

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 23, 1951

To Mr. Schmidt and Miss Stockwell

Subject: Digest of President Truman's

From Miss Harris

Annual Report to Congress

(1) The nature of the task

We face enormously greater economic problems now than at any time since the end of World War II. We must understand the nature of our defense effort here at home. Our job has three parts:

First, we must achieve a very large and very rapid increase in our armed strength, including trained men in uniform, planes, tanks, and ships, while helping to strengthen our allies. Current expenditures for national security programs--that is, for our military forces, for economic and military aid to other free nations, and for atomic energy and stock-piling--now are running at an annual rate of about 20 billion dollars, or about 7 per cent of our total national output. By the end of this calendar year they should attain an annual rate of between 45 and 55 billion dollars, or as much as 18 per cent of our total national output. This compares with the roughly 45 per cent of total output devoted to defense during the peak years of World War II.

Second, our capacity must be built up for producing tanks, planes, and all types of military supplies. This capacity must be substantially greater than would be required merely to achieve our present targets for armed strength; it must be large enough to enable us to swing rapidly into full-scale war production if necessity should require. And, third, our basic industrial strength must be increased, so that we can continue to grow stronger rather than weaker if it should prove necessary to continue a defense effort of great size for a number of years. Our facilities for the

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production of steel, aluminum, power, and other basic commodities and services must be built up accordingly.

(2) The power of the American economy to perform the task

There is no question that our economy can sustain these great exertions and still remain strong and grow stronger. In the period between 1940 and 1950 alone our total output in actual units of goods and services grew 50 per cent. This is a good illustration of our prodigious capacity for growth. Even during the past five years since V-J Day our productive strength has increased greatly. To illustrate, more than 90 billion dollars (in 1950 prices) have been invested by private enterprise in plant and equipment in this time. Total manufacturing capacity has increased by between 25 and 30 per cent. Steel capacity is now 12 per cent higher; that of our chemical and machinery industries, 60 to 70 per cent higher.

We may not be able to add to our production and productive capacity so rapidly in the years immediately ahead as we have in the past. We had more unused resources of manpower, plant, and materials in 1940 than we have now, and we must therefore apportion all materials and manpower carefully among military, stockpiling, and industrial needs. After careful examination of our economic resources, the Council of Economic Advisers estimates that we can and should achieve an annual rate of total output more than 7 per cent above the current level by the end of this year. In addition, total productive strength should be increased by at least 25 per cent within the next five years.

(3) The inflationary danger

Production cannot be increased quickly enough to expand the defense program and at the same time have as much left over for other purposes. The

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excess of consumer demand over available goods will rise by many billions of dollars. This will cause intense and mounting inflationary pressures, which must be counteracted. To fight inflation, demand must be held down until supplies can catch up. A stringent stabilization program and sacrifices on the part of all of us, therefore, will be required.

Business men, for example, must pay much higher taxes and must accept restraints and controls upon many of their business practices--including price policy and the use of materials and manpower--which are not customary in peacetime. Businessmen must also be willing to withdraw from enterprises which are non-essential. Workers, too, must accept restraints and controls upon wages, designed to prevent the wage increases which would be attainable if more goods were being produced for wage earners to buy. While the right to bargain collectively will be preserved, workers--along with management--must find ways to settle disputes without stopping essential production. American families must save a larger portion of their incomes, and will have to make their household goods, their linen and clothes, their automobiles and appliances last longer. Finally, all economic groups must pay much higher taxes.

(4) Taxation

A first principle of economic and fiscal policy should be to maintain a balanced budget, and to finance the cost of national defense on a "pay-as-we-go" basis. This will help keep total consumer spending within the capacity of current production, and help prevent inflation. The real economic cost of the defense effort is that we must work harder, reduce consumption, and forego improvements in farm, business, and household equipment. / The cost cannot be put off into the future but must be paid now by the people either through taxation or through the uncontrolled and inequitable

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incidence of inflation.)

President Truman's budget message presented to Congress on January 15, 1950, calls for Federal Government expenditures of \$71.6 billion dollars in the fiscal year 1952--a total 78 per cent above expenditures for the year which ended last June 30. In spite of the new tax measures passed last year, a deficit of 16.5 billion dollars is estimated for the fiscal year 1952, if no further tax legislation is enacted; it is estimated that revenues from existing tax legislation will provide only 55.1 billion dollars in tax receipts in fiscal 1952, and recommendations for the new tax legislation to meet the revenues deficiency will be submitted to Congress shortly.

Every available source of new revenue will be tapped, according to the President. Corporations and individuals should pay much higher income taxes. Excise taxes should both be higher and more extensive. Many loopholes in the tax laws should be closed. Taxation must be supplemented by greatly increased saving, which should provide a "nest egg" with which to purchase goods at a later time when they again become plentiful.

Savings help most in the defense effort and do the most to hold down inflation when they are invested in Government bonds. The Treasury will continue its policy of reducing the amount of debt held by banks; it will attempt to place the maximum proportion of Government securities in the hands of the public, particularly individuals, through extension of its savings bond program.

(5) Credit controls

Regulations W and X, issued by the Federal Reserve Board, are well suited to help deal with moderate reductions in the supply of durable goods and housing. If circumstances force acute reductions in the supply of such

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goods, more direct measures will be needed to assure their equitable distribution. In the meantime, the authority to control housing credit through Regulation X should be enlarged by the Congress to include credit for the purchase of existing homes exempt under the present law.

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

(6) Price and wage controls

Direct controls must be applied as well as tax and credit measures in order to help prevent inflation. In general, the policy should be to hold the price line vigorously. Instances are rare indeed in which further price increases are needed in order to provide adequate profit incentives, but in such rare cases, some price adjustments subsequent to stabilization may be permitted in order to stimulate vital production. On the other hand, in many industrial lines extensive additional production, made possible by military orders added to civilian orders, should result in lower costs and in lower prices to military and to civilian consumers alike.

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

Wages must be stabilized as well as prices because of their close economic connection. It would be impossible to stabilize one without the other. Wage stabilization is the more difficult of the two tasks, because wages are the very livelihood of millions of families while prices are only one factor in the incomes of business. Unless the price line is held, it may not be practical to avoid some "cost of living adjustments" in wages

not found

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in some cases, but the predominant general rule should be to achieve stable wage rates until the flow of consumer goods can be increased correspondingly.

Wage stabilization also involves the problem of maintaining adequate incentives. Peacetime increases in wages, which normally provide these incentives, would add to inflationary forces at the present time. Yet wage incentives might stimulate increased productivity in some cases in the defense industries. Where wage adjustments do become necessary over the long pull to provide incentives, the increased potential spending power might be diverted from the actual spending stream until inflationary pressures become less serious. Linking wage adjustments to increased social security contributions might be one method of accomplishing this objective. Other effective savings programs for workers should be considered also, in order to "freeze" additional inflationary wage payments.

(7) Health, welfare, and other services

Resources will not be available to build or staff as many schools clinics, and hospitals in as many places as would normally be possible, but we nevertheless must not permit inadequate health or educational standards to develop. Somewhat more of our resources, therefore, must be devoted toward improving the health of the general public and toward expanding our local public health services. Under legislation passed last year the Federal Government is stopping up its aid to local school districts, but it is vital also that the Congress act now to give the States additional general aid for school maintenance and operation.

Similarly, all the expansion of social security which was planned for in prosperous peacetime cannot be achieved, but some of the hazards which social security is designed to guard against are increased by the mobilization effort. Increased protection against these hazards will make the mobilization

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effort more effective. In addition, expansion of some contributory social security programs is probably important from the point of view of economic stabilization, because raising the employee's contribution would drain off excessive purchasing power and would therefore tend to be anti-inflationary in effect.

Just as in World War II, special legislation will be required in order to provide housing and community facilities and services to defense workers in certain areas. In the President's message on the national budget for the fiscal year 1952 four categories--housing and community development; education; social security, welfare, and health; and veterans' services and benefits--account for a total expenditure of 7.9 billion dollars, or 11 per cent of total budget expenditures in 1952.