number of such areas is expected to increase substantially during 1952. Special assistance provided by the Defense Housing and Community Facilities and Services Act has been extended to some 65,000 private housing units in these areas. Although the bulk of future need will continue to be met by private construction, larger appropriations for publicly financed defense housing will be required for those types of housing and in those places where private enterprise cannot be expected to meet the need. Additional aid to critical areas for essential community facilities and services should also be provided.

Guiding investment

The necessary shifts in resource use outlined above will involve some further major changes in the pattern of private and public investment. To meet war preparedness objectives, and to work toward the substantial elimination of basic shortages by 1954—when, so far as can now be judged, military production will have passed its peak and be on the way toward a substantially lower maintenance level—investment in Government-aided industrial expansion programs will have to increase further. As tentatively planned, these programs will expand from a level of around 14 billion dollars in 1951 to about 15½ billion a year over the next 2 years. (See table 14.) In addition, essential developmental investment, including that for schools, hospitals, highways, and natural resources, will probably amount to roughly 5 billion dollars in each of the next 2 years.

Reduced availability of materials is expected to force a reduction, comparing 1952 with 1951, of at least one-quarter in all other types of public and private investment. Though part of this decline in the rate of outlays had occurred by the end of 1951, full adjustment to such a pattern cannot be accomplished all at once, because of the necessity of completing a substantial volume of construction now under way.

Programmed expansion of productive capacity. The basic expansion programs are an important part of an economic strategy for a long period of partial mobilization. They contemplate, in addition to meeting the top priority needs of the military, the provision of an enlarged base of additional capacity—not only as a reservoir of quick strength in the event of war, but also as the long-range solution to the problem of adequate supply in all major sectors of the economy while maintaining a large security program.

The bulk of the investment in such programs is private, though publicly-owned facilities constitute a major share of the program for expansion of munitions facilities, and a quarter to a third of the electric power program. The Federal Government has supported the private programs, however, with various forms of financial assistance, in addition to giving them preference over other investment in the allocation of scarce materials.

The full industrial build-up program necessary for meeting mobilization objectives extends well beyond 1952. The progress made during 1951, the availability of materials and equipment, and such advance scheduling

of the programs as has been done, indicate for 1952 and 1953 a continuance of very high rates of investment in these priority expansion programs as a group. The projected rates of outlay, as shown for some major programs in table 14, reflect further work on projects now under way, and work on new projects for which in most instances fairly firm commitments have already been made. The actual rate of progress will depend in part on the availability of structural steel and other bottleneck items for construction and equipment.

These major expansion programs accounted for one-quarter of total private and public nonmilitary investment in 1951; in 1952 they may account for nearly one-third of the total. They will require in 1952 nearly half the copper and steel used in all nonmilitary investment.

TABLE 14.—*Estimated plant and equipment expenditures in selected areas of programmed or Government-aided expansion*

[Billions of dollars, 1951 prices]

Program ¹	1949	1950	1951	1952-53 ²
Total.....	10.8	11.1	14.0	15.4
Electric power ³	2.6	2.4	2.9	3.8
Petroleum.....	2.2	2.3	2.4	2.6
Farm machinery ⁴	1.7	1.6	1.6	1.7
Metalworking machinery ⁴	.4	.4	1.2	1.7
Trucks and truck trailers ⁴	1.6	2.0	2.0	1.7
Natural gas.....	1.1	1.2	1.3	1.2
*Iron and steel (including byproduct coke ovens and iron ore mining facilities).....	.6	.6	1.4	1.2
Railroad equipment ⁴	.5	.2	.6	.7
Aluminum.....	(⁵)	.1	.2	.3
Synthetic fibers.....	.1	.1	.2	.2
*Taconite (iron ore) concentrates.....	(⁵)	(⁵)	(⁵)	.2
*Nitrogen.....	(⁵)	(⁵)	(⁵)	.1

*Indicates programs for which the Defense Production Administrator has announced objectives. Objectives have also been set recently for a number of other programs, not shown in the table and involving for the most part relatively small investment. These include columbite and tantalite, tungsten ore, chromite, cobalt, molybdenum, nickel, sulfur, lead, magnesium, chlorine, hydrofluoric acid, newsprint, lubricating oil, phenol, phthalic anhydride, metallurgical manganese ore, zinc, aniline, high-purity oxygen, and naphthalene.

¹ Most of these "programs" are still only tentative proposals. Figures are in most cases not directly comparable with those in the first column of table 6, partly on account of differences in industry classification and partly because not all projects are covered by tax amortization certificates.

² Estimated average annual rate.

³ Includes both private and public power facilities.

⁴ Figures refer to value of proposed output of the type of equipment indicated, and not to expansion of facilities for producing such equipment.

⁵ Less than 50 million dollars.

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

Source: Defense Production Administration.

Public investment. Many lines of public investment outside the direct military area play an essential role in the defense build-up. These include, among others, the public electric power program, minerals development, highways, and land, water, and forest conservation. Others are considered in the next section.

In view of the increased pressure on scarce materials in 1952, stemming from the build-up of the security program and defense-related industrial expansion, many lines of public investment need to be curtailed still further. But this curtailment will have to be highly selective. This can be achieved

by a combination of materials allocation and careful Federal, State, and local budgeting. Some cut should be feasible in nonmilitary public construction as a whole.

The electric utilities, private and public, are planning to increase capacity by about 30 million kilowatts, or nearly 40 percent, during the next 3 years. Even with this program, power availability is likely to remain a critical problem in certain regions where large load increases will occur, such as the aluminum-producing Pacific Northwest and the areas where large new atomic energy plant requirements must be met. Looking farther ahead, the increasing emphasis on the chemical, electrometallurgical, and other large power-using industries indicates a continuing rapid growth of power requirements. Power development by public agencies needs to play an important part in meeting them, particularly where Federal multi-purpose river developments can provide large additions to power capacity along with other desirable results. Hydroelectric projects already begun should be completed rapidly. New projects serving defense and other essential requirements which should be undertaken are the St. Lawrence seaway and power project and the Niagara River redevelopment, to furnish 1½ to 2 million kilowatts of capacity to users in the northeastern part of the country; and also several projects in the Pacific Northwest.

Basic resource survey, research, and experimental programs, as well as some actual land, water, forest, range, and mineral conservation and development projects, need to be strengthened, since these provide the underpinning for long-range production increases. For the immediate period ahead, those activities less essential for defense will have to be postponed, but such postponement cannot long be continued without sacrifice to longer term security and production objectives.

Although the atomic energy program is now directed primarily toward the production of weapons, the possibilities for future peacetime use of atomic energy and isotopes have not been forgotten. Several private utilities and other companies, with the cooperation of the United States Atomic Energy Commission, are investigating the technical and cost characteristics of the joint production of materials for weapons and electric power for general use. Fortunately, almost all of the fissionable material being produced, as well as a portion of the investment now being undertaken by the Atomic Energy Commission, will be useful for peaceful purposes when the world situation no longer requires that they be kept available for defense.

The rate of maintenance of the highway system has for the past decade averaged far less than would be required to keep it in even reasonably adequate condition in the face of the phenomenally rapid growth of traffic. Although some reduction in highway expenditures has to be made in the immediate future, higher levels of construction and maintenance activity should be resumed as quickly as possible. The Federal highway aid program should be extended promptly, to avoid any lapse when the present program expires.

Restrictions on nonessential investment. The impact of materials restrictions on business investment has only recently been felt. But late in 1951, as the supply of metals and equipment tightened and as direct controls over construction were made effective, the rate of investment in some less essential types of construction and equipment began a sharp decline. (See charts 21 and 22.)

In 1952, with the national security programs sure to absorb resources at a greatly increased rate, and the likelihood that the high priority industrial expansion programs will take at least as much as in 1951, it is evident that other types of investment must be brought well below 1951 levels.

Private housing construction, for example, will have to be cut, probably by at least 20 percent. In the commercial and nondefense-related industrial categories, very few new construction starts are currently being approved, and most of the current construction activity of those types represents merely the completion of projects already well under way. A continuance of this rigid restriction on new starts through 1952 would bring the volume of commercial construction by the end of the year down to perhaps half its current level, which is in turn well below that of a year ago. Such a rigorous policy, however, is not contemplated. As projects under way are completed in 1952, it will be feasible and desirable to permit new starts where most needed (e. g., in areas of rapidly increasing employment), while at the same time keeping the level of construction activity and the use of scarce materials below present levels in commercial, nonpriority industrial, and miscellaneous construction.

Business investment in machinery and other producers' durable equipment is currently accounting for a much larger dollar outlay than all private construction combined, and also absorbs larger amounts of scarce metals. (See charts 19 and 28.) The rate of output of equipment is controlled by allotments of controlled materials to equipment producers; but effective control to assure the direction of equipment to uses of greatest urgency requires further development.

Dispersal. One important problem related to achievement of security objectives is industrial dispersal. In previous Reviews, the Council has recommended two general types of dispersal: first, avoidance of over-concentration of industrial facilities within particular industrial and labor market areas, and, second, within the framework of the whole economy, a regional decentralization of industry which looks toward further development of cores of economic strength in the less developed large regions of the country. The President has already directed that applications for aid for industrial expansion as well as the allocation of critical materials for construction purposes be reviewed with an eye to dispersing essential defense activities within given labor market areas. More work needs to be done toward specifying precise standards for governing this kind of dispersal, and seeing that it is balanced with an adequate dispersal of housing and

community facilities and services. Under this policy, the principal instrument of dispersal must remain the location of new facilities. But over the course of a decade, assuming a high level of investment in new plants, possibly one-third of the present total value of industrial plant could be located according to dispersal standards.

Less headway has been made toward building up diversified and inter-related centers of industrial strength in various larger regions of the country, such as the Far West and the Southeast. Here again, the need is to establish workable standards to guide private firms and Government agencies in the selection of sites for new essential industrial operations.

Increasing agricultural production

Increased agricultural production, up to the limit of available acreage, and with special increases in feed crops, is contemplated in the Department of Agriculture's goal for 1952. The recent high level of farm output, about 40 percent above the 1935-39 average, has been a major restraint on inflation. Further gains are necessary to meet domestic consumption, exports, and storable reserves. Price support programs again will be used for this purpose.

The existing farm price support legislation for basic commodities, including wheat, corn, and cotton, was written during 1948 and 1949. It was intended to cushion producers against abnormal drops in prices which might result from production in excess of market demand. It was feared that large carry-overs would hang over the market and depress prices; also, that they would lead to excessive losses from price support operations and alienate public support for the farm program as a whole. Therefore, the 1949 legislation provided for a reduction in price support levels when stocks were large, in order to stimulate consumption and to hold down production.

The present situation is quite different from that envisaged in 1948 and 1949. The Secretary of Agriculture has asked farmers for maximum production of several of the basic commodities. Our reserves of wheat, corn, and cotton are all at lower levels than can be considered safe or desirable. Yet under existing legislation, if farmers succeed in increasing production sufficiently to build up reserves to safe or desirable levels, they could be penalized by having their support prices reduced from 90 percent to as low as 75 percent of the effective parity. This possibility may act as a deterrent to maximum production of basic commodities by raising concern in the minds of many farmers lest the Government, after enlisting them in an all-out production drive, might leave them worse off as a result of their patriotism and hard work. Support prices for corn, wheat, cotton, and dairy products at 90 percent of parity have already been announced.

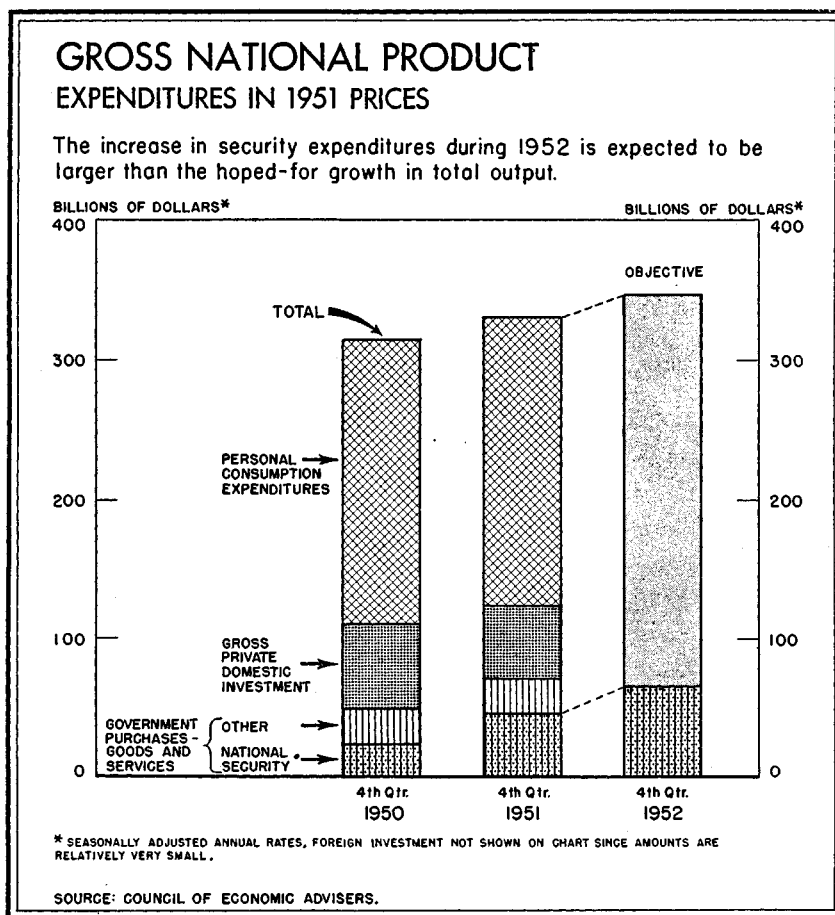
In addition, wider and more effective use of fertilizer is necessary. Expansion programs for nitrogen and other fertilizers should be expedited, and adequate quantities of farm machinery provided. Newly irrigated

land coming into production this year will contribute to the 1952 increase in output.

Over-all production objective for 1952

In 1952, the primary production objective is to boost the annual rate of output for defense by about 20 billion dollars—most of it in military hard goods items and military construction. About half of this should represent additional production; about half would be diverted from civilian durable goods production and construction. (See chart 30.)

CHART 30



By the methods discussed above, it should be feasible within the year to lift the annual rate of total output, for defense and civilian purposes combined, by at least 5 percent, or about 15 to 20 billion dollars. About two-thirds of this increase, or at least 10 billion dollars, should be a net gain in the area of durable goods, including construction.

These 1952 production figures, it should be emphasized, are not a forecast. They only set forth desirable and feasible objectives. Enlargement of defense production and total production in 1952 depends primarily on the vigor and initiative of producers and workers. It depends upon the effectiveness and cohesion of the whole economic mobilization effort. It depends also on the success of the policies designed to remove roadblocks.

MINIMIZING BUSINESS DISLOCATION

Minimizing local unemployment and geographical dislocations

Although the national total of unemployment remained at a low level throughout 1951, a number of areas have serious unemployment problems. Many of these areas concentrate on one or two major types of industrial activity; for example, textiles in Lawrence, Massachusetts, and coal mining in Scranton and Wilkes-Barre, Pennsylvania. The defense production program has not had much impact on such areas. Without a substantial increase in demand for the products of these areas, a continuance of the problems confronting them is likely. While in some instances war contracts can be let in these areas, little surplus labor can be absorbed by this method. A number of new plants are being located in isolated communities where a labor force is practically nonexistent, so that we can expect, before very long, some migration of the unemployed from areas of labor surplus to these new locations.

Steps are now being taken to compile a directory of existing unused facilities which could be used for defense production. In addition, long-range estimates of manpower requirements and resources are in process of being developed. With such information at hand, we can expect greater success in placing contracts in areas where the labor supply is available, thus reducing unemployment, and at the same time helping to avoid the geographic dislocation problems discussed above.

A special type of defense unemployment, which has become acute in some metal-using centers, has resulted from a discrepancy between expanding defense and contracting civilian work. Certain industrial areas, such as Detroit, have been hard hit by this development. Despite the efforts which the Government is making, the unemployment problem in some of these areas will unfortunately continue in 1952.

To alleviate this problem, the Director of Defense Mobilization is appointing an interdepartmental committee of production, procurement, and manpower agencies to assist in dovetailing civilian industry cutbacks with defense expansion on an area and industry basis. In line with approved military requirements, the Department of Defense has been trying to place more defense contracts in Detroit, with some success in terms of the number of contracts, but the dollar value of such contracts has shown some decline. Every effort should be made by the industries in this area to do as much of their own work as possible in Detroit. For example, some

of the automobile production now being carried on in tight labor areas might be drawn back into plants in labor surplus areas.

New defense plants, procurement contracts, and military installations are affecting larger regions of the country, and should be related to the broader regional economic potentialities and problems if major geographic dislocations are to be avoided. Several Federal agencies are making good headway in the programming of natural resources development, which is basic to economic growth, in a number of larger river basins and other regions. The Council hopes that it is contributing to this end by sponsoring a series of regional economic studies which, while not conceived originally as defense projects nor primarily focused on defense needs, have given a good deal of attention to them since Korea. With the cooperation of the Joint Committee on the Economic Report, studies relating to the South and New England have been completed. Another is now under way in the Southwest. Prepared independently by highly qualified economists and others who live in those regions, these studies indicate specific ways in which the present defense program may affect underlying economic problems of the regions, and look beyond the immediate program to the problems which will arise during and after the transition to the later maintenance phase of the defense effort.

Utilization of small business

In view of the large growth in defense output during 1951, some dislocation of business, and particularly of small concerns, might have been expected. Actually, business viewed as a whole showed little evidence of distress; and not all of the distress that appeared resulted from the mobilization effort.

In lines of business where the limiting factor was materials supply, the mildness of the over-all impact of the defense program in 1951 was due to a combination of factors. Stocks of needed materials and components were high at the beginning of the year. Many producers showed remarkable ingenuity in stretching their reduced allotments of critical materials by redesigning their products. Finally, so long as it was feasible, it was Government policy to allot sufficient materials to each industry, even to those producing clearly nonessential goods, to keep it going until defense orders began to take up the slack. Provision was made for exceptional allotments to individual producers in hardship cases.

But a mobilization effort necessarily creates serious problems for small business as a class. Small business firms are more vulnerable to material shortages than larger firms, because their profitability is generally more severely affected by reductions in their operations, their output more narrowly specialized, and their financial position weaker. The industries in which a mobilization effort calls for major increases in output and capacity are, in large part, those in which small-scale production is the exception

rather than the rule; and in general, the facilities of small firms are less easily adapted to defense production.

The increased stringency of materials supply in 1952 will intensify the need for many firms, particularly smaller ones, either to get into defense production or to redesign their products in such a way as to make much less use of scarce materials. It will no longer be possible on so extensive a scale to allot such materials to nonessential production in cases where the only justification is that it permits a firm to continue operations.

Quite aside from the need to alleviate distressed conditions caused by material cutbacks, it is obviously in the national interest that there be a greater diffusion of defense production in our industrial structure. It is advantageous to spread arms production experience. Small plants have a production potential which should be preserved against the day when it would be needed to support total mobilization. Production bottlenecks may be eliminated by a more effective utilization of small manufacturing facilities. Moreover, the mobilization program should not be permitted to impair competition.

Government assistance to small business, particularly through the services of the Department of Commerce, is an activity of long standing which is now being intensified. In addition, a number of measures have more recently been taken by the Defense Department and the mobilization agencies to increase the participation of small business firms in the defense program, and to lessen the impact of material shortages. Information is circulated on prime and subcontract opportunities. An industry distress program has been set up on a regional basis, to identify those firms hardest hit by allocations, assemble information on their capabilities for producing defense goods, and bring them together with procurement officials and prime contractors. Users of controlled materials in very small quantities are permitted self-certification.

The Small Defense Plants Administration was recently created as an independent agency, to aid in developing ways of using small business concerns most effectively in national defense and essential civilian production. It has statutory authority to enter into prime contracts with Government procurement agencies, and to arrange for the performance of such contracts by letting subcontracts to small business concerns. It should be noted, however, that no funds have been appropriated to finance this contracting function. SDPA also has the power to recommend to the Reconstruction Finance Corporation loans to enable small concerns to engage in defense and essential civilian production. A working arrangement has already been agreed upon to implement this operation.

Perhaps the most important responsibility of this new agency is that of determining, jointly with the procurement agencies, that it is in the interest of the national defense program to let a specific contract to a small business concern. Once this joint determination is made, the contract must be

placed with a small concern. If effective procedures are devised by SDPA and the procurement agencies, this should be a concrete way of effectuating the frequently expressed policy of Congress that a fair proportion of Government procurement be placed with small business concerns.

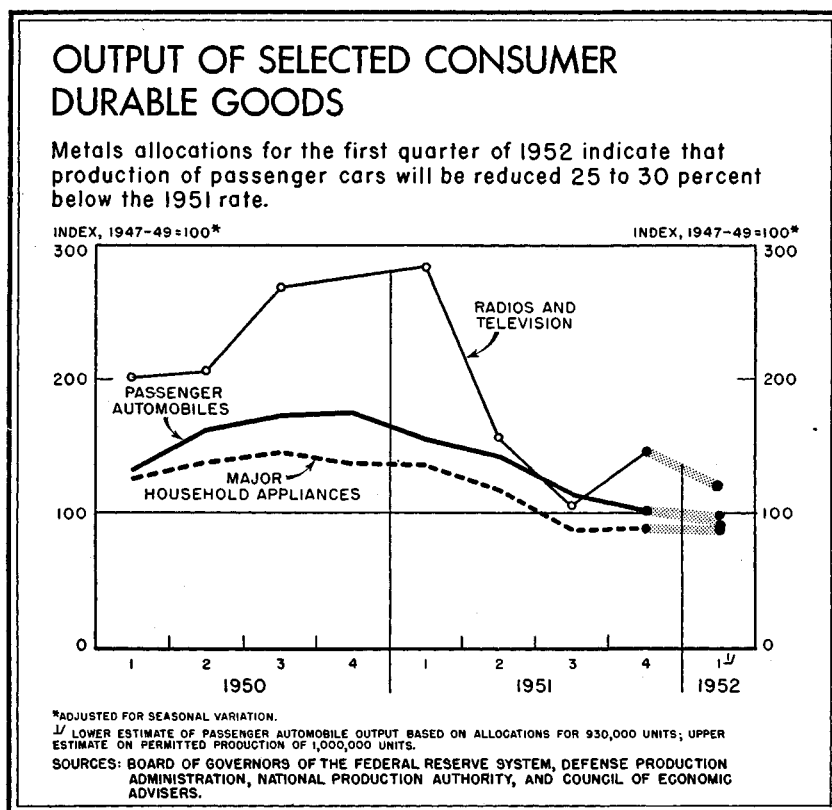
SUPPLYING CONSUMER NEEDS

Outlook for consumer goods

With the security program now scheduled, and reasonable increases in total production, consumer supplies will be adequate to meet essential needs in 1952. Since there will be cutbacks in the output of metal-using durable goods, any increased demand arising from a higher income total will be manifested mainly in increased production of nondurable goods and services.

The output of textiles, food, and many other products can be expanded without interfering with the defense program. Judging from peak rates of output in 1950 and 1951, production of textiles, apparel, shoes, and furniture could be raised by over 25 percent from recent levels, and production of carpets could be doubled. The food outlook also is relatively good and

CHART 31



should permit some rise in food consumption, with the largest increases in the more expensive items such as meats and frozen fruits. The capacity for synthetic fibers is being increased, which will further supplement the supply of cotton and wool in 1952 and 1953.

In major metal-using consumer durables, the outlook is quite different. Production of passenger cars in the first quarter of 1952 will be between 900,000 and 1 million units, or a little more than half the average quarterly rate in 1950. Allocations for steel and other metals for use in major household appliances, such as ranges, washers, and refrigerators, and for radio and television sets, are also being reduced to 50 percent or less of the rate in the base period, which in most instances is the first half of 1950. However, absorption of stocks of materials and substitutions will temporarily permit somewhat higher rates of production. (See charts 4 and 31.)

The projected production levels for appliances and automobiles are not so low in relation to recent demand as the size of the cuts from 1950 suggests. Sales of passenger cars and major appliances declined from 1950 to the second half of 1951 by between 20 and 25 percent, as shown in chart 18. Nevertheless, the supply of passenger cars is likely to be below the level of demand in 1952, while other durable goods will become more scarce as the present ample stocks are worked off.

It is not likely that output of automobiles can be increased much in the second and third quarters. It now appears likely that less than 4 million cars will be produced in 1952, compared with 5.3 million in 1951, and 6.6 million in 1950. While this is below the number which would be desirable in order to retire over-age vehicles rapidly, the continuance of even this rate for the next few years would maintain or somewhat increase the number of cars in use.

The cutbacks in production of metal-using consumer goods raises problems of maintaining adequate supplies of lower priced lines of merchandise. Manufacturers at present are free to shift to higher priced lines, so long as they stay within their metals allocations. As materials become scarcer, a tendency may develop to concentrate on the high-profit margin items—which in general are also the more costly. A shift in production toward a higher proportion of expensive goods not only adds to living costs, but in most cases makes for a less efficient use of materials. Consequently, the production and stabilization agencies are considering measures to be applied in the event that low priced goods tend to disappear from the market.

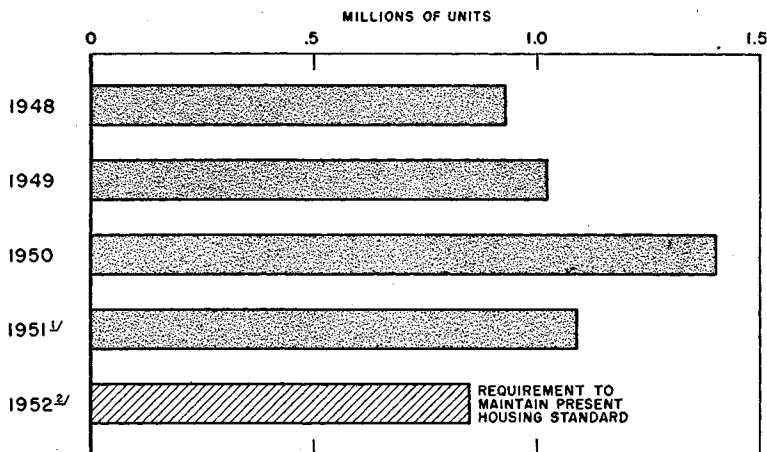
Housing

Although 6 million new houses have been produced since the end of World War II, demand remains at a high level because of backlog requirements, high living standards, and a high rate of family formation. Credit restrictions introduced in 1950, which were relaxed by Congressional action in September 1951, plus a stringency of funds for Government-insured mortgages in the latter part of 1951, helped to reduce the number of starts

CHART 32

NEW HOUSING STARTS

Housing starts in 1951 were about 15 percent below 1950, but higher than in any other year on record. A cut of about 20 percent is expected for 1952.



^{1/} PRELIMINARY ESTIMATES.
^{2/} ESTIMATED.

SOURCES: DEPARTMENT OF LABOR AND HOUSING AND HOME FINANCE AGENCY.

of nonfarm housing from 1.4 million in 1950 to about 1.1 million units last year. (See chart 32.)

In 1952, a large net migration will be needed to meet the labor requirements of areas containing defense establishments or military installations. New housing accommodations will be required for a large proportion of these workers, and a Federal program for aiding private construction of about 200,000 units is in operation. In addition, sufficient defense housing can be provided only if the Government assists in financing necessary community facilities and actually builds houses in some areas. Besides the unusual strains on housing capacity arising from movements of defense workers, there is a need for new housing to take care of the 600,000 to 700,000 new families which will be formed next year. Although part of these families can be housed in units vacated by families moving to defense areas, it is estimated that, for the economy as a whole, 800,000 to 850,000 new nonfarm dwellings would be needed in 1952 merely to maintain present housing standards.

It is hoped that this number of units can be produced in 1952. The outlook for materials supplies indicates that substantial further economies in the use of scarce materials in housing construction will be required if this goal is to be reached.

Housing construction in 1952 must of necessity fall considerably short of the annual rate which would meet long-term needs. To replace structures which are below standards of health and decency, and to house the growing population, an average of nearly 1½ million new nonfarm units a year would be required throughout the 1950's. A large number of these should be publicly-financed low-rent housing for low income families. In 1952, even with prospective cuts in total housing, at least 75,000 of these units should be built. This would be about the same as in 1951, and much less than the average annual rate contemplated by the authorizing legislation.

An inadequate supply of new housing is part of the price we must pay for national defense. But the economic and social costs of the housing deficit can be aggravated or mitigated, depending upon the policies adopted. Since addition to the housing supply during the next two years at least must be held down to between one-half and two-thirds of the actual need, it is essential that the bulk of the supply be channeled into areas where it is needed most, and that within these areas and elsewhere there be concentration upon reasonably priced housing coupled with severe limitation of luxury housing. In all housing construction, there should be strenuous efforts to limit the utilization of critical materials, such as copper, in view of the fact that adequate housing can be provided with available substitutes. The proportion of low-cost housing to the total new housing supply should be appreciably raised above recent performance. This is an obviously desirable requirement for a mobile and contented labor supply in a defense emergency. The World War II experience, with appropriate adaptations, provides such well tested techniques for bringing about these necessary adjustments that they should be speedily effectuated in the year ahead.

Essential public services

Education. To meet the needs of the very large number of children who will be added to the school population in the next 6 years, some 200,000 additional classrooms with adjunct facilities should be constructed. In areas where school needs are due to increased Federal activities, Congress has authorized aid to school construction. It is necessary to continue and extend the present program to cover all critical defense areas. No less urgent is the need for a large increase in the number of teachers trained for elementary and secondary schools. In some States, it would be difficult to improve teaching and operating standards of education without adequate general Federal aid. At least a start in this direction should now be made. To promote needed higher education, and to correct the inequality of opportunity in the present draft procedure, an appropriate Federal scholarship program appears even more urgent now than when it was previously recommended.

Health. By 1954, the Nation will need an estimated addition of 22,000

physicians, 9,000 dentists, and 49,000 nurses beyond those now in sight. A program of Federal aid to medical education, including nursing, is urgently required if the increase in health personnel is to keep pace with the growth in population, instead of continuing to fall behind it. Federal aid is required to help organize local public health services in those communities which do not have them. Shortages of scarce building materials have forced a slow-down in the rate of hospital construction despite vigorous conservation measures, but hospital construction should be stepped up again, as soon as extreme pressures of defense construction programs begin to subside.

Social security and welfare. The integrity and economic purposes of social security and welfare programs should not be cut away by inflationary rises in the cost of living. Even with an effective anti-inflation program, some adjustments of social security benefits are necessary to preserve the intended effects of the programs. Looking further ahead, other improvements are needed to provide protection to meet costs of medical care and loss of earnings due to illness; these and other health problems will be studied by the President's Commission on the Health Needs of the Nation.

HELPING TO STRENGTHEN OTHER FREE NATIONS

It is our purpose, in the interest of security, to strengthen the individual and collective defenses of the nations of the free world, to encourage production and the development of their resources, and to facilitate their effective participation in the United Nations system for collective security. Although considerable progress was made toward some of these objectives in 1951, the economic situation has not improved in all areas of the free world, and in some it has deteriorated.

Under the Mutual Security Act of 1951, Congress appropriated for the fiscal year 1952 a total of 7.3 billion dollars of new funds, and reappropriated more than 800 million dollars of unobligated funds remaining from the fiscal year 1951, for aid to foreign countries. As table 15 shows, over 5.9 billion

TABLE 15.—*Foreign aid appropriated under Mutual Security Act of 1951*

[Millions of dollars]

Area	Total foreign aid	Military aid ¹	Economic aid ²
Total.....	\$ 7, 329	5, 789	1, 440
Europe.....	\$ 5, 941	4, 819	1, 022
Near East and Africa.....	556	396	160
Asia and Pacific.....	772	535	237
American Republics.....	59	38	21

¹ For purchase of finished military equipment, technical military training, and some items consumed directly by military forces.

² For purchases of tools, raw materials, equipment, foodstuffs, etc.

³ Includes 100 million dollars for Spain not allocated between "military" and "economic" aid.

NOTE.—Excludes reappropriated funds.

Detail will not necessarily add to totals because of rounding.

Source: Public Law 249, 82nd Congress.

dollars of the newly appropriated funds were provided for Europe, nearly 5 billion dollars for military aid, and slightly over 1 billion dollars for economic aid. The Mutual Security Act provides for limited transfers of funds between military and economic aid for Europe, as well as for limited transfers of funds between areas. It requires that a minimum of 10 percent of the economic aid to all areas administered under the terms of the Economic Cooperation Act take the form of loans.

The purposes of the aid provided to Europe, as stated in the Act, are to help carry out the plans for defense of the North Atlantic area, while at the same time maintaining the economic stability of the area. Despite many difficulties, there is reason to believe that progress toward both objectives will be achieved. As a result of the re-examination of military goals for the defense of Europe, and the screening of military requirements which has just been completed, considerable progress has been made in reconciling defense requirements and economic and political capabilities. Beyond this, attainment of the objectives in Europe requires the most efficient use of its production and foreign exchange resources.

Western European developments and their appraisal

In Western Europe, the economic expansion stimulated by the outbreak of war in Korea continued. Industrial production averaged 10 percent higher in 1951 than in 1950, according to preliminary estimates, as chart 33 indicates. The increase in output varied considerably among countries, ranging from 20 percent in Germany and 18 percent in Belgium to 4 percent in the United Kingdom. Agricultural production in the current crop year appears to be averaging about the same as in the preceding crop year. The limiting effects of raw material scarcities on industrial output were not as restrictive as had been anticipated at the beginning of the year, but all of Western Europe suffered from a shortage of coal, nonferrous metals, and steel-making materials. Western Europe's coal production is running about 2 percent less than before the war, while its industrial production is over 40 percent higher than its prewar level, thus creating an unusually high demand for coal.

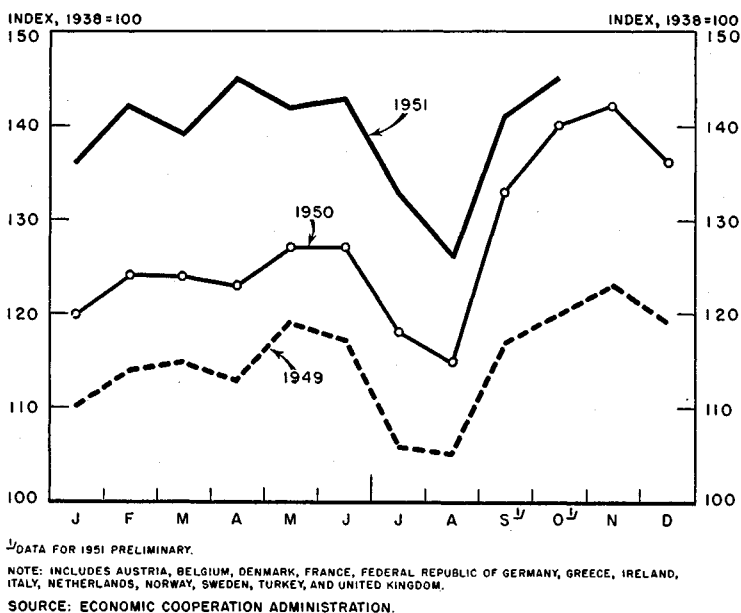
The Western European economy as a whole was operating near its currently practical capacity in 1951. In some instances where plant appeared available, raw materials or labor were not; and where labor seemed available, there was a shortage of plant or materials. Strong efforts were being made to increase output and capacity further. Germany and Italy were the only countries with substantial pools of unemployed.

High consumer and business purchasing, higher incomes, and high prices of imported raw materials raised wholesale prices sharply after the Korean outbreak until the spring of 1951. These prices then fell somewhat as raw material prices receded, but began to rise again in some countries in the fourth quarter. (See chart 34.) The cost of living in most countries followed a similar pattern.

CHART 33

INDUSTRIAL PRODUCTION IN WESTERN EUROPE

Production in 1951 surpassed 1950 levels, but by a diminishing margin in recent months.



The expansion of demand and production, and the rise in prices of raw materials imported from non-European sources, caused a serious deterioration in the Western European foreign trade position. Despite the improvement in the position of Belgium and Germany by an annual rate of approximately 1 billion dollars, the trade deficit of Western Europe as a whole rose by an annual rate of approximately 3 billion dollars from the second half of 1950 to the first half of 1951. In the second half of 1951, it fell slightly, but the trade position of the United Kingdom and France continued to worsen, as shown in table 16.

From 1947 to the year ending June 30, 1951, Western Europe's total production of goods and services rose by an estimated 28 percent. Although this rise brought production to a level 19 percent above 1938, it did not permit a significant rise in per capita consumption above the 1938 level. The reason is apparent from table 17, which shows rough estimates of the changes in output and other sources of supply, and the use made of them. A large part of the rise in production since 1938 has been offset by the loss of income from foreign investments which had to be liquidated during World War II, and by the higher prices of imports in relation to exports. The

TABLE 16.—*Foreign trade of Western Europe with rest of world*

[Billions of dollars, annual rates]

Trade and country	1949	1950		1951	
		First half	Second half	First half	Second half ¹
Imports ²	-22.3	-20.8	-22.8	-29.7	-30.9
Exports.....	18.8	17.7	21.8	25.7	27.4
Trade balance ³	-3.5	-3.1	-1.0	-3.9	-3.5
Trade balance by country:					
Belgium-Luxembourg.....	.2	.2	-.2	.2	.6
France.....	-.2	-.1	.7	.3	-.1
Western Germany.....	-.9	-.5	-.5	.1	.4
United Kingdom.....	-.8	-.5	(³)	-2.0	-3.0
Other countries.....	-1.8	-2.3	-1.1	-2.5	-1.5

¹ Estimates based on incomplete data.² Imports and trade balances based on f. o. b. imports, estimated by deducting 10 percent from c. i. f. imports.³ Less than 50 million dollars.NOTE.—Minus sign indicates imports or import surplus.
Detail will not necessarily add to totals because of rounding.

Source: Organization for European Economic Cooperation.

remaining increase since 1938 in the goods and services available for domestic use has been devoted to a considerable increase of investment, and to a rise of consumption approximately proportional to the rise in population.

TABLE 17.—*Available resources in Western Europe*

[1949 prices and average 1949 exchange rates]

Item	Calendar year 1938	Calendar year 1947	Year ended June 30, 1951 ¹
Billions of dollars			
Total resources:			
Available for home use:			
Gross national product.....	143	133	170
Net imports of goods and services financed by:			
Income from overseas investments.....	3		
Grants, borrowing, or liquidation of reserves.....	1	8	1
Adjustment for terms of trade.....	+2		-3
Total resources available.....	149	141	168
Uses:			
Gross private domestic and public investment.....	26	27	33
Government consumption, including defense.....	24	22	25
Private consumption.....	99	92	110
Total uses of resources.....	149	141	168
Dollars			
Per capita uses of resources:			
Gross private domestic and public investment.....	105	103	121
Government consumption, including defense.....	97	84	92
Private consumption.....	400	350	404
Total per capita uses.....	603	536	618

¹ Estimates based on incomplete data.

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

Source: Organization for European Economic Cooperation and U. S. Economic Cooperation Administration.

Some of the new burdens which are causing external financial difficulties in Europe—particularly in Britain and France—must necessarily accompany the pursuit of the basic objectives of the free nations. The past year saw substantial progress in one of these objectives, the strengthening of military defenses. In the expansion of Western Europe's own military production, and in our shipments of finished military equipment, however, the progress made has been less than was hoped for earlier this year, and the objective of maintaining economic stability has not been achieved.

To some extent, the present economic difficulties of the Western European countries are temporary. First, they resulted partly from replenishment and accumulation of inventories, which is not a continuing process. Second, the decrease of imports by the United States, which contributed to a reduction of the sterling area's earnings, will probably not continue much longer and now shows signs of being reversed. Third, the terms of trade of the United Kingdom and several of the other large trading countries have recently begun to improve. Finally, the speculative outflow of capital from the United Kingdom, which has contributed to a 1.5-billion-dollar drain of British gold and dollar reserves during the past 6 months, may stop and perhaps be reversed, as other temporary adverse factors disappear and as remedial measures become effective.

Fundamental problems nevertheless do exist. The most important are the substantial increases in Western European defense expenditures which lie immediately ahead, the great difficulty some of these countries are having in restraining the inflationary pressures which are aggravating their balance of payments as well as their price problems, and the difficulty in expanding coal production to adequate levels.

Military versus economic aid. To provide aid in a way which contributes most to attaining its purposes, it should be recognized that the distinction between "military" and "economic" aid bears no close relationship to the distinction between the military and economic objectives of aid. A rigid distinction between "military" and "economic" aid according to what the aid funds are spent on or what goods are shipped from the United States may, in fact, impede the attainment of the objectives. To the extent that aid must be spent to provide military equipment, and may not be spent on civilian goods, it limits the choice as to where particular goods may be produced, and thus may decrease efficiency in the use of total aid. The expenditure of aid funds on military goods produced in the United States may serve an economic purpose, if it relieves the receiving country of some of the need for increasing its own military production and for curtailing production for civilian use. Conversely, so-called "economic" aid, which is spent on non-military goods, may serve defense purposes by making possible fuller use of the receiving country's productive capacity, or a greater diversion of its production from civilian goods and exports to military goods than would

otherwise occur. Whether the result of the aid is to carry out military or economic objectives depends on the policies followed by the receiving country in the use of its total resources, which should be based on advance agreement between ourselves and the receiving country as to specific goals and methods for achieving them.

United States import barriers. Under the mandatory amendments in Section 104 of the Defense Production Act passed last summer, imports of certain specified commodities have been prohibited. Although potential imports of these commodities are relatively unimportant from the point of view of the United States market, they are an important potential source of dollars for many other countries. These restrictions deprive the producing countries of opportunities for more rapid progress toward self-support, and the precedent discourages efforts to develop American markets for other products. At the same time, they run counter to the very principles of liberalizing world trade which we have taken the leadership in pressing.

The economically underdeveloped countries

In contrast to the more advanced countries of Western Europe, expansion of military strength is a major problem in only a few of the economically underdeveloped countries. Our major concern in most of these countries is to help them overcome chronic poverty by supporting their economic development, which must start from low levels and, in some cases, must reverse a process of deterioration. In some of them, for example, per capita food consumption has not regained even the low prewar levels. The United States has long been interested in the material progress of the peoples of these areas, both because that progress is an end in itself, and because it is one of the most essential elements in the development of stability and democracy. In the present state of world tension, this interest has become an urgent concern.

The major problems differ greatly from country to country, owing to differences in their geographical positions and political conditions, which affect their vulnerability to aggression or subversion, and to differences in their internal institutions and their basic economic potential. Our security objectives are served not only by the actual economic progress they make, which is necessarily small year by year, but also by a sense of current progress and hope for the future, which our aid, even in its early stages, can help to generate and fulfill.

Although our military program, including assistance to countries sharing in the common defense, necessarily entails a heavy burden upon the productive and financial resources of our people, the United States has supported sound programs for the economic development of underdeveloped countries, and has made significant financial contributions for that purpose.

The net new funds made available to underdeveloped countries by the United States Government and by the International Bank, which the United States actively supports, have increased from the fiscal years 1949 to 1951, as table 18 shows. The Congress, in the Mutual Security Act, increased the economic assistance available for these countries, from appropriated funds, to 418 million dollars for the fiscal year 1952. United States assistance to underdeveloped countries in the form of grants helps bridge the gap which frequently exists between such a country's borrowing capacity and the total investment assistance consistent with carrying out our policy objectives.

TABLE 18.—*Net new funds made available to underdeveloped areas for economic assistance by United States Government and International Bank*

[Fiscal years; millions of dollars]

Item	1949	1950	1951
Total.....	446	654	809
United States grants.....	291	184	142
United States credits.....	47	336	548
International Bank credits.....	109	134	119

NOTE.—Includes underdeveloped countries in the Near East and Africa (except Turkey), Asia and the Far East, and Latin America. Also includes United States contribution to multilateral technical assistance programs and United Nations Relief and Works Agency for Palestine Refugees. Excludes Philippine War Damage Claims of 151 million, 136 million, and 87 million dollars in the fiscal years 1949, 1950, and 1951, respectively. Figures in table are net of cancellations.

Detail will not necessarily add to totals because of rounding.

Source: Department of Commerce and International Bank for Reconstruction and Development.

The Government has also encouraged the investment of private capital abroad, by negotiating treaties relating to double taxation and other provisions affecting foreign investments. Credits for taxes paid abroad have been liberalized, and the area of the authority to guarantee certain risks peculiar to foreign investment has been extended geographically. Provision also has been made to assist the export of capital goods needed in essential projects. In contrast to widely held expectations, actual exports of many capital goods to the underdeveloped countries have increased since acceleration of the defense program. (See appendix table B-45.)

Although the economic situation in several underdeveloped countries, particularly in the Near and Middle East, became worse in 1951, many such countries increased the production of a number of primary products, which will help them to finance further development, and also increased the production of a number of industrial products and of electricity, as table 19 shows.

Many countries, moreover, made significant progress during the year in getting economic development plans under way. Substantial progress was made in both domestic and regional coordination of development plans by nations of Latin America and South and Southeast Asia. These nations also showed recognition of what they must do themselves, and took a realistic view of the pace at which improvement could be expected.

TABLE 19.—*Output of selected commodities in certain underdeveloped areas*

Commodity and area	Unit	1938	1946	1950	1951 ¹
Cement:					
Far East: 4 countries ²	Thousand metric tons.	1,954	2,180	3,260	3,754
Latin America: 9 countries.....	do.....	1,730	3,172	5,389	5,836
Coal:					
Far East: 5 countries.....	do.....	33,060	31,358	34,992	36,804
Latin America: 3 countries.....	do.....	4,040	4,855	3,852	4,948
Cotton fabrics, woven:					
India ³	Million metric tons.....	3,940	3,670	3,300	3,720
Latin America: 3 countries.....	do.....	53	92	77	73
Electricity:					
Far East: 6 countries.....	Million kwh.....	2,842	4,398	5,957	6,880
Latin America: 10 countries.....	do.....	4,655	8,025	11,599	11,916
Rice ⁴ :					
Asia: total.....	Million metric tons.....	143	(4)	139	142
Rubber:					
Far East: 8 countries.....	Thousand metric tons.....	893	812	1,784	1,854
Steel, crude:					
India.....	do.....	985	1,320	1,464	1,511
Latin America: 3 countries.....	do.....	165	616	1,063	1,351
Sugar, raw ⁴ :					
Far East: 9 countries.....	do.....	7,367	(4)	5,887	6,349
Tin (metal content):					
Far East: 3 countries.....	do.....	89	16	78	102
Bolivia.....	do.....	26	38	32	36
Africa: 2 countries.....	do.....	19	25	23	20

¹ Estimates based on incomplete data.² Includes in 1938 and 1946 the area that now is Pakistan; excludes it in 1950 and 1951.³ Crop years. Data from FAO "State of Food and Agriculture, 1951."⁴ Not available.

NOTE.—The output shown for each commodity represents the total of the region from all countries shown in the source.

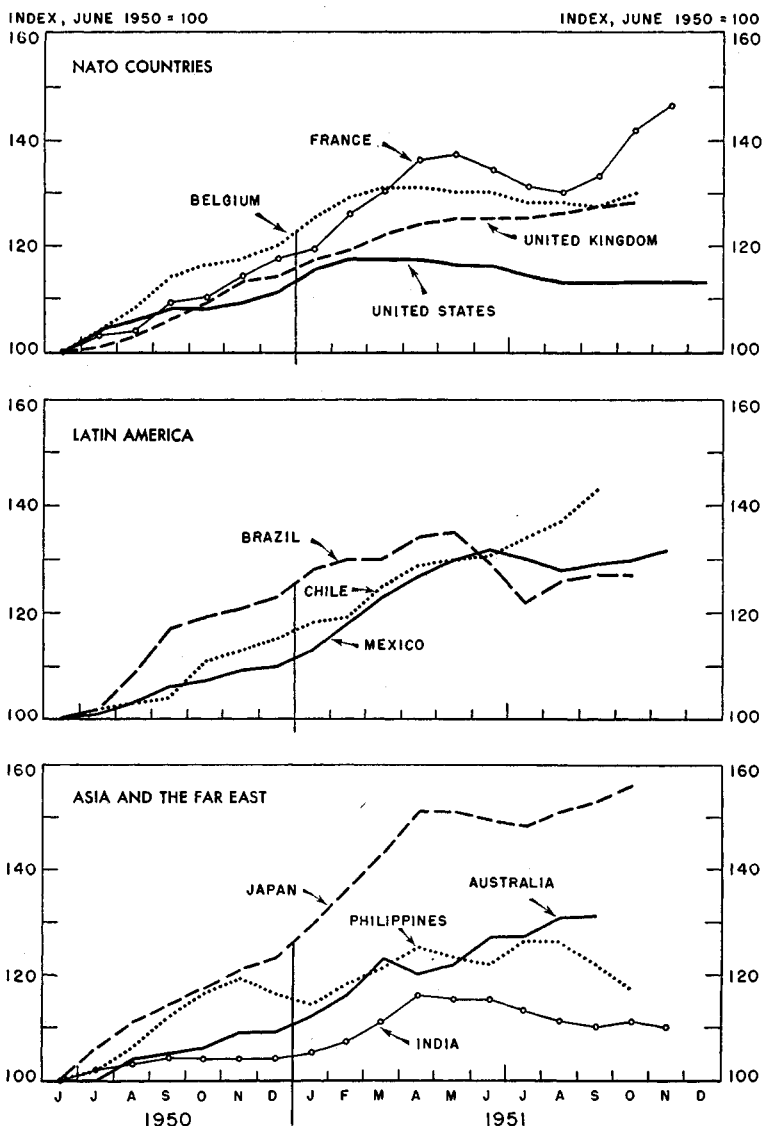
Source: United Nations Monthly Bulletin of Statistics, December 1951 (except as noted).

Sharing of scarce commodities

Besides extending financial aid to other free nations, the United States is helping to secure equitable distribution of scarce commodities, both by active participation in international arrangements and by its own domestic controls. In early 1951, the United States, the United Kingdom, and France took the lead in setting up an International Materials Conference to promote increased production and the conservation of scarce materials, and to assure equitable distribution of free world supplies. Beginning with the third quarter, this Conference recommended allocations for sulfur, tungsten, and molybdenum. The record for the third quarter indicates that United States exports of sulfur and molybdenum were approximately equal to the Conference's recommendations. In the case of tungsten, our actual imports considerably exceeded our recommended share, but the excess will be taken into account in future allocations. Beginning with the fourth quarter, allocations were also recommended for nickel, cobalt, copper, and zinc. The Conference has also arranged for emergency allocations of newsprint; a small amount of Canadian output originally scheduled for United States consumption was diverted to a number of countries faced with critical shortages. Five of the six remaining commodities covered by IMC were found to be in sufficiently ample supply to make allocations unnecessary, and in the case of wool it was not possible to reach agreement between producers and consumers.

WHOLESALE PRICES IN SELECTED COUNTRIES

Wholesale prices have risen more in most foreign countries than in the United States since June 1950, and in many a 1951 lull has ended.



SOURCE: INTERNATIONAL MONETARY FUND.

This country has also taken unilateral action to facilitate essential exports of capital goods. In May of 1951, the Director of Defense Mobilization announced a policy of providing adequate exports of scarce supplies by priorities or by directives to producers whenever necessary, and stated the types of foreign needs which would be given positive export assistance. Since then, there has been an acceleration of priority assistance and a diversification of the methods used to help foreign countries meet their essential needs.

Since shortages of raw materials and capital goods are likely to continue through 1952 and, for most commodities, for several years, our allocation devices should be maintained and in some cases extended and strengthened. The United States should continue the provision of priority assistance for exports of capital goods to friendly countries.

World aspects of inflation and stabilization

The period of price stability which began early in 1951 in the United States was followed by a slackening of price increases in most other countries, and stability or actual declines of prices in some. Although the situation differs greatly from country to country, there is in general a greater tendency toward inflation in most other countries than in the United States. (See appendix table B-25.) While wholesale prices in the United States rose to a post-Korean peak of 17 percent above June 1950, a rise of 30 percent or more was experienced in 10 of the European and 10 of the non-European countries for which statistics are available. Generally speaking, the abatement of pressures since the post-Korean peak in these countries has been far less than in the United States. In contrast to the United States, where wholesale prices have risen hardly at all since their April-to-September decline, wholesale prices in many other countries started to move up again after an earlier lull, or have risen almost continuously since June 1950, as chart 34 illustrates. Prices in some of the Western European countries have already risen at a pace that endangers support for necessary defense expansion. In November 1951, the wholesale price level in France, for example, was 46 percent above June 1950. The world's post-Korean price inflation is additional to a large price rise experienced from the end of the war to the Korean outbreak.

The major burden of restraining inflationary pressures in other countries must rest upon these countries themselves, but the United States can do much to help. The most important contribution we can make to a solution of this serious problem, apart from the alleviating effect of our aid, is to control our own domestic inflationary pressures effectively. In the context of the world inflationary problem, it is especially important for us to refrain from action which will have an inflationary effect on prices of internationally traded commodities—those we export as well as those we import—for it is chiefly through these commodities that inflationary pressures in the United States are communicated to other countries. In the case of some of the major raw materials, we are contributing to a multi-

lateral solution of this problem through international allocations. The role of the Government in purchasing for the stockpile is also important. Although the effect of actual stockpiling operations in the post-Korean rise of raw material prices was much less than was widely believed, it is an important potential factor in the markets for the stockpiled commodities. When it is necessary to accelerate purchases, this should be done carefully to avoid violent alternations of heavy purchasing and complete withdrawal from the market.

FINANCING THE GOVERNMENT PROGRAM

Savings through budget economies

Intensive efforts have been made by the Congress and the Executive Branch to effect budget economies, both inside and outside the national security program. Following the President's directive of July 21, 1950, all departments and agencies conducted a detailed review of Government programs "for the purpose of modifying them wherever practicable to lessen the demand upon services, commodities, raw materials, manpower, and facilities which are in competition with those needed for national defense." Such programs as highway assistance and Federal aids for housing and community development outside critical defense areas have been restricted to expenditure levels substantially below those authorized in the basic legislation. General flood control projects and rural electrification and telephone loan authorizations have been similarly curtailed. Regular procurement of operating supplies and equipment has been held to minimum amounts, and inventories in excess of the lowest practical working levels have been made available to the General Services Administration for appropriate disposition.

Intensive efforts should continue in this direction. However, the non-defense areas do not contain the "fat" often attributed to them. Federal expenditures for all programs except national security, veterans' benefits, and interest on the national debt will be about 65 percent higher in the current fiscal year than in the fiscal year 1940. In comparison, the index of wholesale commodity prices is nearly 130 percent higher, and the consumers' price index almost 90 percent higher. Despite a rapidly expanding population and a great increase in the total product of the economy, Government programs which are directed toward servicing the general needs of the people and building up our natural resources have been held down.

Tax legislation of 1950 and 1951

Three major tax bills have been enacted since the Korean outbreak. The first was initiated almost immediately after the initial involvement in Korea, with the agreement by the Administration and the Congress to convert the pending tax revision bill into a substantial revenue-raising measure. Legislative action was completed in sufficient time for higher income tax with-

holding rates to become effective October 1, 1950. The second revenue measure, which was the Excess Profits Tax Act of 1950, was passed in the final week of the Eighty-first Congress, and affected approximately half of 1950 profits. The latest measure was the Revenue Act of 1951, which became law in October. This Act adopted only about half the aggregate tax increase recommended by the President in January 1951 for individual income, corporate profits, and excise taxes.

In a full year of operation, the post-Korean tax measures will yield an estimated additional 15 billion dollars at 1951 income levels. This represents an increase of almost one-third in the revenue productiveness of the Federal tax system, and is certainly a notable legislative achievement in view of the high tax rates already in effect in 1950, and the short time during which these successive measures were adopted. On the other hand, they provided substantially less revenue than had been requested, and substantially less than is needed to keep pace with expenditures.

The revenue legislation of 1950 and 1951 was a major part of the stabilization program, operating to bring consumer and business demand into closer balance with available supplies of goods and services. Largely as a result of the higher tax rates, the proportion of total personal income absorbed by Federal individual income taxes rose from 8 percent (seasonally adjusted) in the second quarter of 1950 to about 11 percent at the end of 1951. The proportion of total corporate profits absorbed by Federal corporate income and profits taxes advanced from 45 percent to almost 60 percent during the same period.

Nature of the financing problem ahead

Partly as a consequence of the higher tax rates, and partly as a result of the inflation of prices and growth of incomes following the adoption of the expanded security program, the fiscal year which ended June 30, 1951, produced a surplus of 3.5 billion dollars in the conventional budget accounts. The surplus was more than twice this amount on a consolidated cash basis, due to the excess of cash receipts over payments in the various trust accounts.

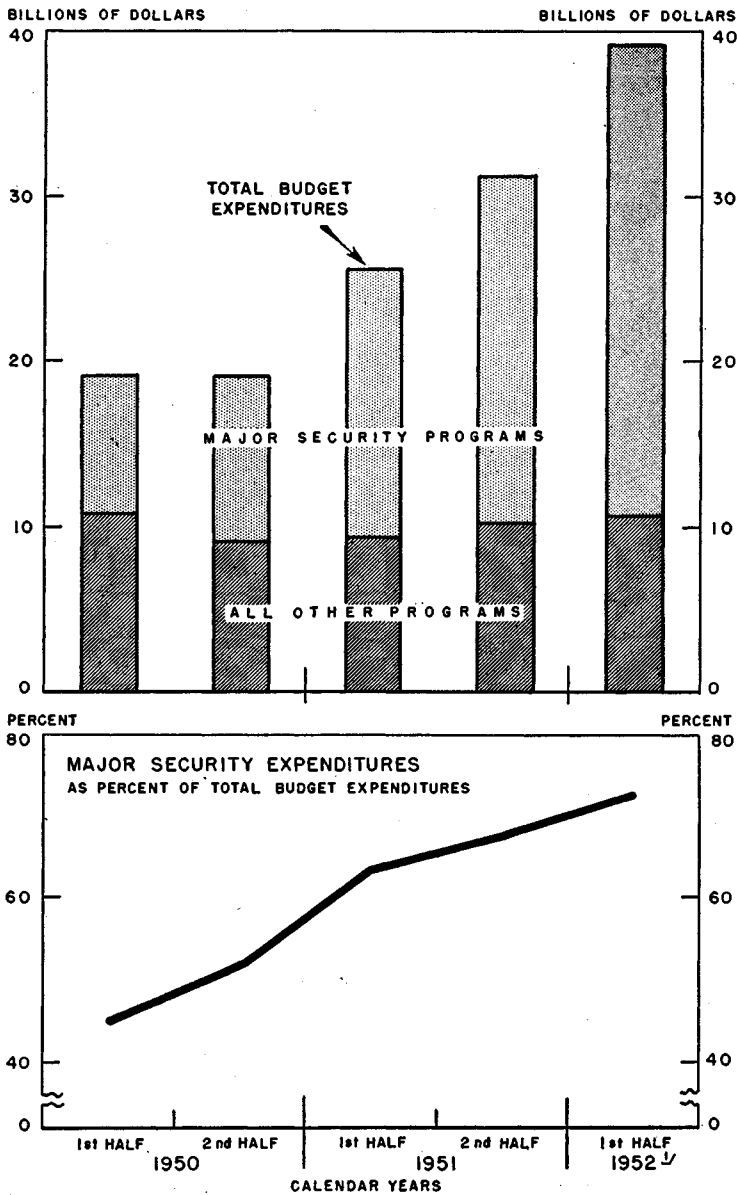
For the current fiscal year, which began July 1, 1951, budget expenditures are expected to total approximately 71 billion dollars. The increase over last year's total is virtually equal to the expansion in the major national security programs. (See chart 35.) Net budget receipts are estimated at almost 63 billion dollars. The indicated excess of expenditures over budget receipt is about 8 billion dollars. A considerable portion of this deficit can be financed by the excess of cash receipts over expenditures in the trust funds. On a consolidated cash basis, the estimated fiscal year deficit is about 4 billion dollars.

As a result of the expected further increase in national security expenditures, the annual rate of total Federal expenditures will rise to between 85 and 90 billion dollars by June 30, 1953. For the fiscal year 1953, under existing revenue legislation, a budget deficit approaching twice the size of the

CHART 35

FEDERAL BUDGET EXPENDITURES

The expansion of expenditures for the major security programs has approximated the increase in total budget expenditures since 1950.



current year's budget deficit is indicated. To pay for the projected volume of expenditures without reliance upon new borrowing from the public would thus require large additional revenue legislation, and a heavier total tax load than has ever before been imposed in the United States.

A large element of uncertainty exists regarding the future development of expenditures under the defense program. Our present planning is based on a program which would build up strength to the required level, and continue the maintenance and modernization of our defensive equipment at that level. This may require expenditures in the fiscal year 1954 at least as high as those proposed for fiscal 1953. Thereafter, it is anticipated that expenditures will gradually decline to a substantially lower "maintenance" level.

Throughout the defense period, the Council has emphasized that it is sound economic and fiscal policy to pay for the national security program through taxation. But in view of the decision of the Congress in 1951 not to take all of the tax action requested of it by the President, it is virtually impossible through tax increases to prevent substantial deficits in the calendar year 1952, and in the fiscal year 1953. Thus, the action of last year in effect constituted an abandonment of the pay-as-we-go policy, at least for the time being. Lost ground cannot be made up overnight.

Consequently, we must now look ahead to the fiscal year 1954 and following years, as well as to 1953, in considering appropriate tax legislation for the calendar year 1952. A considerable time span usually is required to accomplish necessary changes in the tax structure and to collect the taxes under them. Consideration must be given to the effect of the tax bite upon consumers and small and large business enterprises, and upon general popular support. The speed of tax increases must allow for these factors, without relinquishing the objective of restoring a balanced budget as rapidly as feasible.

Each year the question of legislation must be reappraised with a view to determining what specific course of action, in the light of current and prospective conditions, would be most nearly in accord with the longer-run basic policy position. The chief tax policy questions which must be answered are whether additional taxes should be adopted in 1952 and, if so, whether the amount should be sufficiently large to achieve a balanced budget in the fiscal years 1953 and 1954.

The Council continues to attach great importance to the principle of the balanced budget during periods of heavy expenditure and inflationary pressure such as characterize defense mobilization. The Council does not believe, however, that the principle of paying the cost of defense expenditures out of taxes during the mobilization period requires that sufficient taxes be proposed or adopted to balance the budget in the peak years 1953 and 1954. We believe that it is not imperative to do so, in view of the longer-run budget outlook, and that it would be unwise to attempt to do so, in

view of the size and speed of the tax increases that would now be required—a result in part of the inadequacy of tax legislation last year.

Considering all factors involved, the Council recommends that the immediate tax legislation be the completion of the program proposed by the President a year ago, including such technical changes as would improve the equitableness and yield of the Federal revenue system.

The yield of the Revenue Act of 1951 is estimated at 5.4 billion dollars, at calendar year 1951 levels of income, or only about half the amount specifically proposed by the President. In the case of the individual income and corporate taxes, the increases approximated two-thirds of the amount proposed. A considerably smaller proportion of the amount proposed for excises was enacted. There are, furthermore, various revenue-losing features in the Act. As stated by the President on signing the bill, "this legislation does little to close the loopholes in present tax laws, and in some respects provides additional means by which wealthy individuals can escape paying their proper share of the national tax load through such devices as excessively liberal 'capital gains' provisions, family partnerships, and excessive depletion allowances on oil and gas and certain mineral properties."

Misconception arises when there is a failure to distinguish between the real economic burden of the program, which is measured by the diversion of resources and supplies from civilian uses, and the financial burden of the program as indicated by the level of taxes. The method of financing the security program does not necessarily decrease or increase the real economic burden, and consequently does not directly determine the size of the program that can be afforded. At any particular time, however, there are limits beyond which it would be unwise to raise the rates of a specific tax or of taxes in general.

The limit beyond which tax increases become harmful cannot be determined by any figure or ratio which would be applicable to all situations. The limit depends not only on the ratio of taxes to incomes at any one period of time, but also on how rapidly taxes have been increasing in the recent past. It depends also on whether incomes in general are rising, are remaining the same, or are declining. Finally, it depends to no small extent on the recognition by the taxpayer that the money is needed for imperative national purposes, and that the burden is being distributed in a fair manner.

The Council recognizes that tax rates have risen rapidly during a short period of time, and are so high that their effect on incentives must be carefully watched. Nevertheless, we do not believe that the economic limit of taxation has been reached. As we indicated at midyear 1951, we feel that the tax objectives stated by the President earlier in the year are well within the ability of the taxpayer and the economy to support.

The alternative to relying upon the conventional tax sources for the additional revenue requirements would be to introduce a new, broad-base tax. One new type of taxation, which could raise substantial amounts of revenue, is a general sales tax. Whether imposed in frank manner upon

retail sales or disguised as a general manufacturers' excise tax, resort to it would be a portentous departure from national tax policy which should not be considered at this time.

Provided the national security programs follow the pattern now indicated, rate increases in existing tax sources and the proposed improvement in the tax structure would be adequate at high levels of employment to yield a surplus in budgets designed to support the ordinary Government functions, plus the cost of the expanded military establishment when it reaches maintenance levels.

With the additional revenue which might be obtained from carrying through the above suggestions, the margin of excess of budget expenditures over receipts would be reduced to about 10 billion dollars a year during the period of 1 to 2 years when budget expenditures will be at the peak level now contemplated. A considerable portion of this deficit, however, would not result in an addition to the debt held by the public, but would be absorbed by the excess of some 4 to 5 billion dollars of cash receipts over disbursements in a number of trust accounts.

The effect of a Government deficit on inflationary pressures is dependent in large degree on the extent to which spending is restrained by methods other than taxation. Indirect and direct controls help to limit the rise of incomes. By giving some assurance of price stability, these controls also increase the willingness of consumers to hold their spending to levels of current need. The tendency of business and consumers not to spend is strengthened also by cutting down the availability of consumers' and producers' durable goods, through direct controls imposed on the use of scarce materials and on the operating rates of industries that consume such materials. In these various ways, spending may be restrained, savings increased, and sources of funds developed as outlets for the Government securities which are issued to finance the deficit. Under conditions expected to prevail over the next year or two, when consumer and business spending will be restrained by various controls, the situation should be favorable for minimizing the inflationary impact of deficits of moderate size and duration.

State and local government fiscal policies

The present defense economy finds State and local governments with important responsibilities, not only for direct participation in defense activities but also for supporting the Federal programs and policies made necessary by the defense effort. These governments, for instance, have primary responsibility for civil defense and the many financial and operational problems which it entails. They must also provide special services, or expand their normal governmental services, in areas where there is a large population influx because of defense activities. The Federal Government, under the terms of existing or proposed legislation, will help to relieve the more serious instances of defense-imposed burdens.

It is of equal importance that State and local finances be conducted in such a manner that positive support will be given national policies and objectives. In the interest of reducing inflationary pressures, any surpluses should be used to retire debt, or build up reserves to ease future financial problems. Continued restraint in borrowing is, of course, essential. In connection with the Voluntary Credit Restraint Program, in which the State and local governments are cooperating, criteria have been developed for appraising the essentiality of State and local bond issues.

Cooperation along these general lines was of great value during World War II. There are many indications that State and local officials are no less aware of their responsibilities today.

MAINTAINING ECONOMIC STABILITY

Outlook for inflationary pressures

The relative price stability during the last 9 months of 1951 reflected three conditions: first, a series of direct and indirect controls which limited prices, wages, credit, and the expansion of incomes; second, a voluntary disposition on the part of consumers to buy more cautiously and to save more; and third, a reduction in inventory buying by business and inventory liquidation in some lines of civilian goods. These three conditions interacted upon one another. The controls would not have been as effective in holding the price line, in the face of rising incomes, without the trend toward increased voluntary saving; the increased saving would probably not have been so pronounced if the imposition of controls had not put a brake upon the inflationary spiral which succeeded the Chinese intervention and which induced speculative buying; and the controls would not have been so effective, nor consumer and business buying so cautious, if it had not been for the large inventories accumulated in the previous period. The impact of rising security expenditures on economic stability in 1952 turns upon these three interacting conditions.

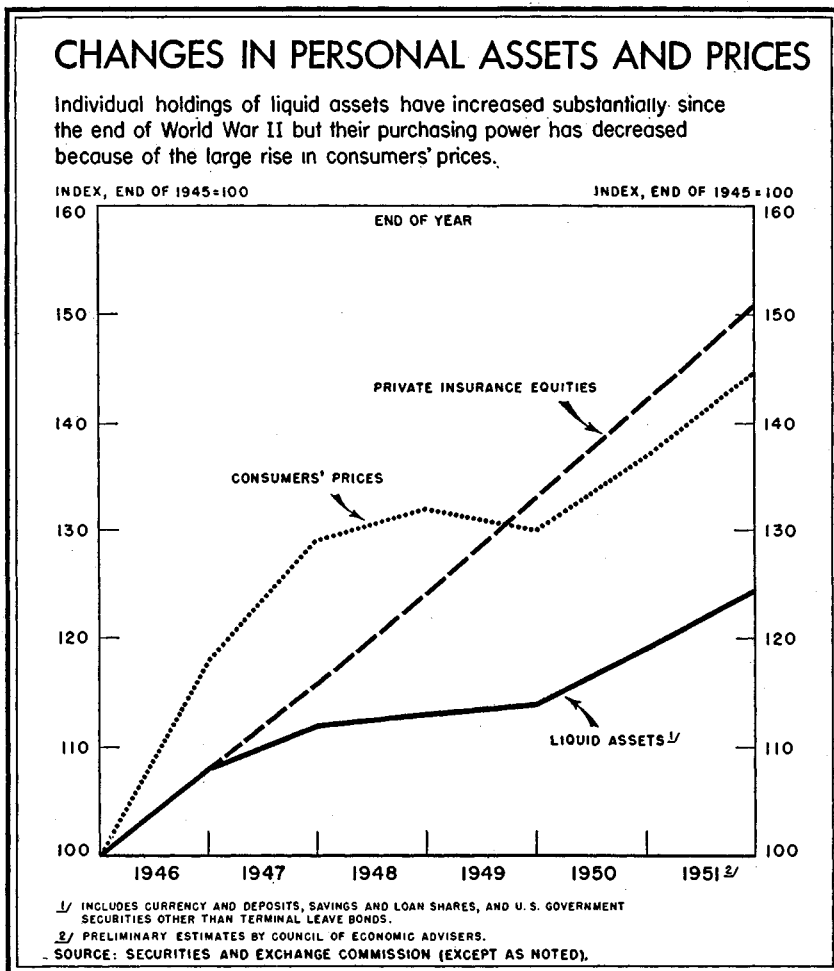
Within this year, national security expenditures are again scheduled to rise by an annual rate of about 20 billion dollars. More people will be drawn into the labor force, some will shift to higher paying defense jobs, and some will work longer hours at premium pay. In addition, some wage adjustments will occur. While increased taxes can take a large bite out of these increases in income, a substantial proportion—perhaps two-thirds—will be added to spendable funds. If the increase in total output during the year is at the rate of at least 5 percent, it is estimated that disposable income within the year would rise by about 15 billion dollars.

The first issue to be considered is how much of this additional income will be saved and how much spent. If the recent high rate of consumer saving should continue, the amount of additional buying would only moderately exceed the amount of additional civilian supplies that can be made available without hurting defense production. But if consumers or business should

again intensify their buying, and if the rate of saving should decline and the use of credit expand, serious inflationary pressures would result.

The shift in the saving rate, from an average of 5 percent or less to around 10 percent during the last three quarters of 1951, reflected some temporary factors. These included a reaction to previous buying sprees, to higher prices, and to credit tightening. But it is not unlikely that many American families, who during World War II had their first opportunity to build up some reserves, have become more "saving conscious." Having satisfied urgent demands for many consumer durables by 1951, they may now be ready to replenish their liquid asset reserves, and to attain a higher level of family and personal security. As shown in chart 36, the increase in the volume of cash, deposits, and Government bonds has been less than the rise

CHART 36



in prices since the end of World War II, while the private insurance equities have little more than kept pace with prices. Further, the increase in personal debt has been greater than the increase in financial assets, such as bonds, stocks, and deposits, during the past several years. A reversal of this trend at some time was inevitable, and it came last year with a significant increase in more liquid forms of savings and a less rapid rise in debt.

Nevertheless, while there are grounds for anticipating a continued high saving rate, it would be unwarranted to base economic policy on the expectancy that so high a rate as the recent rate or an even higher rate can be maintained. Even with the continuance and further improvement of the anti-inflationary measures which affected income and saving last year, and with shortages of major durables, there may be some tendency on the part of consumers to revert to a more normal rate of buying. Also, business buying may become more active as a lower ratio of inventories to sales is established. Consumers and businesses are going to have ample funds for a rapid increase in buying.

The rate of business investment in plant and equipment is also an important factor bearing on the outlook for inflationary pressures. Such investment was carried on at an unprecedentedly high rate during 1951, and the plans of businessmen indicate further expansion, at least in the early part of 1952. It seems probable that the major factor limiting the size of business investment will not be the desire of business concerns to expand, but the availability of scarce materials and machine tools. Material shortages may force business investment in plant and equipment to contract somewhat by the latter part of 1952. Commercial and residential construction also is being reduced.

The outlook now is that there will be some increase in inflationary pressures, but that it may be held to a moderate magnitude, even with rapidly rising defense spending, if the brakes upon inflation which were applied in 1951 are not relaxed. But any relaxation would increase the possibility of another inflationary upsurge, which could be even more serious than that of mid-1950 or of a year ago because it would start from tighter conditions of supply in many sectors of the economy.

The reasonable success during 1951 in maintaining stability cannot be attributed to any one cause. Tax increases, credit measures, price and wage controls, and the various allocation policies interacted upon one another. Each link in the chain was essential.

An outstanding feature of 1951 was that stability was maintained despite the shift during the course of the year from a Government surplus to a large deficit. This does not mean that the inflationary pressures would not have been much greater if the deficit had not been reduced by the large tax increases which took effect. But it does mean that, in addition to the tax measures discussed in the preceding section, a variety of other measures must be relied upon to continue their contribution toward over-all stability.

Relationship among stabilization measures

However inflation may be defined, there is no dissent from the view that the ultimate consequence which gives concern is the increase in prices, and especially the increase in prices paid by consumers. Economic policy to forestall price increases must include, first of all, measures to restrain forces which cause higher prices. These measures, which include tax and general credit measures, are sometimes referred to as dealing with the fundamental causes of inflation rather than its symptoms. But as a practical matter, the economic situation at times does not permit pushing such measures far enough to do the whole job alone.

In fact, if such measures are pushed too far, they may operate to frustrate their purpose. Tax policy and general credit policy, as measures to stabilize prices, illustrate this. Each is aimed at limiting some of the causes of price increases, rather than at holding the line on prices when other conditions are pushing the market upward. But each has some partially offsetting effect in adding to the upward pressure. Higher taxes reduce the buying power of consumers and business. In this way they are deflationary. But they also may heighten the demand for higher wages and for larger gross business profits, which is an inflationary aspect. General credit policy, as distinguished from selective credit controls, is designed to dampen business investment generally, and thereby to stabilize prices. But the increase in interest rates, which is either the principal tool of general credit policy or is its normal consequence, is an increase in the cost of capital, and this involves an increase in costs of production and may tend to press prices upward. Moreover, both tax and credit measures, if pushed too far, may so impede production as to be self-defeating.

Consequently, in the current situation, it is necessary to turn also to controls which will directly prevent the inflationary forces from producing their normal effect upon market prices. It is incorrect to say that these controls treat only the symptoms, and not the fundamental causes, of inflation. In practical effect, they restrain the growth of inflationary forces, besides helping to hold the price line against such forces. It is seriously misleading to think in terms of two distinct categories, one of policies which will restrain forces leading to price increases, and the other of policies which will hold down price increases despite the upward trend of the market.

Wage control is a good example of a policy which combines these objectives. Wage advances mean higher costs of production, and higher costs of production are a powerful force in raising prices. Wage increases also expand consumer buying power, which is equally potent in its effect upon market prices. But wage control, while directed to restraining these forces which directly influence prices, is also designed to break an inflationary spiral already under way, by holding the line on wages which would normally rise in response to conditions of a tight labor market and a rising cost of living.

Price control policy, although usually thought of as a measure to prevent price increases which would otherwise be caused by other forces, also has the purpose of restraining the inflationary spiral itself. The interaction of prices is obvious. A rise in one price affects many others, and the stabilization of any one price limits some of the force which is pressing upward the price of other goods. Price control also has the purpose of limiting the increase in incomes, which is the normal result of advancing price levels.

Credit policy

During the first quarter of 1951, several measures to limit the inflationary expansion of private credit were added to those which had been undertaken in the second half of 1950. These included increases in the reserves required of member banks; further steps to check the transfer of Government securities to Federal Reserve banks, and thus to curtail a large source of new lending power for banks and other financial institutions; the inauguration of the Voluntary Credit Restraint Program; and the tightening of selective credit controls requirements.

During the last 9 months of the year, no new measures were initiated to tighten credit. In fact, as a result of congressional action, down payments were decreased and maximum maturity periods lengthened in connection with loans for consumer durables and for housing. In addition, beginning at the end of September, the Federal Reserve System added about 900 million dollars to its holdings of Government obligations, to relieve an acute tightness of credit while the Treasury was engaged in a considerable volume of new financing and refinancing. During October and November, the Federal Reserve reduced its portfolio of Government securities to about the level which it held early in September.

It seems reasonable to conclude that credit policies, both of a general and selective character, contributed to the relative stability of the last 9 months. However, credit policy should now be adjusted to differences between the situation in 1951 and that likely for the period ahead. Private credit expansion is likely to become a less important inflationary factor, and the rising gap between money income and civilian goods a more important one. Business demand for loans to finance construction and inventory accumulation will probably be more greatly curbed by the allocation of materials than earlier in the defense period. It would be unwise, however, to rely unduly on this development and to relax present credit restraints. Credit for some non-business purposes, such as instalment and mortgage credit on houses, may expand to compound the problem presented by rising incomes. The supply of private funds for mortgage loans may also increase, as financing institutions which invest heavily in mortgages accumulate funds from higher personal saving and from repayments of existing loans. In this situation, there may have to be greater reliance on selective credit controls.

In addition, the situation with regard to Treasury financing will change. The deficit in the fiscal year 1953 will be substantial. It will be sound policy

for the Treasury to borrow new funds insofar as possible from nonbank sources, to minimize the inflationary potential of the deficit. Greater limitations on the opportunities to make private loans because of allocations of materials, restraints on the demand for credit, and high levels of personal liquid saving may help to provide investors with funds for investment in Government securities, to a considerable extent in long-term issues. It will be an important goal of economic policy to develop and maintain market conditions favorable to the flotation of the largest feasible quantity of long-term obligations.

Concern for debt management objectives does not require that general credit policy be withdrawn from the struggle against inflation. The tactics that are used to curtail the supply of lendable funds may merely have to be modified to suit new situations; for example, the instrument of reserve requirements may have to be relied upon more heavily than in the past. In order that credit policy may function more effectively during the next phase of mobilization, the Council recommends that there should be restored to administrative authority a more flexible discretion in the formulation of selective credit regulations.

It is also suggested that the Board of Governors of the Federal Reserve System be given additional authority over reserve requirements. In the opinion of the Council, higher reserve requirements may be a suitable means of curbing bank lending in certain specific situations. Increased reserve requirements can be used to offset bank lending power arising from Federal Reserve purchases of Government securities or from gold imports. One plan for increased authority over reserve requirements, which has been previously recommended by the Council, would permit certain Government securities to be carried as reserves. If banks were permitted to carry Government obligations in reserves, there would be some inducement to hold these securities rather than to offer them on the market, with the possible consequence of the creation of new lending power through Federal Reserve bank purchases.

Separate note by Mr. Clark upon monetary and credit policy

No economic theory relating to the stabilization of the economy is more important than that of general monetary policy, which many believe can of itself accomplish the stabilization purposes of the Employment Act of 1946, but the usefulness whereof in a strong inflationary movement has been challenged in former reports of the Council of Economic Advisers.

Early in 1950, the Douglas committee regretfully commented that "Our monetary history gives little indication as to how effectively we can expect appropriate and vigorous monetary policies to promote stability, for we have never really tried them." This is not quite accurate. Monetary policy was used vigorously in 1920, and the resulting "stabilization" was a disaster the farmers have not yet forgotten. It was used again in 1928-29, and of that episode the British expert, Hawtrey, has said, "The dear money policy ac-

complished its purpose in the end. It stopped speculation by stopping prosperity."

We are now able to study efforts to establish the stabilization value of monetary policy in our greater economy in which the institution of banking has been revolutionized by a great national debt which has multiplied the liquid assets in bank portfolios. The Council of Economic Advisers, which, unlike other Government agencies, has the responsibility of considering all national economic policies and their effect upon each other, must give attention to the collateral consequences when it studies our recent experience. In the light of the problems of a defense program which must be integrated, the following anomalies created by monetary policy stand out.

It has enabled the banks to increase their earnings more than enough to match the heavy increase in their taxes in 1951. Nearly every other business and industry found net profits reduced as result of Government policies under the defense program.

An increase of one-third in the basic commercial interest rate of larger banks, leading to general increases in other bank interest rates, was hailed as a valuable contribution to economic stability. All other business men are criticized when they exploit a situation by raising their prices by a much smaller percentage.

When restraint must be imposed elsewhere upon the freedom of decision, the Nation imposes positive control, as in forcing young men into military service, in limiting the production of General Motors, and in fixing prices. To limit the expanding activity of banks, we are offering them larger profits upon the existing level of loans.

The cost of new private capital has been increased and an effort has been made to tighten credit for industry. Vital defense-related industries must expand and the Government will have to finance their expansion to the extent that private capital is inadequate.

The Government is spending large sums to assemble and distribute business information in order that businessmen may reduce to the minimum their uncertainties about the trend of the economy and may plan more confidently. Monetary policy is being based upon the principle that the financial world must be kept in great uncertainty about future interest rates and the availability of credit.

There is general agreement that every effort should be made to place the Government debt in long-term bonds in nonbank hands. The Treasury now finds no market for long-terms and its heavy financing has to be in the form of short-term securities eligible for bank portfolios.

When the size of Government expenditures is giving us deep concern, the interest charge on the Government debt is increasing.

If these miscarriages were the unavoidable results of a monetary policy which is a successful instrument to stabilize the economy, they might be accepted. I do not believe that monetary policy can be successfully used

for that purpose in the kind of economy and institutions which we now have. In recent action, that policy has had utterly perverse consequences.

The advance in short-term interest rates in August 1950 was followed by the greatest expansion of business loans in our history.

The increase in long-term rates in March 1951, coming after the price freeze in January had taken the steam out of boiling markets and when a seasonal contraction of business borrowing was due, had no effect upon new business investment.

The more rigorous the use of monetary policy, the more rapid was the increase in new investment in plant and equipment, the very channel through which monetary policy, if effective, operates on its way to the final objective of dampening inflationary forces.

And to complete the topsy-turvy picture, the more rapid the growth in money supply, creating "more dollars chasing goods," the quieter became the consumers' markets. (Conclusion of separate note by Mr. Clark.)

Price control

In the first stages of price control policy after the general freeze in January 1951, which all recognized could be only temporary, it was necessary to concentrate upon a large variety of broad-gauged "interim" adjustments to remedy inequities and to bring the price structure into balance. This was because the great upward movement of prices before the freeze had not been uniform, and had resulted in many advance runners and many laggards. But this process was only to be the prelude to more enduring, more enforceable "tailored" regulations, i. e., regulations geared to the problems of individual industries and commodities.

This work was delayed considerably and complicated by the amendments to the Defense Production Act. The amendments weakened the powers of price control by preventing certain necessary actions and by requiring a number of adjustments, all of which could only have the effect of raising ceiling prices. After the adjustments required under the law had been carried out, the Office of Price Stabilization was able to push ahead in the autumn with tailored regulations, hinged upon adjustments necessary to develop a sound and reasonable price structure.

The general policy now should be to hold the price line, while work proceeds vigorously with the issuance of tailored regulations. However, since the new amendments seriously interfere with the effective carrying out of this policy, these amendments should be reviewed and the obstacles to sound price control eliminated. In addition, the furtherance of this policy involves the following tasks.

Narrowing the gap between ceiling and market prices. After the general freeze halted the runaway spiral in prices, price controls and the lull in many markets resulted in sharp drops in the prices of cotton, wool, fats and oils, hides, and other commodities. When prices fall below ceilings, there are three alternatives: (1) exempt commodities on a stand-by basis; (2) con-

tinue current ceiling prices; or (3) make the ceilings more realistic by lowering them toward the market levels.

In general, it is in the most volatile markets that a substantial gap exists between ceiling and market prices. At the time of the general freeze, these commodities had advanced excessively, spurred on by a high degree of speculation. To maintain these ceiling prices would be to permit the return of excessively high prices if speculative markets develop. Under these circumstances, and because dangers of general inflation are still present, it would appear desirable to bring ceilings down to levels much closer to existing market prices, insofar as this is feasible while keeping ceiling prices "generally fair and equitable" as required by law. An effective barrier to any major advance in these wholesale areas would prevent undue pressure against retail prices, when markets now weak begin to firm up again. OPS has already taken action of this sort in the cases of glycerin, hides, wool, tallow, soap, detergents, and carpets. Further action is under study with respect to other commodities.

Stabilization of consumers' prices. This is the most difficult task confronting the OPS. These prices directly affect the public, and are closely connected with the effectiveness of wage stabilization. While part of the recent rise in the consumers' price index reflects seasonal factors, a major part results from the lack of adequate control over many items making up the cost of living. Of the items entering into the consumers' price index, about 17 percent are exempt from price controls by law. These are primarily services. In the case of rents, representing another 11 percent, only partial controls exist. Only slightly over one-half of the items in the consumers' price index are completely under the control of the OPS.

With respect to food prices, the program for controlling beef prices has been weakened by the abolition of slaughtering quotas. Progress has been made in developing dollars-and-cents ceilings for a number of food items. Thus, in addition to the beef ceilings, there are dollars-and-cents wholesale ceilings for pork products, lamb, and veal. In the further development of simple, enforceable regulations, the OPS is now experimenting in three cities with community dollars-and-cents ceilings covering a wide variety of grocery items. However, under existing legislation, action to stabilize retail food prices cannot be completely successful.

Development of pricing standards. With the completion of the "interim" pricing program, the need for standards to guide price control operations becomes more acute. The kind of standards chosen determines the degree to which price control permits escalation of cost increases or requires absorption. The main formula used to straighten out the distortions and inequities caused by the general freeze was pre-Korea prices plus specified cost increases up to specified cut-off dates. For the future, to use a cost-plus standard would mean continuous escalation of higher costs, and permit a constantly rising price level.

In April, the Director of Economic Stabilization took the first major step toward the development of permanent standards. He directed the OPS, once the "interim" program was completed, to grant general price increases to any industry only if its current earnings before taxes fell below 85 percent of its return on net worth in the 3 best years of the period 1946-49. The purpose of this directive was to prevent unnecessary price increases by requiring a reasonable amount of cost absorption and, at the same time, to assure industry of an adequate earnings base. If an increase became necessary under this standard, it was not to exceed the amount necessary to assure this minimum rate of earnings.

As this standard applies only when industries seek price relief, two factors have reduced the need for its application. First, the generally high level of profits finds most industries earning well above the standard. Second, the "interim" program provided adjustments for industries which might otherwise have sought relief under this standard. However, a few industries have applied for price relief and their cases are being considered under this standard.

The outcome of the current steel case will be a major factor in determining the future of effective price control. It cannot be stated too strongly that, while effective price control depends upon effective wage stabilization, it also depends upon cost absorption where feasible, instead of automatic escalation of cost increases into price increases.

The problem of standards is not confined to this issue alone. There has already been issued a relief standard to provide protection for exceptionally high-cost sellers. There is need for the development of a product standard to govern cases where relief may be in order for an individual product of an industry, contrasted with all its products. Considerable preliminary work has been done in developing this standard.

Price control must also be concerned with preventing price ceilings from becoming an impediment to production in areas vital to defense or essential civilian production. In such situations, what is needed is a coordination of production and price controls. Frequently, the problem is not one of price, but of materials, or manpower, or proper use of production controls. But in some cases, price is also a consideration. Price adjustments to encourage production have already been made in the cases of machine tools and lead and zinc.

Price control over the longer run. A firm price policy does not mean that price control should continue indefinitely in every sector of the economy and for every item. If the international situation does not worsen, a rising production trend should make it feasible at a later date to reduce substantially and progressively the area of coverage of price control. The Council has never been impressed with the argument, which seems to prove too much, that no prices can be controlled unless all prices are controlled. After we get over the production hump, for the long period ahead we must be

prepared and ready to use selective price controls geared to strategic areas. In that situation, we should rely for general stabilization upon other anti-inflation weapons. Except in an emergency period, such as the present, the benefits of general price controls are outweighed by their drawbacks.

Wage stabilization

Wage policy is even more difficult than price policy, because it involves the very livelihood of millions of families, who have come to regard periodic wage increases as an index of their progress in an economic society which they believe to be strong enough to grant them that progress. Nonetheless, price stabilization cannot be maintained without wage stabilization.

The sound public appreciation that prices and wages must both be stabilized if either is to be stabilized has been blurred by the incorrect impression that prices and wages are exactly alike and should be treated exactly the same. Thus, it is sometimes said that any wage increase *must* necessitate a price increase; and that where the price line is held absolutely, the wage line must be held absolutely. This is a superficial view. Under conditions of expanding markets and rising productivity, which has been the long-range trend in the American economy, a constant relationship between prices and wages would cause business profits to rise out of line with wage incomes, and would not provide consumer purchasing power sufficient to support expanding markets. In a normal peacetime economy, wages should rise relative to prices—by lower prices or higher money wages—when the general productivity of the economy enlarges. This is fully recognized by business.

This principle, however, is not entirely pertinent to a defense emergency, when a large part of the expanding output is absorbed by the defense program, and is consequently not available for purchase by consumers. If wage incomes rise as fast or faster than the total of expanding output, while a large and growing part of this output is bought by the Government, there will clearly be an inflationary redundancy of consumer buying power, unless compensated for by sufficiently higher taxation and a higher rate of saving. Yet entirely to deny productivity increases to wage earners would involve the greater difficulty of a growing disparity between wages and other forms of income, which are likely in the long run to reflect the productivity and production trends of the economy as a whole—and in the long run to move generally upward in a defense period. In addition, the flat denial of productivity increases would remove an important or potentially valuable incentive factor.

Consequently, the Council has maintained the position since the commencement of the defense emergency that productivity allowances should be included within the framework of a well-rounded wage stabilization program. However, we have urged that these increases should be held to the likely productivity increases for the economy as a whole—that is, in the neighborhood of 2 to 3 percent—instead of being allowed to reflect in

particular cases a higher rate of productivity increase in particular industries. For the latter course would tend to create a pattern of wage increases under wage stabilization which would necessitate price increases, except among those industries or firms where the actual rate of productivity increase is highest.

Since even the moderate policy of productivity increases here portrayed would tend to augment the income stream more rapidly than the increase in civilian supplies, such a policy should be accompanied by certain safeguards. One of these safeguards might be that consideration be given to regard these productivity increases as incentive payments, and to tie them in with efforts on the part both of employers and workers to maximize actual productivity increases. Another safeguard would result if, in accord with suggestions which the Council has made before, more systematized efforts were made to divert necessary wage increases into forms of saving rather than into immediate payments for immediate spending purposes. This we believe to be one of the most neglected areas in the program thus far. For practical reasons, the Council has favored cost-of-living adjustments. These can be consistent with the stabilization program if sufficient efforts are made to hold the price line. The difficult necessity of a sufficiently flexible wage program to maintain equity, incentives, and industrial peace points up the urgency of a sufficiently strong tax, credit, and voluntary savings program to curtail excessive spending.

The Council views with approval the very substantial progress already made by the Wage Stabilization Board toward firming up elements in its wage stabilization program, and urges speed in the work now under way to close the remaining gaps in wage policy. We have repeatedly stressed that wage stabilization requires a fairly stable and established wage policy, enunciated generally and adhered to firmly. General policies must of course be administered, and in applying them to particular cases the Board must properly be concerned with avoiding hardship and inequities. Yet we have never believed that a purely pragmatic adjustment of the wage policy to suit the exigencies of each hard case as it arises could result in effective wage stabilization. A bad wage policy is not better than no wage policy; but a moderately good and firm wage policy is better in the long run than a highly uncertain wage policy would be even if the latter achieved more perfect results in a few specific cases. This is certainly true from the viewpoint of general public understanding and support, an overwhelmingly important consideration under current conditions.

The problem of longer-range stability

Increasing interest is being manifested in the outlook for the economy, if and when international difficulties subside and the defense program is correspondingly reduced. Even when the defense program levels off at a relatively constant figure, the great build-up now under way in productive

facilities will leave us year by year with increasing resources seeking non-defense utilization. While the urgency of dealing with our immediate defense problems is so great as to demand concentrated attention, it would be a lack of foresight not to give serious thought and study to more distant problems also. In some respects, immediate policies can take account of these more distant problems without sacrificing immediate objectives. In any event, concern about the more distant future, implanted in the minds of the producing community, has an important bearing upon the vigor of their commitment toward the defense effort itself. It is therefore desirable to discuss certain aspects of this issue now.

In the first place, it should be recognized that we are likely to be confronted with a new set of problems before the defense period is over. For example, unless the international situation worsens, there should be within a year or two an ample supply of steel and some other materials now in short supply. This will permit the modification of some of the materials controls. But at that time, with purchasing power so ample and a new backlog of demand for durables built up, there may well develop a new phase of inflationary pressures from private and public spending which will require some containment. This is one of the reasons why there should be continuously available an ample and flexible assortment of economic tools to be adjusted quickly to changing situations. Particularly, as we look forward to the progressive relaxation of the direct controls, the tax structure and credit devices should be brought to a better state of readiness for dealing with new conditions. As restrictions upon materials are released, some credit controls may be more needed a year hence than they are now.

We should also be prepared for another contingency. If at the time defense spending declines, business investment and consumer spending were also to decline, the result would be a period of slackness, which although perhaps temporary, might require changes in policies regarding taxation, controls, and long-range public programs.

While it is now desirable to be better prepared to meet changing economic problems both within and beyond the defense period, the precise unfolding of economic events cannot be forecast with enough precision to justify now the making of those blueprints for which some are calling. Instead, we may draw assurance from the knowledge that the general techniques to be used when conditions change are fairly well-known and accepted. There is always a need for continuing and intense study of the specific ways in which private and public policies can be applied to cope with changing economic conditions.

Another point of interest is the concern of some parts of the business community that those programs of rapid expansion, which are now needed to support the defense effort, will result in considerable excess capacity when the defense effort levels off on a maintenance basis. Those voicing this concern should be mindful that, if we should falter in the current effort,

we could lose all. Adjustments, of course, will have to be made. We cannot expect all economic activities to continue at all times on an equally high level. However, recent experience illustrates the capacity of our economic system for flexible adjustment to a decline in defense outlays. Although World War II was unfortunately succeeded by the cold war, the annual level of public outlays was reduced by more than 60 billion dollars between 1944 and 1947, and sustained at this lower level until well into 1950. With only minor faltering, these years evidenced new high levels of peacetime production and employment. A rising standard of living absorbed quite fully our expanded productive facilities in factory and field.

It is sometimes said that this new postwar experience of avoiding major dislocation for so long a time was due to the great backlog of demand built up during World War II. Undoubtedly, this was an important factor. But much of the rise in the standard of living, contrasted with the years before the war, was, for instance, in many services, where obviously there was no such thing as a backlog. And it is highly probable, although insufficient economic analysis has been devoted to this problem, that the high demand for durables from 1946 until now has been due not mainly to backlogs, but rather to the fact that people always have a wide range of unfilled desires—if not pressing needs—which they will try to satisfy as soon as the incomes and productive capacity of the Nation rise sufficiently. In addition, a variety of Government programs and private action, as well have contributed greater stability to incomes, so that it may be easier to maintain relatively full employment. The current defense effort will be building up new backlogs for housing, for other durables, and for some types of industrial expansion, which are now being deferred to make way for the expansion of the industrial mobilization base. There is no reason to accept the gloomy hypothesis that we would do a worse job of adjustment when defense spending declines than we did after World War II, particularly since the reduction of defense outlays in the future would be far smaller in proportion to the Nation's economy than the reductions which took place between 1944 and 1947.

This generally favorable outlook does not mean that long-range problems are being ignored. As a matter of fact, the current defense build-up represents a blending of factors which include consideration of the longer-range future. The size of the military program itself represents some calculated risks, which weigh the desirability of maximum military strength against the desirability of avoiding excessive dislocations in the general economy. None of the basic expansion programs has gone beyond the capacity of a reasonably full employment economy to absorb output a few years hence, even in the event of a much reduced defense program. This consideration, as well as current shortages of materials, has entered into the determination of how large these expansion programs should be.

One further point should be added. The better the current job is done, the more assurance the economic community will have about the future. Insofar as industrial dislocation is held to a minimum under the current program, industry and labor will share the confidence that greater dislocations can be avoided in later years by the same application of prudent, consistent, and timely policies as the need arises.