2/23/51

Testimony Jan 25

M.S.E.
Pages - 18
35-37

82d Congress }
1st Session }

JOINT COMMITTEE PRINT

THE ECONOMIC AND POLITICAL HAZARDS OF AN INFLATIONARY DEFENSE ECONOMY

MATERIALS PREPARED

FOR THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

BY THE

COMMITTEE STAFF

Printed for the use of the Joint Committee on the Economic Report

UNITED STATES
GOVERNMENT PRINTING OFFICE
89427 WASHINGTON : 1951

JOINT COMMITTEE ON THE ECONOMIC REPORT

(Created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

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LETTERS OF TRANSMITTAL

FEBRUARY 23, 1951.

To Members of the Joint Committee on the Economic Report:

For the information of members of the Committee and others interested, I am transmitting herewith a staff report entitled, "Economic and Political Hazards of an Inflationary Defense Economy."

The basic data are drawn from the Committee's recent hearings on the President's Economic Report and from Government and private publications and staff conferences with technicians inside and outside the Government.

The report attempts to present the most reliable estimates on the basic problem of inflation which can be obtained. It is now submitted to members of the Committee for consideration and such suggestions as they may wish to make.

JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report.

FEBRUARY 21, 1951.

The Honorable JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

DEAR SENATOR O'MAHONEY: In accordance with committee instructions in July 1950, the staff has endeavored to follow the effects of sudden increases in governmental defense commitments since the outbreak of the Korean War, not only on the economy as a whole, but on its various segments. I transmit herewith a staff memorandum assembling the best available data on what is perhaps the most important single result and problem; namely, inflation.

In part I an attempt has been made to prepare an economic model, or what is better called a budget for the Nation, for the current fiscal year and the next fiscal year. The estimates included in this Nation's economic budget are based upon the Committee's recent hearings on the President's Economic Report, upon staff discussions with technicians in the executive branch of the Government and with nongovernmental economists, and upon a thorough canvass of all available current comments published in outstanding economic journals and business periodicals. Quantitative estimates are hazarded concerning the likely trend of defense expenditures, production, private demand, and the like. From these computations estimates are derived of the inflationary pressures likely to be generated by excess consumer money demand and excess business spending. A corresponding quantitative appraisal is made of the effectiveness of various proposed stabilization measures to remove or neutralize such inflationary pressures. The aggregate results are translated into a Nation's economic budget covering the period up to June 30, 1952, that is, the end of fiscal 1952.

In part II materials have been assembled indicating the extent to which inflation in many countries has been the handmaiden of communism, and other subversive political and social movements. This section owes much to many people and agencies, including Dr. Sergius Yakobson, senior specialist on Russian affairs, in the Legislative Reference Service of the Library of Congress.

In appendix A are summarized the views of more than 30 economists and business executives who testified before the committee in the January 1951 hearings held on the President's Economic Report. Appendix B summarizes, under appropriate headings, the views and recommendations submitted in writing by outstanding organizations of businessmen, farmers, labor, and consumers, in response to your letter of January 23. In appendix C the technical methods and assumptions are set forth and the basic statistical charts and tables reproduced which were used in compiling the estimates summarized in part I.

The detailed economic and statistical job of preparing the major portions of this report was done by James W. Knowles, assisted principally by Hope G. Sham, Othella Pompier, and Eleanor F. Rabbitt. Members of the professional staff of the Joint Economic Committee have rendered assistance here and there and given critical scrutiny to the final results. The estimates, though admittedly estimates, are believed to represent the best informed guesses available inside and outside the Government. Unfortunately, official quantitative estimates by those responsible for economic mobilization have not yet been publicly disclosed.

Respectfully submitted.

THEODORE J. KREPS, *Staff Director.*

THE ECONOMIC AND POLITICAL HAZARDS OF AN INFLATIONARY DEFENSE ECONOMY

Introduction

Throughout the recent hearings held by the Joint Committee on the Economic Report, all witnesses emphasized the need for a coordinated program of increased taxation; rigid Government economy; efficient price, wage, production, and materials controls; and increased savings. At first dominant emphasis was placed on production, requirements, and programing. As Leon H. Keyserling, Chairman of the Council of Economic Advisers, stated, priority should be given to such questions as "What are the goals?" "How do they relate to each other as to size and magnitude?"[1] The Economic Report of the President similarly advocated attacking three problems in the following order of importance: (1) Satisfying security needs, (2) increasing output, (3) preventing inflation.

As the hearings progressed, however, though detailed recommendations continued to be made on all phases of defense mobilization, those necessary to combat inflation received increasing emphasis. Indeed, even among such measures, cumulative stress was laid on the imperative necessity of promptness in putting an adequate tax and money-supply control program into effect. To delay, to "wait and see," without immediately stepping hard on available brakes now, it was urged, would inevitably cost this Government many additional billions of dollars in defense expenditures next fall and thereafter.

In this matter practically all the witnesses that appeared before this committee endorsed the major recommendation made in December of 1950 by the thousands of businessmen who belong to the Committee for Economic Development. In their pamphlet, Paying for Defense, they placed at the very head of their program:

> *Produce substantial surplus in the Federal cash-consolidated budget in the first half of 1951.*—Rearmament expenditures lag behind orders and production. We should take advantage of the opportunity in the first half of 1951 to put a definite stop to inflation. If inflation is not stopped by mid-1951 it will be much more difficult to stop it later.

A letter addressed to this committee on January 12 of this year by more than 400 economists gave equal emphasis to the same injunction in the following terms:

> Raise tax revenues faster than defense spending grows so as to achieve and maintain a cash surplus. Merely to balance the budget is not enough. If the inflationary pressure is to be removed, taxes must take out of private money incomes not only as much as Government spending contributes to them, but also a part of the increase in private incomes resulting from increased private spending of idle balances and newly borrowed money.

[1] The questions which Mr. Keyserling raises were asked in connection with his appearance before the Joint Committee on the Economic Report during a series of hearings held in connection with the committee's review of the January 1951 Economic Report of the President. The hearings began on January 22 and extended through February 2, 1951. In the following pages of this report these hearings will be referred to by the day of the hearing only. Mr. Keyserling appeared on January 22.

The real burden and sacrifice represented by defense expenditures, it was agreed, cannot be escaped. It has to be borne now. The only choice that remains is—how? Shall it be distributed by a policy of drift and further destructive inflation? Or will intelligence and courage be mustered to enact at once an adequate tax and monetary program? Shall the inescapable burden of defense be distributed haphazardly and inequitably or thoughtfully and deliberately?

The fact received increasing elaboration that the economic problem involved reaches far beyond the budgetary one. To accept the simple mathematical balancing of estimated receipts and disbursements now as an occasion for self-congratulation or the test of a satisfactory tax program was regarded a tragic delusion. Worthy as budget balancing is, the more crucial task is that of stopping inflation; the anti-inflationary influence of added taxes at this time clearly outweighs customary budget-balancing objectives.

It was conceded that more would be known about the extent of the Government's financial needs at some later date in the legislative year. The rate of expenditure, the requirements for defense, and the possibilities of economy are always, of course, more accurately known in retrospect. But the tempting hope that the unpleasant necessity of enacting added taxes may somehow be avoided by procrastination was believed certain to prove false. Desirable as maximum equity under the tax structure as a whole may be, no equity is served by failing to meet the paramount need now to absorb "hot money" bidding up prices. An income dollar collected in taxes before it can make itself felt in the inflationary spiral bidding up prices of goods and services is far more effective, it was pointed out, than is a tax dollar collected after prices and costs have risen.

To take things easy, to temporize, to place lesser objectives first, is openly to court disaster by drifting into that debauchery of the currency which Lenin and Stalin have favored for decades as the most powerful and most subtle sixth column propelling capitalistic countries toward communism. For inflation corrodes production incentives, makes "suckers" of savers, inflicts arbitrary hardships on those receiving fixed incomes and generates the kind of social injustice and social unrest in which the propaganda of communism is most successful.

The witnesses agreed unanimously that everything possible must be done to eliminate waste, to postpone expenditures not vital or essential to long-run economic strength and military preparedness, and to get maximum mileage for the tax dollar in both civilian and military procurement. But the desire and determination to make continuous and painstaking efforts to economize should not blind the Congress, it was felt, to the unparalleled opportunity to effect now a substantial cut in future Government outlays through prompt enactment of additional taxes.

Some of the witnesses that appeared before this committee had just served as members of a Committee on Economic Stabilization recently organized under the auspices of the Twentieth Century Fund. Their director of research, likewise one of our witnesses, called attention to this passage in their forthcoming report entitled "Mobilization and Economic Stabilization":

> Inflation is, among other things, a sign that the country is giving divided support to the national effort. If we are willing to appropriate money for defense,

but unwilling to take it away from ourselves, we are trying to escape the basic fact of diversion of resources, and the necessity of initial curtailments of civilian supply. We are supporting national defense with one hand and sabotaging it with the other. Such a policy is consistent neither with efficient defense nor with social equity.

The indispensable first condition for success is that the American people be prepared to impose on themselves the taxes needed to make any anti-inflation program a success.

These experts repeatedly emphasized, however, as did the other witnesses, that higher taxes now are no substitute for other vital measures such as allocations, direct controls, canny debt management, and credit curbs. An increased tax take now was deemed necessary in order to make other controls work. Efforts to control prices and wages, for example, no matter how zealously and efficiently enforced, will be futile precisely to the extent that this Nation fails to remove the inflationary steam under the boiler now. It was similarly pointed out that efforts to stimulate savings or to float E bonds might flop if continued price rises be permitted to gnaw further at peoples' confidence in the value of the dollar. If the inflationary train of events now propelling this economy is to be slowed down, everyone, it was emphasized, whether consumers, businessmen, labor, farmers, or Government must forego attempts to create individual shelters from general shortages and sacrifices. If the common task is well done, there will, to that extent, be greater likelihood that in a year or two direct controls can be relaxed, so that the economy can then go forward steadily, surely guided by general indirect fiscal and monetary controls flexibly adjusted to ever-changing economic conditions.

PART I

ECONOMIC IMPLICATIONS OF PRESENT DEFENSE SPENDING PLANS

The inflationary implications of present defense mobilization plans have nowhere yet been fully set forth in quantitative terms. Alarms have been sounded and general guesses made, resembling forecasts that a strong wind will blow but failing to state whether the velocity will be 20 miles or 100 miles an hour.

This memorandum tries to summarize the best available data on the extent to which present defense plans are likely to affect consumer expenditures and other components of gross national product. All estimates are based on two propositions: (1) that prices will be successfully stabilized somewhere near the levels of January 25, 1951; (2) that the goal set for increases in production in the Economic Report of the President will be met; namely, 25 percent during the next 5 years.

No allowance is made for reduction in the budget or sharp curtailment of Government expenditures below the figure set in the President's budget message. The reasons are twofold: the exact size and nature of such curtailment can at the present time not yet be assessed expenditure estimates for the military program may turn out too low, such that reductions in nonmilitary items may well be offset by increases in military expenditures. The fact should be noted that outstanding military authorizations and obligations at the end of fiscal 1952 are estimated to be $80 billion. Even a slight acceleration of expenditures relative to obligations will result in several billion dollars of military expenditures in excess of that estimated in the President's budget. In other words, even with drastic economies both in military and nondefense items, the total Federal budget may equal or even exceed $71.6 billion. However, consequences of a higher and a lower Federal expenditure level are shown.

Between June and December 1950, the index of consumers' prices increased by 4.7 percent, while the index of wholesale prices rose by 10.4 percent. Had prices been allowed to continue to rise unchecked at such rates consumers' prices by June 1952 would be 20.2 percent above June 1950. The wholesale price index on the same basis would be 48.5 percent above June 1950. Detailed figures are shown in table I below.

TABLE I.—*Wholesale and consumer price trends, June 1950 to June 1952*

Item	June 1950	December 1950	June 1951	December 1951	June 1952
Wholesale prices:					
All commodities (1926=100)	157.3	173.7	[1] 191.7	[1] 211.6	[1] 233.6
June (1950=100)	100.0	110.4	[1] 121.9	[1] 134.5	[1] 148.5
Consumer prices:					
All items (1935–39=100)	170.2	178.4	[1] 186.5	[1] 195.4	[1] 204.6
June (1950=100)	100.0	104.7	[1] 109.6	[1] 114.8	[1] 120.2

[1] Estimated value if rate of price increase since Korea is not diminished.

Source: June and December 1950 data from U. S. Department of Labor, Bureau of Labor Statistics.

Concerning the dominant causes for the price rise from June 1950 to date, there was practically unanimous agreement among the experts that testified at the January hearings. It has not been due to an unbalanced Federal Government budget. In actual fact there has been a surplus of receipts over expenditures, one that was anticipated and announced by this committee last July.

On the contrary, the inflation experienced thus far owes its impetus to the civilian segment of the economy and has been the result (1) of "scare" buying by consumers seeking to be "sitting pretty" individually in a period of general shortage (to that end they borrowed, liquidated savings, and scrambled for merchandise); (2) of anticipatory buying, inventory accumulation, and speculation by business firms financed by phenomenal profits and abundant bank credit; (3) of a price push-up designed to forestall getting stuck with a "low" price ceiling in the event of a freeze; (4) of rapid acceleration of construction of plant and equipment in order to "beat the gun" on materials controls and allocations; (5) of increases in materials costs and frenzied bidding for scarce resources and manpower; and, finally, (6) of investment shifts by individuals and institutional investors from liquid assets and fixed income securities into physical goods and equities. These inflationary forces set in motion by warranted expectations and unwarranted fears of what the Government might do, will be given the impetus of substantial Government deficits unless we pay as we go, tax heavily, increase production per man-hour, increase savings, contract credit, control the money supply, and effectively enforce direct controls over prices, wages, materials, and manpower.

In fact, if prices are to be stopped at or near January 25 levels, expenditures of all kinds, whether by consumers, by business, or by Government, will have to stay in line with the volume of goods available for each. For the Government, that implies *at the very least* keeping total expenditures below the level of aggregate receipts, in short, something better than pay-as-we-go.

What Is Total Production Likely To Be?

The total amount of goods available obviously depends on total output. How much is the economy likely to be able to produce in fiscal 1952? That, of course, will depend, first on the number at work. In table II below, census and other data are used to arrive at a reasonable estimate of the total manpower and womanpower available both for civilian and military purposes. This number will be about 65.5 million persons in fiscal 1952, or about 8.4 percent above fiscal 1950.[1] The average number of hours, which will be worked per week, will probably be increased to 43.6 in fiscal 1952 or about 4.3 percent above fiscal 1950. The probable increase in per capita productivity seems rather likely to continue to rise to an average level in fiscal 1952 about 4 percent above fiscal 1950.[2]

All estimates summarized herein are explained in appendix C to this memorandum. They have been evolved and determined on the basis of four fundamental goals:

1. That the bite of defense expenditures will be increased from present levels of 7 percent to one of 16 to 20 percent of gross national product by the end of fiscal 1952.

[1] See appendix C, p. 53.
[2] See appendix C, p. 66.

2. That military expenditures will be substantially kept at a level continuing to take an 18 percent bite out of the economy for 10 or 15 years or more.

3. That the Nation's economic objectives will continue to be:

(*a*) Maximum efficient use of the skills of our population and our resources with production increasing at a long-run sustainable rate.

(*b*) Price stabilization at approximately the levels at which they were frozen on January 25.

(*c*) Taxes equitably distributed with minimum impairment of production incentive or of basic living standards.

4. That political courage and public support will be mustered adequate to impose and enforce controls selected on the basis of science and fact rather than by brokerage of pressures.

If these goals are to be achieved, gross national product, measured in constant prices (using as base those prevailing in June 1950) will increase from the actual figure $263.4 billion in fiscal 1950 to $288.0 billion in fiscal 1951, and to $310 billion in fiscal 1952. In short, the increase in real output for fiscal 1951 is estimated to be 9.3 percent above fiscal 1950, and that for fiscal 1952, 7.6 percent above that in fiscal 1951.[3] Details are shown in table II.

TABLE II.—*Gross national product in constant prices, employment, average weekly hours, and productivity, fiscal years 1949–52*

Fiscal year	Total employment		Average weekly hours		Productivity index (1950=100)	Gross national product in constant prices [1]	
	Actual (millions of persons)	Index (1950=100)	Actual	Index (1950=100)		Actual (billions of dollars)	Index (1950=100)
1949	60.7	100.5	42.5	101.7	96.1	259.2	98.4
1950	60.4	100.0	41.8	100.0	100.0	263.4	100.0
1951	[2] 63.2	[2] 104.6	[2] 42.4	[2] 101.4	[2] 102.8	[2] 288.0	[2] 109.3
1952	[2] 65.5	[2] 108.4	[2] 43.6	[2] 104.3	[2] 104.0	[2] 310.0	[2] 117.7

[1] U. S. Department of Commerce series in 1939 prices converted to June 1950 prices.
[2] Estimated.

Unfortunately June 1950 prices are already a lamented memory. What is the dollar level of gross national product likely to be if this country is successful in stabilizing prices at approximately the levels of, or at least not a great deal above, those on January 25, 1951? All things considered, such a dollar volume would be at least $325 billion.[4]

[3] See appendix C, p. 73.
[4] See appendix C, p. 79.

Estimated Excess Consumer Demand

Against this volume of output, how much money is likely to be running around loose in the economy, in consumers' pockets, in business, and in Government? That will depend most of all, of course, on how much the Government spends. Needless to say the inescapable fact is that wages will be paid and profits will be earned on the production both of civilian items and of defense items, yet consumers will obviously spend their incomes (except for actual amounts saved) mostly for consumable goods, and business will spend its earnings and borrowings mostly for capital goods. Consumers will have funds to buy civilian goods which defense requirements keep the economy from putting out in a volume large enough to absorb all the consumer buying power in consumers' pockets.

How much is this deficiency in the output of consumer goods likely to be? Or to ask the same question in another form: How much excess consumer buying power will there be? It will be low if Government outlays for military and other goods and services are low, and high if the Government bite out of total production is high. In order to define "low" in quantitative terms, table III and the other tables assume that a total Federal Government outlay in fiscal 1952 of $65 billion would be low. A total of $85 billion is assumed to be high, while $75 billion (about the magnitude estimated in the President's budget) is assumed as the medium estimate.[5] How great will be the difference between consumer demand and supply of consumable goods under these three assumptions? A glance at table III will show that it is estimated at $3 billion at the low, $10 billion at medium, and $16 billion at high levels of defense expenditures.[6]

[5] See appendix C, table II, p. 58 and p. 81.
[6] See appendix C, particularly pp. 81 and 82.

TABLE III.—*Excess consumer inflationary demand on the basis of existing tax program, fiscal years 1950, 1951, 1952*

[Billions of dollars]

Description	1950 actual	1951 estimate	1952 estimates		
			Low [1]	Middle [2]	High [3]
Gross national product (current prices)	260.8	[4] 298.4	[4] 325.0	[4] 325.0	[4] 325.0
Less:					
Capital consumption allowances	19.6	22.0	26.0	26.0	26.0
Indirect business tax and nontax liability	22.1	24.8	25.0	25.0	25.0
Business transfer payments	.7	.7	.7	.7	.7
Statistical discrepancy	−.6	0	0	0	0
Plus: Subsidies less current surplus of Government enterprises	.2	0	0	0	0
Equals: National income	219.2	250.9	273.3	273.3	273.3
Less:					
Corporate profits and inventory valuation adjustment	30.9	41.0	44.0	44.0	44.0
Contribution for social insurance	6.2	7.3	8.0	8.0	8.0
Excess of wage accruals over disbursements	0	0	0	0	0
Plus:					
Government transfer payments	14.7	12.3	10.0	10.0	10.0
Net interest paid by Government	4.7	4.9	5.0	5.0	5.0
Dividends	8.0	10.0	7.5	7.5	7.5
Business transfer payments	.7	.7	.7	.7	.7
Equals: Personal income	210.2	230.5	244.5	244.5	244.5
Less:					
Personal tax and nontax payments	18.9	22.8	24.5	24.5	24.5
Federal	16.4	20.0	21.4	21.4	21.4
State and local	2.5	2.8	3.1	3.1	3.1
Equals: Disposable personal income	191.3	207.7	220.0	220.0	220.0
Less: Personal savings	9.3	8.9	11.0	11.0	11.0
Equals: Consumer demand	182.0	198.8	209.0	209.0	209.0
Supply (prices at beginning of period) expenditures for gross national product	262.7	288.0	325.0	325.0	325.0
Less:					
Gross private domestic investment	37.3	48.5	51.0	48.0	44.0
Net foreign investment	−1.1	−3.5	−3.0	−3.0	−3.0
Federal purchases of goods and services	23.7	32.4	49.0	59.0	69.0
State and local government purchases of goods and services	18.9	19.7	22.0	22.0	22.0
Equals: Consumers' supply	183.9	190.9	206.0	199.0	193.0
Consumer inflationary pressure, excess of consumer demand over supply	[5] −1.9	[6] 7.9	3.0	10.0	16.0

[1] Assumes Federal consolidated cash expenditures of $65 billion.
[2] Assumes Federal consolidated cash expenditures of $75 billion.
[3] Assumes Federal consolidated cash expenditures of $85 billion.
[4] Assumes prices stabilized at approximately Jan. 25, 1951, levels, with wholesale prices some 11 to 13 percent above June 1950 levels, and retail prices 6 to 8 percent above June 1950 levels.
[5] For fiscal 1950 the inflationary excess was negative, prices declining by about 1 percent.
[6] For fiscal 1951 the inflationary pressure will result in a substantial rise in prices of 6 to 8 percent; a larger price rise than indicated by the primary inflationary excess demand shown above because secondary spiralling effects have been permitted.

Source: The U. S. Department of Commerce, Bureau of the Budget, and staff of the Joint Committee on the Economic Report.

INFLATIONARY BUSINESS SPENDING

Now let us take a look at business spending. Business too will earn profits both on the civilian output it sells, and on that part of its production which is taken by the Government. But it will spend such profits only for civilian items, especially for plant, equipment, and other capital goods. How much will business demand for capital goods exceed the supply of such goods? That, too, depends on whether the bite out of the economy taken by defense and other

expenditures by the Government is low, medium, or high. In table IV detailed estimates are given according to which excess business demand will be $3.3 billion at low rates of defense expenditures, $6.3 billion at medium rates, and $10.3 billion at high rates. Note that corporate profits may well remain unchanged at a level of $44 billion which, while 10 percent higher than the high rate earned in 1950 (that in turn more than 20 percent higher than the highest level ever reached in business history), may nonetheless remain the same, whether Government expenditures are low, medium, or high.[7]

TABLE IV.—*Business inflationary spending on the basis of present taxes, fiscal years 1950, 1951, 1952*

[Billions of dollars]

Description	1950 actual	1951 estimate	1952 estimates		
			Low [1]	Middle [2]	High [3]
Demand (current prices):					
Corporate profits before taxes and inventory valuation adjustment	30.6	[4] 41.0	[4] 44.0	[4] 44.0	[4] 44.0
Less:					
Corporate profits tax liability	12.8	24.5	24.0	24.0	24.0
Inventory valuation adjustment	.3	—4.0	0	0	0
Dividends	8.0	10.0	7.5	7.5	7.5
Plus:					
Capital consumption allowances, etc	19.8	22.0	26.3	26.3	26.3
Dissaving	6.6	15.2	12.5	12.5	12.5
Equals: Business demand	35.9	47.7	51.3	51.3	51.3
Supply (prices at beginning of period):					
Expenditures for gross national product	262.7	288.0	325	325	325
Less:					
Federal Government purchases of goods and services	23.7	32.4	49	59	69
State and local government purchases of goods and services	18.9	19.7	22	22	22
Consumer expenditures	183.9	190.9	206	199	193
Equals: Business supply	36.2	45.0	48	45	41
Business inflationary pressure: Excess of business demand over supply	[5] —.3	[6] 2.7	3.3	6.3	10.3

[1] Assumes Federal consolidated cash expenditures of $65 billion.
[2] Assumes Federal consolidated cash expenditures of $75 billion.
[3] Assumes Federal consolidated cash expenditures of $85 billion.
[4] Assumes prices stabilized at approximately Jan. 25, 1951, levels with wholesale prices some 11 to 13 percent above June 1950 levels, and retail prices 6 to 8 percent higher.
[5] For fiscal 1950 the inflationary pressure was negative, prices declining about 1 percent.
[6] For fiscal 1951 the inflationary excess will bring about a substantial rise in prices of 6 to 8 percent; a larger price rise than indicated by the primary inflationary excess demand shown above because secondary spiralling effects have been permitted.

Source: The U. S. Department of Commerce, the Bureau of the Budget, and the staff of the Joint Committee on the Economic Report.

INFLATIONARY GOVERNMENT SPENDING

In the third place, let us take a look at Federal Government expenditures and Government receipts.[8] Note here that the figures deal with actual cash outlays and cash receipts, not the ordinary administrative budget. As will be remembered, the total of Federal Government expenditures given in the President's budget message was $71.6 billion. But this omits certain transfer payments such as social security outlays. The total cash to be paid out is $74.1 billion. Note, too, that the cash budget may actually be balanced for fiscal 1951, even though the traditional budget is estimated to show a deficit of $2.7 billion. Further details are shown in table V below.

[7] See appendix C, p. 80.
[8] As estimated in the President's budget message, January 1951.

TABLE V.—*Consolidated Federal cash budget, fiscal years 1950 to 1952*

[Billions of dollars]

Description	Bureau of the Budget		
	1950 actual	1951 estimate	1952 estimate
Receipts from the public:			
Direct taxes on individuals	18.1	22.3	26.8
Direct taxes on corporations	10.9	13.6	20.0
Excise taxes and customs	8.0	8.8	8.8
Others	3.9	4.6	5.7
Total cash receipts	40.9	49.3	61.3
Payments to the public:			
National defense and directly related activities	17.7	27.1	51.9
Military services	12.4	21.2	41.5
International security	4.7	4.8	7.5
Atomic energy	.6	.8	1.3
Promotion of defense production	0	.3	1.1
Civil defense	0	(1)	.5
Economic stabilization and allocation	(1)	(1)	.3
Past wars and emergencies	13.6	10.6	10.5
Interest	4.3	4.1	4.6
Veterans	9.3	6.5	5.9
Civil functions: Total	11.9	11.3	11.4
Total cash payments	43.2	49.1	74.1
Excess of receipts from public		.2	
Excess of payments to public	2.2		12.8

[1] Less than 100 million dollars.

Source: Bureau of the Budget, based on existing tax law.

METHODS OF REMOVING INFLATIONARY PRESSURES

Thus far no method has been mentioned for absorbing the excess dollars except that of marking up prices, that is, inflation. Inflationary pressures invariably take this outlet if a policy of drift or "wait and see" is followed.[9] For the current fiscal year, the excess of $7.9 billion in consumer demand plus the excess of $2.7 billion in business spending represented almost entirely the consumer and business anticipatory buying since last June, and accounts completely for the sharp jump in prices that has occurred thus far. The effect which a $16 billion consumer excess demand added to a $10.3 billion excess business spending would have in fiscal year 1952 (these will result if Federal expenditures rise as high as $85 billion) can only be guessed at but certainly in the absence of further tightening of controls these inflationary pressures could easily blow the lid off prices, and accelerate the present inflationary price spiral despite present controls. For the fact should be remembered that all these figures are estimated on the premise that there will be efficient enforcement of the controls and taxes now in operation.

[9] See appendix C, p. 85 and following pages.

On the other hand, note that if Federal Government expenditures are held down to $65 billion the total excess ($3 billion consumers plus $3.3 billion business) is sufficient, again *with full and efficient operation of present controls and taxes*, to cause wholesale and retail prices to continue to rise at nearly present rates of increase. If Federal Government expenditures take the middle course, i. e., do not exceed $75 billion (the President's cash budget figure is $74.1 billion), the total excess will be $16.3 billion ($10 billion consumer plus $6.3 billion business) or enough *despite present controls and existing taxes* to cause prices to rise at least twice as fast as they have risen since June 1950.

Clearly other outlets than inflation must be devised for such excess money demand, both on the money side and on the goods side. On the money side, excess consumer buying power can be lowered by taxes, by preventing increases in borrowing, and by stimulating savings, especially the purchase of Government bonds. Excess business buying power can likewise be diminished by taxes, by general and selective control of commercial bank credit expansion, and by increased business saving.

On the goods side, consumer buying can be restricted and savings stimulated by simple nonavailability of merchandise such as automobiles, etc. The capital expenditures of business can likewise be limited by direct inventory control, allocations, priorities, etc.

In table VI a combination of these methods is presented in quantitative terms. The figures are useful only in indicating the possibilities and the magnitudes which, realistically thinking, one ought to keep in mind.[10] While there is considerable leeway for variation in detail, the total additional tax and control effort must be at least as great as the figures presented below because—and this fact bears repeated emphasis—the assumptions underlying these estimates are conservative. The figures showing the amount of inflationary pressure, in other words, will be at least those here given. If because of delay or lack of political courage our total effort falls short, by this much will the evils of inflation be aggravated.

As the Guaranty Trust Co. has cogently stated:[11]

> The question is whether the sacrifice shall be distributed by taxation, with some regard for fairness in the present and future, or whether it shall take place by inflation, which imposes the burden without equity, order, or control. Inflation bears most heavily on those whom a rational tax system is designed to spare: the aged, the disabled, the widowed, the orphaned, and the educational and philanthropic institutions that are exempt from statutory taxes for good social reasons. It penalizes these groups not only today but for years to come, because it destroys the value of the savings, the insurance, and the pension funds on which they will depend for future support. It undermines the social security that is a major objective of our economy and promotes the social unrest that is a primary aim of our enemies.

[10] See appendix C, p. 91.
[11] In the Guaranty Survey, February 1951, vol. XXX, No. 10, p. 3.

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TABLE VI.—*A tentative program for removing the inflationary pressures, fiscal years 1951 and 1952*

[Billions of dollars]

Description	1950	1951	1952		
			Low [1]	Middle [2]	High [3]
Excess consumer demand	−1.9	7.9	3.0	10.0	16.0
Increased personal taxes	0	0	[4] 1.7	[4] 7.2	[4] 10.3
Increased excise taxes	0	0	[5] 1.0	[5] 2.0	[5] 4.0
Increased corporate taxes	0	0	[6] .3	[6] .8	[6] 1.7
Price rise or fall	[7] −1.9	[8] 7.9	0	0	0
Excess business demand	−.3	2.7	3.3	6.3	10.3
Increased corporate taxes			[6] 1.3	[6] 3.3	[6] 6.3
Direct controls: additional saving [9]			2.0	3.0	4.0
Price rise or fall	[7] −.3	[8] 2.7	0	0	0

[1] Assumes Federal consolidated cash expenditures of $65 billion.
[2] Assumes Federal consolidated cash expenditures of $75 billion.
[3] Assumes Federal consolidated cash expenditures of $85 billion.
[4] Implies increase in personal taxes of 2 billion dollars on the low assumption, 8 billion dollars on the middle assumption, and 12 billion dollars on the high assumption.
[5] Implies an increase in excise taxes of 1 billion dollars on the low assumption, 2 billion dollars on the middle assumption, and 4 billion dollars on the high assumption.
[6] Implies increased corporate taxes of 2 billion dollars on the low assumption, 5 billion dollars on the middle assumption, and 10 billion dollars on the high assumption.
[7] For fiscal 1950 the inflationary pressure was negative, prices declining about 1 percent.
[8] For fiscal 1951 the inflationary pressure resulted primarily in a rise in prices of 4.7 percent between June and December 1950.
[9] Implies use by the Defense Production Authority of inventory limitations, priority allocations, material control programs, and investment limitations to direct and limit business investment to the extent indicated.

THE DEFLATIONARY EFFECT OF TAXES

In trying to estimate how much of a deflationary influence tax increases exert, one must take note of a complicating and in many ways a baffling problem. Taxes that keep consumers and business from spending or that come directly out of such spending are fully effective in bringing down excess buying power. But if taxes come out of savings, that is, out of funds that were not going into the market to bid for goods and services, they may not have a deflationary effect, even though they do raise moneys for the Government. The kind of taxes levied is therefore highly important.

In table VII an attempt is made to evaluate quantitatively the economic effects of the tax levies that might be necessary to help remove the inflationary pressures at low, medium, and high levels of Federal cash expenditures. In view of the current lack of facts concerning the impact and incidence of various kinds of taxes, no pretense can be made that these estimates represent anything more than the best guesses now available.

From the general economic point of view, the usefulness of increased taxes to curb inflation is beyond cavil. But caution must be exercised that the specific kinds of taxes levied do not limit the production of the things needed to fight communism. On the contrary, taxes should be such as to leave the productive efficiency of the labor force at a reasonable and sustainable maximum. Thus in designing excise taxes, clearly the heaviest impact should be borne by those durable goods, services, and luxury products whose demand it is desired to curtail because they compete with defense items in terms of

raw materials, labor skills, or plant. Such excises must also be designed, however, to avoid heavy burdens on strict necessities such as basic foods for home consumption. For if such is not done, tens of millions of low-income consumers, among whom are found a substantial fraction of workers and farmers, will be seriously short of the necessities required for efficient participation in the defense program. The production of defense products will be less than the maximum.

TABLE VII.—*Proposed Federal Government fiscal legislation and its economic effects, Federal fiscal year 1952*

[Billions of current dollars]

Description	Net additional Government funds and private tax liabilities	Estimated economic effects—				
		On corporate undivided profits	On personal income	On consumer demand	On individual voluntary savings	On gross national product
LOW—$65 BILLION						
Individual: Income taxes	2.0			−1.7	−0.3	
Business:						
Excise taxes	1.0			−1.0		+1.0
Corporate income taxes	2.0	−1.3	−0.7	−0.3	−0.4	
Total	5.0	−1.3	−0.7	−3.0	0.7	+1.0
MIDDLE—$75 BILLION						
Individual: Income taxes	8.0			−7.2	−0.8	
Business:						
Excise taxes	2.0			−2.0		+2.0
Corporate income taxes	5.0	−3.1	−1.9	−0.8	−1.1	
Total	15.0	−3.1	−1.9	−10.0	−1.9	+2.0
HIGH—$85 BILLION						
Individual: Income taxes	11.6			−10.4	−1.2	
Business:						
Excise taxes	4.0			−3.9		4.0
Corporate income taxes	10.0	−6.3	−3.7	−1.7	−2.0	
Total	25.6	−6.3	−3.7	−16.0	−3.2	4.0

EXISTING TAX BURDEN ON LOW-INCOME BRACKETS

If one wishes to be sure to tax consumption, where should the tax fall? On income brackets below $2,000? Or above $4,000? The answer appears clearly in table VIII. Notice that the nearly 2,500,000 spending units with incomes in excess of $7,500 spent nearly 3 times as much on durable goods as did the 17,000,000 spending units getting less than $2,000.[1] Of course, they spend less on food.

Inasmuch as average wages per week are about $64, let us assume that the average factory worker gets about $3,200 (50 times $64) a year. In short, about half of the Nation's spending units get about $3,000 or less. How much of total consumer expenditures do these people in the lower half account for? Note from column (1) of table VIII that it is about three-tenths of the total.

The way to cut consumption, therefore, is to cut into the incomes of those getting over $3,000. That's where the big bulk of the consumption is done. And the way to cut such incomes is to step up the income tax in those brackets.

[1] About 1,600,000 of the 2,500,000 spending units with incomes above $7,500 are families; the 17,000,000 spending units with incomes below $2,000 include 10,000,000 families.

TABLE VIII.—*Consumer expenditures*

(A) ESTIMATED DISTRIBUTION OF CONSUMER EXPENDITURES, BY INCOME BRACKETS, FOR 1948 IN PERCENT OF TOTAL

Spending unit income brackets (in $1,000)	Total (1)	Total retail sales (2)	Retail food sales (3)	Retail sales less food (4)	Liquor sales (5)	Tobacco sales (6)	Durable sales (7)	Personal income tax (8)
0-1	3.9	3.9	4.1	3.9	0.9	3.9	2.2	0.1
1-2	9.3	9.3	11.4	8.2	8.9	11.4	5.6	2.6
2-3	18.1	18.1	20.5	16.7	17.2	21.1	18.2	8.5
3-4	20.7	20.7	21.8	20.1	22.5	22.9	20.0	12.9
4-5	14.4	14.4	14.2	14.5	12.7	14.3	15.8	12 2
5-7.5	16.1	16.1	14.6	16.9	16.4	14.1	17.0	19.6
7.5 up	17.5	17.5	13.3	19.8	21.4	12.2	21.2	44.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(B) APPLICATION OF 1948 ESTIMATES TO 1950 TOTALS

[In billions of dollars]

0-1	7.4	5.0	1.8	3.2	0.03	0.2	0.6	0.02
1-2	17.7	11.9	5.1	6.8	.3	.5	1.5	.5
2-3	34.5	23.1	9.2	13.9	.5	.8	4.7	1.6
3-4	39.5	26.5	9.8	16.7	.7	.9	5.2	2.5
4-5	27.5	18.4	6.4	12.0	.4	.6	4.1	2.4
5-7.5	30.7	20.6	6.6	14.0	.5	.6	4.4	3.8
7.5 up	33.4	22.4	6.0	16.4	.6	.5	5.5	8.5
Total	190.8	127.9	45.0	82.9	3.0	4.0	26.0	19.3

NOTES.—Items (1) and (2) are estimated 1948 distributions for total consumer expenditures. Items (3), (5), and (6) are estimated 1948 distributions for food, liquor, tobacco, and durables expenditures. For detail see article referred to on p. 15.

The lower half of the table, that labeled (B), is only a very rough approximation of the desired information, as it applies estimated distributions for 1948 to estimated total for 1950.

Total consumer expenditure of 190.8 billion and retail sales of 127.9 billion are Department of Commerce estimates. Total retail sales of food, liquor, tobacco, and durables are estimated on basis of Department of Commerce data.

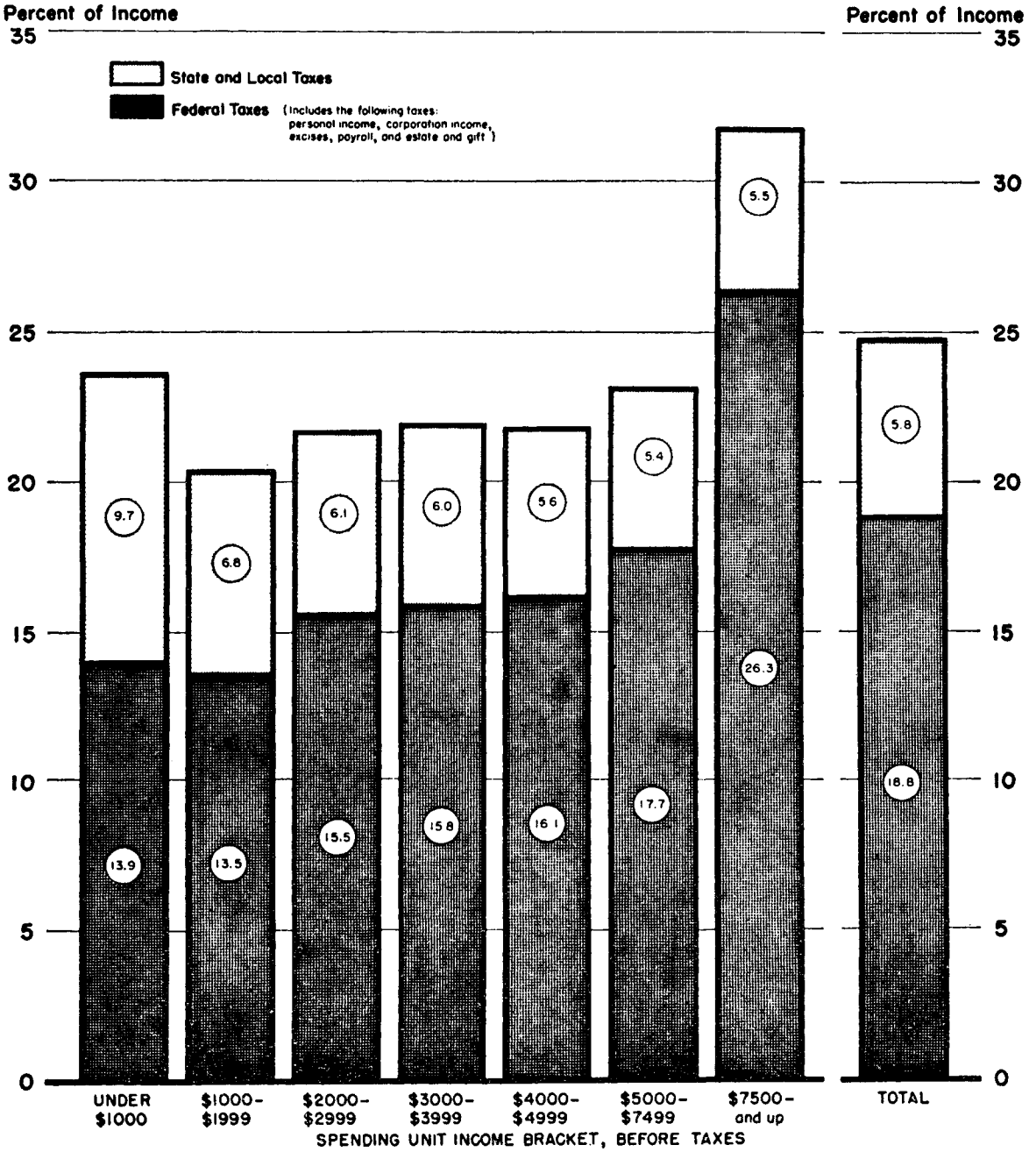
Source: See hearings, Jan. 31, 1951, R. A. Musgrave.

Increased emphasis is lent to such a procedure on grounds of equity. Who now actually bears the heaviest percentage burden expressed in terms of taxes to income? The families getting less than $1,000 or those getting over $3,000? The fact is shocking but true that it is those in the lowest-income bracket who already bear a disproportionate share of the tax burden. On this point, Prof. R. A. Musgrave presented to the Joint Committee on the Economic Report in its recent hearings an advance copy of the results of a research group study at the University of Michigan. The data are summarized in table IX in the form in which they are soon to be published in the National Tax Journal. The table merits most careful study. Note that the total tax structure in this country, including State, local, and Federal taxes, bears most heavily on those getting under $1,000 a year. Only the small number lucky enough to get $7,500 a year or over bear a larger proportionate share of the total tax burden. That fact is graphically depicted on chart 1.

A further fact should likewise be kept in mind. If the theory that needed sacrifices should be imposed somewhat equitably is the only one that squares with the American conscience, then note that the considerable rise in food prices has already imposed no small amount of belt-tightening upon tens of millions of families in the low-income brackets because their incomes tend for the most part to consist of

CHART 1

1948 TAX PAYMENTS AS PERCENT OF INCOME BY INCOME BRACKETS



SOURCE From "Notes for Panel Discussion on Fiscal Policy", by R. A. Musgrave before the Joint Committee on the Economic Report, January 31, 1951

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wages, salaries, pensions, or other incomes that usually increase less rapidly and therefore fall behind in the inflation merry-go-round.

TABLE IX.—*1948 tax payments as percent of income by income brackets*

	Spending unit income bracket, before tax, in dollars							
	Under 1,000	1,000–1,999	2,000–2,999	3,000–3,999	4,000–4,999	5,000–7,499	7,500 and up	Total
Federal Government:								
1. Personal income taxes	0.2	2.8	4.4	5.5	7.0	9.3	12.3	7.8
2. Corporation income taxes	6.1	4.3	3.8	3.7	3.7	3.8	9.9	5.6
3. Excises	5.1	4.3	4.0	4.0	3.5	3.4	2.3	3.4
4. Payroll taxes	2.5	2.1	3.3	2.5	1.9	1.2	.5	1.7
5. Estate and gift taxes							1.4	.4
6. Total	13.9	13.5	15.5	15.8	16.1	17.7	26.3	18.8
State and local government:								
7. Total	9.7	6.8	6.1	6.0	5.6	5.4	5.5	5.8
All levels of government:								
8. Total	23.6	20.3	21.6	21.8	21.7	23.1	31.7	24.7
Addenda:								
9. Percent of spending units	12.2	17.7	22.9	20.1	11.6	10.2	5.3	100.0
10. Percent of income	1.9	7.0	14.8	17.9	13.4	16.3	28.8	100.0

1. For details see The Distribution of Tax Payments by Income Groups in 1948, by R. A. Musgrave, J. J. Carroll, L. D. Cook, and L. Frane, to be published in the National Tax Journal in issue for March 1951.
2. Effective tax rates in table IX are computed on the basis of the Department of Commerce estimate of personal income of $211.9 billions plus imputed retained earnings of corporations and the unshifted portion of corporate income taxes of $20.6 billion. It is assumed that the total personal income thus determined is distributed in the same way as the estimated distribution of money income by the survey research center of the University of Michigan in the 1949 Survey of Consumer Finances, prepared annually for the Board of Governors of the Federal Reserve System.
3. Line 2 of table IX is based on the assumption that one-third of the corporate income tax is shifted forward to consumers in higher prices and one-eighth backward in lower wages. If it is assumed that the corporation tax is not shifted, the percentages in line 8 become as follows: 20.4, 17.8, 19.1, 19.5, 19.5, 21.7, 33.8, 24.0. For alternative assumptions see article cited in note 1.

On the other hand, what brackets of income get most of the windfall benefits? Those, of course, that are effectively organized to increase their incomes or receive direct benefit from increases in prices; that is; the flexible incomes derived from profits, from returns on farm and business operations, from speculation in the commodity and stock markets, from ownership of equities, and from dividends. In what income brackets do such incomes increasingly become more and more important? In those from $4,000 on up. Clearly, increased taxes should tap windfall incomes most. Those benefiting most from inflation are increasingly found in brackets above $3,000–$4,000.

Even if one attempts to tax such windfall gains, say by designing a rate schedule to raise large additional sums from corporate profits, the fact is perverse but true that in the years of high-level economic activity ahead there is likely to continue to exist most of the time a sellers' market, one in which through price rises, taxes on corporate profits can be most readily passed on to consumers. To design a corporate tax structure such that it will fall mainly on the corporations themselves, thus reducing their inflationary potential, or upon their stockholders through a reduction in dividends, is most difficult. Thus the prime beneficiaries of inflation, those receiving flexible incomes such as dividends and profits and other entrepreneurial returns, which in turn constitute the major portion of the incomes of those in the upper income brackets, are most likely to emerge from this emergency, as indeed they have from every war in American history, considerably wealthier and better-off, both absolutely and relatively, than before. Every war seems to bring its crop of war millionaires.

These are some of the considerations that make so extremely difficult and complicated the task of estimating what the economic effect will be of various types of taxes, as has been done in table VII above, and in Dr. Musgrave's study, a portion of which is reproduced in table IX.

If, however, the estimates in table VII come even moderately close to actual likelihood (and it is felt that they do), then the total program which has a chance of coming reasonably close to removing excess consumer and business inflationary pressure (thus helping to keep prices at approximately January 25, 1951, levels and making other defense and control programs work) can be summarized in brief as it is done in table X and table XI. Note that these tables virtually recapitulate all estimates and epitomize the reasoning given thus far.[12] Note, too, that in each case inflationary pressures are removed but only because of the assistance of direct controls in increasing consumer and business savings.

TABLE X.—*Estimated inflationary pressure at low, middle, and high levels of Federal Government expenditures in fiscal 1952*

[Billions of dollars]

Description	Federal cash expenditures		
	Low	Middle	High
Federal cash expenditures	65.0	75.0	85.0
Total inflationary pressure [1]	6.3	16.3	26.3
Consumer:			
Demand	209.0	209.0	209.0
Supply	206.0	199.0	193.0
Inflationary pressure	3.0	10.0	16.0
Business:			
Demand	51.3	51.3	51.3
Supply	48.0	45.0	41.0
Inflationary pressure	3.3	6.3	10.3

[1] See tables III and IV.

TABLE XI.—*Estimated additional taxes and controls needed to remove inflationary pressures*

[Billions of dollars]

Description	Low		Medium		High	
	Tax liability	Deflationary effect	Tax liability	Deflationary effect	Tax liability	Deflationary effect
Effect on excess consumer demand of—						
Increased personal taxes	2.0	1.7	8.0	7.2	12.0	10.3
Increased excise taxes	1.0	1.0	2.0	2.0	4.0	4.0
Increased corporate taxes	2.0	.3	5.0	.8	10.0	1.7
Total	5.0	3.0	15.0	10.0	26.0	16.0
Effect on excess business demand of—						
Increased corporate taxes	2.0	1.3	5.0	3.3	10.0	6.3
Direct controls, additional savings	----	2.0	----	3.0	----	4.0
Total	----	3.3	----	6.3	----	10.3

[12] For a different and more detailed statement of the final results in the form of a Nation's Economic Budget, see appendix C, p. 94, table XIV.

Substantial Budget Surplus Required To Curb Inflation

A final question presents itself. If direct controls and monetary and fiscal policies are adopted, adequate substantially to remove the inflationary pressures that under present legislation are inevitable, will such taxes likewise balance the Federal budget and implement a pay-as-we-go policy? The answer is briefly shown in table XII.[13] Note that the general conclusion which one almost unavoidably reaches here is that such a program, if it is to be at all adequate to help make our present price and wage controls work, will have to be one which will *more than balance* the Federal cash budget.

If one considers the period from July 1946 to date in its entirety, the fact emerges clearly that the total Government debt now is less than on July 1, 1946. Thus the marked increase in prices since that date occurred while the Federal Government was paying its way. During the 2 years, 1947 and 1948, despite a substantial surplus of revenues, prices rose sharply. In 1949, despite the Federal deficit, wholesale and retail prices fell. Again, the abrupt price jump in prices that took place in the second half of 1950 occurred while the Government was operating in the black. The fact that the program here suggested falls somewhat short of enabling the Government to continue to do so greatly reemphasizes the fact that this is not a maximum but a minimum program.

In short, by the amount that Government cash expenditures exceed $70 billion, by that amount the minimum amount of additional taxes to be raised should exceed $15 billion, and the sooner the better. Excessive demand is like yeast. An extra $10 billion in taxes levied in the first quarter of 1951 will do more to check inflation than $12 or $15 billion in the fourth quarter. By that time rising prices will again kite defense expenditures in the same way that the price rise from April to December 1950 absorbed nearly $3 billion of defense appropriations.[14] Such emasculation of our tax and defense dollar, if allowed to continue, will explode in financial disaster and catastrophic inflation.

Table XII.— *Estimated additional taxes and the Federal budget, fiscal year 1952*

[Billions of dollars]

Description	Assumptions		
	Low	Middle	High
Cash consolidated budget:			
Cash expenditures	65.0	75.0	85.0
Cash receipts (existing law)	60.0	60.0	60.0
Cash deficit (existing law)	5.0	15.0	25.0
Proposed additional taxes:			
Increase in individual income taxes	2.0	8.0	12.0
Increase in excises	1.0	2.0	4.0
Increase in corporation taxes	2.0	5.0	10.0
Total (liability basis)	5.0	15.0	26.0
Total collections in fiscal year 1952	4.2	13.3	24.9
Cash deficit (proposed tax legislation)	.8	1.7	1.1
Conventional budget deficit (proposed legislation)	4.5	5.4	4.8

[13] See appendix C, p. 95.
[14] See S. Rept. No. 2684, 81st Cong., 2d sess., December 20, 1950, p. 3.

Suppose Tax Increases Are Delayed?

As was previously stated, the industrialists, business executives, and economists that testified before this committee unanimously agreed and, in fact, emphasized strongly that direct controls over wages, prices, and production could not possibly halt the rising tide of inflation threatening America *unless such controls were backed early enough and vigorously enough with fiscal and monetary measures.*

Thus far in this staff memorandum, the discussion of the economic implications of defense mobilization has been limited to quantitative estimates and statistical tables showing the magnitude, and location within the economy, of the excess of incomes available to consumers, business, or Government, over the supplies of goods and services available to each. All computations have been based on the hope that adequate tax and monetary policies would be drafted soon enough to enable direct controls over prices, wages, and production to function effectively.

But what will happen if this Nation fails so to do? *What will be the fruits of delay, of procrastination, of a policy of "too little and too late"?*

An examination of monetary statistics provides the rudiments of an answer. Every increase in bank reserves of $1 can bring about an increase in potential lending power, in other words, credit expansion, on the part of the banks of $5 to $6. The amount of the Federal Government debt other than that held by the Federal Reserve Bank System, Government trust funds, or individual savings bonds, is such that if commercial banks, other financial institutions, and individuals cared to force the Federal Reserve System to buy the Government securities they own, bank reserves would be increased enough to permit at the very minimum an increase in currency and deposits of three or four times the present volume of currency and deposits in circulation.

If by any chance the public thought that such an event were going to happen, and if the rates of turn-over of circulating media (bank deposits plus currency outside the banks) were to rise to something like their 1929 levels, it would make possible a further increase in the effective monetary supply of two to three times. This would be adequate to support a price level easily five times higher than the present *even if the United States Treasury did not borrow a single additional nickel.* In short, this is what could then happen here: a runaway "hyper-inflation" that might balloon the price level at ever-increasing rates of increase to astronomical levels. It is this fear, fortunately not yet widespread, that accounts in part for the flurry in the cashing of E bonds since June of 1950. It is this fear that may have helped to propel some investment funds into real estate, commodities, and equities. It is in part this fear-induced flight from the dollar that has caused the velocity of circulation of demand deposits to jump to a 15-year high in recent months. Unless promptly nipped in the bud, it can lead to runaway inflation.

PART II

INFLATION AND COMMUNISM

Many readily concede the catastrophic, destructive powers of inflation, but feel that "It can't happen here." Such "pushing of one's luck" coupled with misplaced confidence that things will turn out all right has pervaded many another government until it was destroyed by subversive elements who promptly stabilized the economy and the price system under a new government. All the destructive elements which history and economic analysis show to be necessary to disintegration of the currency and destructive run-away inflation are as prevalent here in the United States as in almost any country in which hyperinflation has ever occurred.

The tremendous growth in the public debt which has occurred in the last 10 years, together with the ability by private parties at their option to convert such debt into bank and money reserves creates the potential for an inflationary conflagration, once the tinder caught fire. The good sense and the confidence of the American people in their Government and in the private enterprise system have so far prevented this potential from exploding. However, it could happen here if through timid tax, budgetary, and monetary policies, direct controls were allowed to break down. It is significant that, almost without exception, *every country suffering a run-away inflation in recent years has not only had rigorous laws on the books providing for direct controls over prices, wages, and materials, but virtually astronomical interest rates and drastic penalties for noncompliance.* In China, for example, the maximum penalty for violation of price regulations was beheading. Yet, despite brief halts from time to time, prices continued to zoom upward, in large part because tax, budgetary, and monetary policies were too easy, too little, and too late.

Inflation: The Enemy Sixth Column

In his book entitled "Economic Consequences of the Peace," John Maynard Keynes observed:

> Lenin is said to have declared that the best way to destroy the capitalist system was to debauch the currency * * * Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.

This excerpt has been widely quoted, particularly so because it was published in 1919 less than 2 years after the Communists took over Russia. Nowhere, however, does a similar statement appear in the published works of Lenin or Stalin.

Though a direct statement—be it by Lenin or Stalin—on the deliberate use of inflation as a tool for fostering revolutionary unrest and promoting world revolution seems to be lacking, the Communist

point of view can easily be ascertained on the basis of the party's general theory of revolution and its interpretation of the present world situation.

In the summer of 1915 Lenin, in his study, The Collapse of the Second International, enumerated the following three prerequisites for a revolution. He wrote:

> For a Marxist there is no doubt that a revolution is impossible without a revolutionary situation; furthermore, we know that not every revolutionary situation leads to revolution. What are, generally speaking, the characteristics of a revolutionary situation? We can hardly be mistaken when we indicate the following three outstanding signs: (1) it is impossible for the ruling classes to maintain their power unchanged; there is a crisis "higher up," taking one form or another; there is a crisis in the policy of the ruling class; as a result, there appears a crack through which the dissatisfaction and the revolt of the oppressed classes burst forth. If a revolution is to take place, it is usually insufficient that "one does not wish way below," but it is necessary that "one is incapable up above" to continue in the old way; (2) the wants and sufferings of the oppressed classes become more acute than usual; (3) in consequence of the above causes, there is a considerable increase in the activity of the masses who in "peacetime" allow themselves to be robbed without protest, but in stormy times are drawn both by the circumstances of the crises and by the "higher-ups" themselves into independent historic action.
>
> Without these objective changes, which are independent not only of the will of separate groups and parties but even of separate classes, a revolution, as a rule, is impossible. The coexistence of all these objective changes is called a revolutionary situation. This situation existed in 1905 in Russia and in all the periods of revolution in the west, but it also existed in the seventh decade of the last century in Germany; it existed in 1859–61 and 1879–80 in Russia, though there was no revolution in these latter instances. Why? Because a revolution emerges not out of every revolutionary situation, but out of such situations where, to the above-mentioned objective changes, subjective ones are added, namely, the ability of the revolutionary classes to carry out revolutionary mass actions strong enough to break (or to undermine) the old government, it being the rule that never, not even in a period of crises, does a government "fall" of itself without being "helped to fall." [1]

This is how the Marxist views a revolution * * *

Lenin believed further that inflation particularly accentuated and aggravated the "wants and sufferings" of the proletariat in capitalist countries—prerequisite No. 2 of a successful revolution—and called for a remedy through revolutionary action. In September 1917 in The Threatening Catastrophe and How To Fight It, he said:

> The question of the rise in the fixed price of grain has yet another side to it. This rise means a new chaotic increase in the issue of paper money, a new step forward in the process of increasing the high cost of living, increasing the financial disorganization, and bringing nearer a financial collapse. Everybody recognizes that the issue of paper money is the worst kind of a compulsory loan, that it worsens the conditions principally of the workers, of the poorest section of the population, that it is the chief evil in the financial confusion.
>
> * * * * * * *
>
> There is no other way of earnestly fighting the financial disorganization and the inevitable financial collapse than a revolutionary rupture with the interests of capital and organization of really democratic control, i. e., control "from below," control of the workers and the poorest peasants over the capitalists—that way which all our preceding analysis deals with.
>
> The unlimited issue of paper money encourages speculation, allows the capitalists to make millions, and places tremendous obstacles in the path of the much-needed expansion of production; for the dearth of materials, machines, etc., grows and progresses by leaps and bounds. How can matters be improved when the riches acquired by the rich through speculation are being concealed?
>
> An income tax with progressive and very high rates for large and extra-large incomes, may be introduced. Our Government, following the other imperialist

[1] Collected Works, vol. XVIII, New York 1930, pp. 279-280.

governments, has introduced this tax. But to a considerable extent it remains a fiction, a dead letter, for, in the first place, the value of money is sinking faster and faster; secondly, the concealment of incomes is the more general the more their source is speculation and the more the preservation of commercial secrets is safeguarded.

To make the tax real and not fictitious, real control and not one on paper is required. Control over the capitalists, however, is impossible if it remains bureaucratic, for the bureaucracy itself is connected and intertwined with the bourgeoisie by thousands of threads. This is why in the Western European imperialist states, whether monarchies or republics, financial stability is achieved only at the price of introducing "labor duty" which creates for the workers military penal labor or military slavery.

Reactionary bureaucratic control—this is the only means known to the imperialist states, the democratic republics of France and America not excluded; this is how they shift the burdens of the war onto the proletariat and the laboring masses in general.

* * * * * * *

In nationalizing the banks, in making the circulation of checks compulsory by law for all the rich, in abolishing commercial secrets, in introducing the confiscation of property for concealing incomes, etc., the workers and peasants, organized in unions, could most easily render control both effective and universal, i. e., control over the rich, control which would return to the treasury the paper money issued by it, by taking it away from those who have it, from those who conceal it.

For this purpose a revolutionary dictatorship of the democracy headed by the revolutionary proletariat is necessary, i. e., for this purpose democracy must become revolutionary in deeds.[2]

Later Soviet authors (for instance M. Ioelson in the War of Currencies [Moscow, 1935] and the contributor of the article on inflation to the Great Soviet Encyclopedia) pointed out that inflation means in the beginning only an "impressive redistribution of national income to the benefit of the ruling classes" and "pilferage of the workers" but that in the end it hits the bourgeoisie as well since it favors the debtors to the disadvantage of the creditors and leads to economic instability, to complete disorganization of economic life and to chaotic conditions in the capitalistic countries.

Thus inflation is regarded by the Communists both as a symptom of an economic crisis and of a progressive decay of the capitalist system and as a welcome ally in the struggle waged by them against the democratic camp. No amount of regulation, asserts a 1950 publication of the Institute of Economics of the U. S. S. R. Academy of Sciences on the Aggressive Ideology and Policy of American Imperialism, can effectively control inflation and combat the crisis of overproduction. The spread of inflation in the United States after World War II—insists Moscow—has already produced a radical decline in the real wages of the American workers, has lowered the purchasing power of the American masses and has sharpened the conflict between production on one side and consumption on the other.

The Communists see eye to eye with those speculators in the United States who by word and deed are encouraging a "flight from the dollar." They too point out that savers are "suckers" to buy or hold E bonds if at the end of the 10-year period they find their principal reduced in buying power by an intervening inflationary price rise. It is equally unreasonable to expect that, having saved, they will invest their savings in the securities of private enterprises, if they are to see their savings disappear, as did so many in the last great depression, in the bankruptcy of enterprises swept down in the agony of severe deflation. On the one hand, there is the spectre of inflation

[2] Collected Works, vol. XXI, New York 1932, pp. 206-208.

discouraging private savings; on the other, there is the spectre of a destructive deflation discouraging the investment of savings in private enterprises. Taken together, according to the Communists, they mean the ultimate death of private enterprise itself.

Some Historical Examples of the Relation Between Monetary Instability and Subversive Activities

Given this connection between monetary instability and the undermining of our economic system, it is quite easy to understand Keynes' further statement of 1919: that the inflationary policies which the belligerent governments of the First World War had pursued "from necessity or incompetence" were such as to produce the effects of "what a Bolshevist might have done from design"; and that, by permitting the occurrence of these developments and of the political recriminations which grew out of them, these governments were merely "carrying a step further the fatal process which the subtle mind of Lenin had "consciously conceived."

In 1919, however, the Russian Communist Government had been in power only a bare 2 years; it was not even regarded as certain to survive, to say nothing of its being destined to become a center of activity designed to subvert the economic and political institutions of the Western World. By 1945, on the other hand, Communist Russia had become a military power of the first rank; and its actions in the years following 1945 were such as to leave no doubt of its determination to use both its military power and its Communist Party connections in other countries to spread its own economic and political system to the rest of the world.

These postwar years, moreover, were characterized by economic and political disturbances of precisely the kind which provide the most favorable environment for the activity of elements bent upon subverting the established order. In particular, they were years in which, as a result of the financial disorders created by the war, a large part of the world was confronted by a choice between striving to reestablish monetary stability, on the one hand, and encouraging or permitting monetary developments, on the other, of the kind which, according to the judgment attributed to Lenin, represent "the best way to destroy the capitalist system."

As will be seen presently in the discussion to be devoted to particular countries, the actual tactics pursued by the Russians or their agents in the work of subversion varied from case to case, depending upon the relation of each to the government in power in the particular country involved. Thus, when (as in postwar Austria) the Russians were neither in undisputed military control of the country nor in a position to determine directly the composition of the government of the country, they attempted to ruin the currency in order to discredit the non-Communist government then in power. When, on the other hand (as in Eastern Germany), the Russians were both in undisputed military control and in a position to put into power a government of their own choosing, they pursued policies generally aimed at the maintenance of monetary stability. In intermediate cases, where (as in postwar Hungary and Rumania) they were from the outset in undisputed military control, but had not yet succeeded in imposing a government completely subservient to them, they adapted their

policies accordingly: the destruction of the currency was effected while the non-Communist government was in power, but, once it was certain that a fully Communist regime would be installed, the Russians and their Communist instruments supported a policy of monetary stability.

A different tactical problem was posed for the Russians and their Communist instruments in those countries in which, during the post-war period, the Russians were not in military control, and in which the local Communists had not succeeded in seizing control of the government. Here (Italy and France are examples in Europe and China is an example in Asia), it was a question of taking advantage of the effects of policies, pursued by non-Communist governments "from necessity or incompetence," which, if allowed to continue, would accomplish, so far as the encouragement of subversion is concerned, "what a Bolshevist might have done from design."

AUSTRIA

By the Moscow Declaration of 1943, issued jointly by the United States, the United Kingdom, and the U. S. S. R., it was agreed that Austria was to be reestablished as an independent state. By a series of subsequent decisions, it was further agreed that there would be a joint military occupation of Austria, in which the troops of the three governments named, plus the French, would participate on the basis of respective zones of occupation; and it was agreed that a four-power Allied Council would supervise the activities of an Austrian Government constituted on the basis of free elections to be held at the earliest possible moment after the conclusion of hostilities.

It was clear, therefore, that the Russians would be in full military control of only a fraction of a country which was itself so small, and of such an economic structure, that its split-up into hermetically-sealed Russian and non-Russian zones would present neither the appeal nor the practicability of the kind of split-up that occurred in Germany. It was also clear that the Russians would not be able to use their military power or other direct instruments to bring about the type of sham election which would be bound to return an Austrian Government of the Soviet's choosing. The Russians' hopes for obtaining a government subservient to Soviet desires rested, therefore, on the creation of conditions which would arouse such resentment against a non-Communist Austrian Government or the non-Communist occupying powers as to play into the hands of the Austrian Communists and their Russian sponsors. The debauch of a currency issued by the occupying powers jointly or by a non-Communist Austrian Government would have served this purpose perfectly.

From the very beginning of the planning of the financial aspects of the occupation of Austria, the Soviets, despite repeated invitations from the United States and the United Kingdom, refused categorically to participate in such planning. In retrospect, it is easy to see why: Participation in the planning would have meant the taking of commitments which would have limited their own freedom of action. The result, in any event, was that the planning went ahead without Soviet participation, although the Soviets were kept fully informed as to the details of this planning.

From the standpoint of currency policy, the western planners made two major decisions. First, in recognition of the Moscow declaration's insistence on the reestablishment of Austria as an independent state, the military currency used in Austria was to be different from the military currency used in Germany. Secondly, the monetary separation of Austria from Germany was to be accomplished by a conversion of the currency then circulating in Austria—the German reichsmark—into a distinctive Austrian currency; and, since there was no certainty that the Austrians themselves would be able to produce such a currency in time, there would be first a conversion into the Austrian military currency, which was therefore to be printed in amounts sufficient to take care, not merely of the needs of the occupying powers, but also of the conversion of the whole of the circulating currency.

These conclusions were at once communicated to the Soviet Government, with a request to indicate whether the Soviets would be prepared to use the same military currency as the Western Allies and, if so, what amounts of such currency they desired. The Soviet reply was that they would use the currency, and that they wished to have one-third of the amount that was to be printed. In terms of the relative size and population of the projected Soviet zone, this was not an unreasonable request, *if it could be assumed that the "one-third" thus requested would be used as it was to be used in the non-Soviet zones of occupation: that is, chiefly for the purpose of effecting a currency conversion.* Otherwise, the disbursement of currency to this amount would be simply *added* to the already excessive currency supply that had increased so greatly under the German occupation.

In acceding to the Soviet request for one-third of the printed stock of military schillings, therefore, the Western Allies emphasized their understanding that all four of the occupying powers would use their respective shares of the stock of military currency to effect the planned currency conversion. To this, the Soviets made no reply whatever. The reason for their failure to reply on this point became clear when, a very few months after the cessation of hostilities, and before the Allied Commission was set up in Vienna, they informed the Western Allies that they were reaching the limit of their supply of military currency, and demanded a huge additional amount, to be delivered immediately.

This action confronted the Western Allies with a very serious dilemma. If they acceded without question to the new Soviet demand, the way would be left open for further demands of the same kind, and therefore for the speedy destruction of the new currency with which the Allies proposed to endow newly liberated Austria. If, however, they refused flatly to supply any additional currency, they ran the risk of destroying all possibility of an effective working of the experiment in cooperation with the Soviets which the proposed Allied Council for Austria was designed to represent. They therefore compromised: the Soviets were to have additional currency, but not as much as had been requested; the additional currency to be given to the Soviets was to come from additional printings, out of which the other Allies would also receive additional pro rata shares; and again the Western Allies stated, with all possible emphasis, their understanding that the currency was being given on the condition that the major part of it would be used for the proposed currency conversion, and not for additional expenditures by the occupying powers.

Again the Russians gave no assurance that the currency would be used to effect a conversion. There was all the more reason, therefore, for the Western Allies to press for an agreement on the date and the terms of such a conversion. An agreement was in fact obtained, the date for the conversion being set for the middle of October 1945. Then, when not only the technical details of the proposed conversion were regarded as completely settled, but the currency to be used for the conversion was actually in the process of distribution to the remoter parts of Austria, the Russians blandly announced that they had no intention of permitting the currency conversion to which they had solemnly agreed.

The reason given by the Russians for their sudden change of front was that the provisional Austrian Government was about to be recognized by all four powers, and that therefore it would be improper to effect a conversion of the existing currency into a *military* currency. The conversion must wait, they insisted, until the Austrians would have printed a "national" currency of their own. The hollowness of this pretext was immediately exposed by a letter from Chancellor Renner, the head of the provisional Austrian Government, who insisted that, regardless of plans for a subsequent conversion into a "national" currency, the Austrian Government urgently desired the conversion into military currency to proceed as planned.

The real reasons behind the Soviet change of front were, of course, clear. The Russians had gone along with the use of the Allied military currency as long as they were able to obtain huge quantities of it by allowing the Western Allies to believe that the Russians, like the Western Allies, intended to use it for the purposes of currency conversion. Under great pressure from the Western Allies, they had agreed to currency conversion in order to be able to obtain and dispose of a second large allotment. But now it was clear that the dodge could not be used again: the Russians had discovered a toughness in the western authorities which made it clear that they could not count on obtaining military currency in quantities which would destroy it in a matter of months. It would be different, they calculated, if they had only the Austrians to deal with: then they would be able to come to the Austrians and demand quantities of currency large enough to ruin the new "national" currency in short order.

The Austrians had, in fact, been printing a new currency ever since the end of hostilities in May 1945. The Russians urged them to speed up the printing—if necessary, by printing the currency in very large denominations. It became clear that, by December of 1945, there would be enough to affect a conversion into the new "national" currency. The Western Allies, in full awareness that the future of the Austrian currency would depend on the degree of courage shown by the Austrians in resisting Soviet demands, agreed to set a date in December 1945 for a conversion into the "national" currency. They did so, however, only on the condition that all decisions on the amount of currency to be given to any one of the occupying powers for the purpose of meeting occupation costs would be made by *unanimous vote of the four occupying powers.*

To this crucial condition the Russians objected strenuously; but in the end they acquiesced. The reason for their acquiescence became clear only 3 weeks after the currency conversion, when Russian Army officers appeared at the Austrian National Bank and,

with no reference to the agreement which the Soviet representatives had solemnly accepted only a few weeks previously, peremptorily demanded several hundreds of millions of additional currency for their own use. The Austrians knew of the agreement requiring unanimity on the part of the four occupying powers; they therefore immediately informed the other powers of the Russians' demand.

Letters were dispatched from the other three military commanders forbidding the Austrians to pay out currency until the required unanimous agreement was reached. The Russians stormed and threatened; but the Austrians and the Western Allies stood firm. It was this firmness that preserved Austria from the currency debauchment suffered by countries, such as Hungary, where the Western Allies were not in a position to support effectively the courage of local governments which the Soviets and their Communist agents were determined to subvert.

EASTERN GERMANY

Since the Potsdam agreement put an end to a native German government, the Soviet occupation forces were sovereign in Eastern Germany, in form as well as in substance, up to the time of the establishment of the puppet "democratic republic" in response to the restoration of a considerable degree of sovereignty to Western Germany by the Western Powers. In consequence, the financial history of Eastern Germany does not show the violent inflation characteristic of those satellites that preserved some independence during the first years of Soviet occupation.

By the end of the war, money circulation in all of Germany amounted to about 73 billion reichsmarks of currency, 100 billion of demand deposits, and 125 billion of savings deposits. At least one-fourth of that amount was in circulation in the Soviet zone, including eastern Berlin. The Soviet occupation forces issued an estimated 10 billion marks of occupation money; while this amount was three times as large as the sum issued by all the Western Powers together, it was hardly more than half of the amount of old currency in actual circulation in the zone, and the addition was far more than compensated by the blocking of west bank deposits. The resulting degree of inflation in the Soviet zone was therefore not appreciably greater than that in the western zones.

Moreover, the currency reform of June 1948 was similar to that inaugurated by the Western Powers: like the western reform, it provided for a conversion of 10 old into 1 new mark; the main difference—apart from a slightly better treatment of small savers—concerned the money holdings of public agencies, which were converted at par. In consequence, the per capita money volume was much less reduced than in the west, and this fact may account in part for the depreciation of the Eastern German currency in relation to the western mark. However, since the conversion the volume of money in Eastern Germany seems to have remained relatively stable: there has been nothing resembling the hyperinflation which occurred in areas under governments which the Soviets or their agents wished to subvert.

HUNGARY

The destruction of the Hungarian currency was one of the greatest inflationary catastrophes in economic history. The Soviet authorities had a particular interest in destroying the Hungarian economy because in November 1945, in the only free election held after the war in a Soviet-dominated country, the people had overwhelmingly repudiated the Communist Party and its fellow travelers. But even before that time, in June 1945, the Communist members of the coalition government that ruled the country had defeated a currency reform proposal of the non-Communist Finance Minister, Vasary, which—if accepted and properly executed—might have averted the ensuing financial disaster. The Soviet occupation authorities not only pressed their usual excessive demands for reparation payments and occupation costs, but also continuously interfered with the activities of the central bank, thereby making any effective anti-inflationary action impossible. According to official accounts, about 40 percent of all government expenditures went to the Soviet authorities; in reality, the fraction was very much larger, since the huge expenditures of state enterprises and municipalities for the Soviet authorities were not included in that percentage.

In consequence, the government budget showed an increasingly large deficit, which was covered by the issue of notes. Note circulation rose from 11 billion pengö in November 1944 to the unprecedented figure of 76 septillion (millions of millions of millions of millions) on July 15, 1946. An effort to introduce a "tax pengö" of stable purchasing power failed completely; the ordinary pengö depreciated rapidly in terms of tax pengös, but the tax pengö depreciated equally rapidly in terms of foreign exchange and purchasing power. By the end of July, one tax pengö was equal to 2 sextillion ordinary pengös, but $1 was equal to more than 2 billion tax pengös.

Under these circumstances, the domestic currency—both ordinary and tax pengös—ceased to perform the functions of money. It was then that the Communist Party, under the guidance of the Hungarian-born, but Moscow-trained, economist, Eugene Varga, submitted a stabilization plan, which was immediately accepted and went into effect on August 1, 1946. A new currency, the forint, was established at a conversion rate of 200 million tax pengö or 400 octillion ordinary pengo per forint. This rate virtually wiped out the entire existing stock of currency, bank deposits, and other domestic claims. At the same time, the Soviet authorities made possible the stabilization of government finance by some concessions on reparation payments, while the United States agreed to restore to Hungary the gold stock of the central bank, which had been captured in Germany, and to open a line of credit for the purchase of war surplus.

As soon as it became apparent that the stabilization, for which the Communists could now claim credit, had been a success, the Communists dropped all pretense of collaboration with the non-Communist parties. Exactly 10 months after the currency conversion, on June 1, 1947, the Communists forced the non-Communist prime minister, Ferencz Nagy, to resign and from that time on Hungary must be regarded as a Soviet satellite.

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RUMANIA

As long as the country was under a coalition government not entirely free from western influence and sympathy, the Soviet occupation forces, by their usual demands for reparations and "occupation costs," produced such a disequilibrium in the government budget that the note circulation rose from 357 billion lei at the end of 1944 to 48,452 billion at the middle of August 1947. Prices rose in the same period by about 14,600 percent. Bank deposits rose at about the same rate as the currency circulation, from 41 billion lei at the end of 1944 to 4,853 billion at the end of July 1947. In contrast, government receipts rose by only about 2,000 percent, and the great bulk of government expenditures was covered by the printing press.

In 1946–47, the economy was being completely subjected to the influence of the party: the central bank was nationalized on December 28, 1946; private credit was "controlled" on July 15, 1947; all industry was "coordinated" on June 10, 1947; and a plan for the "equitable distribution and utilization of production," i. e., totalitarian economic planning, was introduced on July 12, 1947.

The time was therefore ripe for the Communist Party to put a stabilization program into effect. The program was announced on June 14, and went into effect on August 15, 1947; the sponsor was the Communist Minister of Industry and Trade, G. Sheorghiu-Dej, who presented the program officially in the name of the Communist Party. The program provided for the issue of 1 new lei for 20,000 old lei; at the same time, however, it strictly limited the amount that could be exchanged by any one holder so that 43 percent of all currency was excluded from the conversion. Not more than 1.4 billion new lei were thus paid to old holders, plus 1.5 billion paid to holders of gold and foreign exchange who were required to surrender their holdings to the Government. At the same time, however, the Government issued large quantities of notes to its own agencies so that by the end of the year the note circulation had reached 24.5 billion new lei. By that time, only about 12 percent of the country's liquid assets were in the possession of those who before the currency reform had held all of them. The destruction of all private savings, especially of the middle classes, and thus of the basis of an individualistic economy, had been successfully executed.

When this was done, it became unnecessary for the Communists to maintain even the semblance of a coalition government. In December 1947, the king was forced to resign, and from that time on Rumania has joined the ranks of the people's democratic satellites.

FRANCE AND ITALY

Although postwar monetary developments in Central Europe provide the most instructive examples of Communist strategy in the European area, the recent economic history of two pivotal Western European countries, France and Italy, also lends itself to some relevant comments.

It certainly is not a mere coincidence that the countries which harbor the two strongest Communist parties outside the iron curtain are at the same time those that have been subjected to the most violent postwar inflations, with prices rising to 55 and 19 times their

prewar level in Italy and France, respectively. See table XIII. This is not to imply that the inflation was actually engineered by the Communists. Rapid open inflation was well under way in both countries at the time of liberation. The large liquid assets in the hands of the public as the result of occupation expenditures, combined with the breakdown of administrative and fiscal controls in the wake of war and liberation, rendered almost inescapable some further inflation during the immediate postwar period. The need for vigorous anti-inflationary policies was widely ignored: Both countries failed to enact timely currency reforms on, e. g., the Belgian model, and in both the belief was widespread that an increase in production would of itself be sufficient to halt the rise in prices.

TABLE XIII.—*Index numbers of wholesale prices in selected countries*

	Austria [1] (March 1938=100)[2] (basic materials) [3]	France [1] (1938=100) (general index)	Italy [1] (1937=100) (general index)	China [4] (January-June 1937=100) (general index)
1937			100	[5] 100
1938	100	100	107	[5] 122
1939	98	105	112	[5] 216
1941	104	171	145	[5] 1,640
1944	104	265	918	[5] 44,789
1945	[6] 104	375	2,203	(7)
1946		648	3,084	(7)
1947	[8] 446	989	5,518	(7)
1948	469	1,712	5,821	(7)
1949	616	1,917	5,528	(7)

[1] Source: Monthly Bulletin of Statistics, Statistical Office of the United Nations, December 1950, vol. IV, No. 12, table No. 58.
[2] Base: March 1938=100. Beginning October 1947 the index shows the ratio of current schilling prices to reichsmark prices in March 1938.
[3] Food, farm products, and industrial raw materials.
[4] Source: China's Economic Stabilization and Reconstruction, D. K. Lieu, Rutgers University Press, New Brunswick, pp. 88, 89.
[5] Figure is for July of each year except for 1944 for which the figure applies to June of that year.
[6] July.
[7] Indexes not carried beyond June 1944 as the postwar indexes are not strictly comparable. See table XIV for postwar China prices.
[8] October–December.

Although, therefore, postwar inflations in France and Italy need hardly be explained in terms of a Communist master plan, there is little doubt that the economic distress and social injustices and tensions created by inflation were of considerable help in gaining mass support for the Communist parties. Moreover, it is quite likely that the Communist parties recognized the advantage they stood to gain from continuing inflation. As members of the postwar coalition cabinets, their ministers advocated the most demagogic economic policies. It is also highly significant that consistent and decisive anti-inflationary policies became possible in both France and Italy only after the Communist ministers had been dropped from the respective cabinets in the spring of 1947. The Italian inflation was broken in the fall of 1947 mainly as a result of the stern credit restrictions ordered by Signor Einaudi, then Minister of the Budget. In France, inflation was considerably slowed down by bold fiscal measures taken by Finance Minister Rene Meyer at the end of 1947 and was finally brought under control by the additional taxes and entirely new restrictive measures in the field of bank credit imposed by the Queuille Cabinet.

Naturally, other factors contributed to the stabilization—the most important being the aid given by the United States under the Euro-

pean recovery program; but the degree of stabilization attained in both countries would have been impossible without the firm internal measures which were opposed by the Communists in each instance. In both countries, the Communist parties realized that their chances for seizing power would diminish with the success of economic stabilization. In France they attempted to disrupt the process of economic recovery and stabilization by the two insurrectionary strike movements of 1947 and 1948. In Italy they concentrated their principal effort on seizure of power through the legal avenue of elections. But the forceful actions of the French Government broke the Communist-led strikes and the Italian voters defeated Communist ambitions at the polls in 1948. In both countries, the weight of responsible opinion supports the belief that the greatest single factor which could revive Communist influence would be a resurgence of the extreme open inflation that characterized the period during which, in both countries, the local Communist parties reached their position of maximum strength.

CHINA

The 1937–49 inflation in China had two phases: the wartime phase and the postwar phase. From 1937, when the Japanese commenced military operations in North China, to August 1945, when East China was regained by the Nationalist Government, prices rose about 500-fold. See table XIII. This represented the accumulation, year by year, of price increases that averaged something more than a doubling per year. An inflation that proceeded at this rate seriously complicated the problems of the Nationalist Government, but it was not catastrophic. The rural economy of wartime free China seemed able to adjust itself to this inflation and to avoid a breakdown.

The second phase started with an acceleration of the rate of price increases. From August 1945 to August 1946 prices rose about five-fold (see table XIV) and this rate continued for about another year, so that in the late summer of 1947 prices were roughly 60 times as high as in August 1945. From 1947 on, the rate of inflation became more and more rapid. By August 1948, when an effort was made to halt the inflation by introducing a new form of currency, prices were 150 times what they had been 12 months before, or about 10,000 times as high as in 1945, and 5,000,000 times the 1937 level.[3] The truly astronomical inflation that followed in 1948–49 can be measured only by comparing the official exchange rates established against the United States dollar, first for the new gold yuan on August 19, 1948 (GY4=US$1) and then for the new silver yuan on July 2, 1949 (GY500,000,000=SY1; SY1.55=US$1), showing a depreciation in less than 11 months by a factor of nearly 200,000,000.

What made the postwar inflation more uncontrollable and at the same time magnified its disruptive effects upon the economy and the political structure was the fact that after the war the center of power of the Chinese Government shifted back to the coastal cities, with their modern industry and banking and their foreign trade. Both during and after the war, the inflation was generated by note issues to finance budgetary deficits. During the war, when the main source of taxable production was agriculture, land taxes could be and were

[3] All these comparisons are to be regarded as approximate. Price movements were not uniform from one region to another, nor among commodities, and there were erratic month-to-month variations.

collected in kind. Nevertheless, only 20 to 30 percent of National Government expenditures were covered by revenue in the years from 1940 to 1944. The budgetary problem became more difficult after the war, when a larger proportion of the potential revenue had to be realized through the money economy. In 1946 and 1947, the Chinese Government depended heavily on the liquidation of real estate and commodities taken over from the Japanese and of surplus stocks transferred by the United States Government, as well as on imports of foreign commodities paid for out of gold and dollar reserves; afterward these sources covered a decreasing percentage, and note issue became the predominant means for financing the ever-expanding expenditures. When prices were doubling every few months (and later even more rapidly), the adjustment of tax rates and public utility charges became exceedingly difficult, and the revenue that was collected depreciated before it could be spent. While in various ways the acceleration of the inflation was thus associated with the broadened scope of the money economy after the war, the inflation itself increasingly caused a deterioration in China's productive capacity and morale.

TABLE XIV.— *Wholesale prices in China*

Period	Total CN$ outstanding (in billion CN$) [1]	Index of prices (December 1945=100) [1]
December 1945	975	100
January 1946	1,100	105
February 1946	1,230	198
March 1946	1,359	289
April 1946	1,528	292
May 1946	1,674	430
June 1946	2,113	420
July 1946	2,167	460
August 1946	2,376	483
September 1946	2,677	572
October 1946	2,900	604
November 1946	3,296	601
December 1946	3,726	647
January 1947	4,510	840

[1] Average for the period.

Source: Paper, The Trend of Inflation in China: 1946–47, OIR Report No. 4331, Mar. 18, 1947, Division of Research for Far East, Office of Intelligence Research, Department of State.

EFFECTS OF INFLATION ON THE PRIVATE ENTERPRISE SYSTEM

The Chinese inflation was typically a currency inflation, and the increase in resources of banks lagged far behind the expansion of note issue and the internal depreciation of the currency. This resulted in a serious exhaustion of the banking resources of the country and in the inability of financial institutions to maintain legitimate financing for productive activities. As inflation advanced, the Chinese banks found themselves deprived of savings and time deposits, and they reacted to this loss by liquidation of long-term investments and by adjusting themselves to short-term operations at very high interest rates. These trends were particularly evident among private banks and less among government banks, which could always depend on advances from the central bank. The process of inflation thus exhausted the capital and deposit of private banks and placed them at a distinct disadvantage as compared with government banks. The

result was that whereas government economic activities continued to receive financial support, private activities were deprived of their normal and legitimate sources of financing—with bankruptcy or speculation as the outcome.

Industrial enterprises typically made high paper profits, but since the calculation of replacement values was difficult if not impossible there was a constant tendency for fixed and working capital to run down in real value.

In dealing with foreign trade, the authorities permitted imports of raw materials and other goods regarded as essential to be made with foreign exchange purchased from official reserves at exchange rates which were not kept closely adjusted to the depreciation of the currency as measured by price indexes or by the black market exchange rates. This policy may have helped to hold back the inflation of industrial producers' costs, but it also had the unfortunate effect of hampering China's exports, which are largely agricultural, and other crude materials. Exporters converting their proceeds through official channels obtained a smaller return in Chinese currency than they could realize through sales of exchange in the black market. Sales of exchange in the black market served to finance a flight of capital.

Intermittent efforts by the Government to halt the inflation through direct controls or prices of commodities or of gold and foreign exchange resulted in the end in an acceleration of the loss of confidence in the currency, and much resentment was caused by such actions as the forced surrender at fixed prices of private gold and foreign exchange holdings in August 1948.

Effects of Inflation on Government Machinery

Inflation exerted its most disruptive effects on the machinery of the Chinese Government. The fact that bureaucrats could not support themselves on their pay, whereas commercial and speculative activities provided attractive possibilities, made a Government appointment a stepping stone toward outside positions. As a consequence, the allegiance of bureaucrats tended to be transferred from the Government to outside groups, and the morale of the public service deteriorated generally. Traditional features of Chinese bureaucracy (such as use of public funds for private purposes) which, limited in the past, did not have serious effects, became so widespread as to cause a breakdown in ordinary administration and to threaten the security of the state itself. For instance, not only did tax collectors tend to delay the transfer of collected funds to the Treasury, but Army disbursing officers often drew out advance funds from the Treasury; and in both groups there were cases where such funds were used in the interim for speculative operations in commodities, gold, and foreign exchange. Such practices accelerated the inflation of prices, which became almost a self-generating process as it led automatically to a higher value of government expenditures and a corresponding growth of the note issue.

The diversity of currencies in the various Communist-controlled areas before 1949 defies any general conclusion, but the fact that their bases were in rural areas, where development of a money economy was retarded, appears to have had a limiting effect upon the inflationary

process, as had been the case for the Nationalist Government during the war. The communists appear to have been keenly aware of the danger that inflation might undermine their economic and political position, and as Communist troops advanced and larger areas were taken under their control, they followed almost ruthlessly a policy of meeting their requirements, so far as possible, by taxation or confiscation rather than by printing currency. As they took over the modern sectors of the Chinese economy, they made special efforts to insure that supplies of basic consumption commodities in the cities would meet the demands. By the spring of 1950 inflation both of money and of prices was apparently brought to an end, although there is evidence that the involvement of Chinese Communist forces in Korea has created new inflationary pressures in China in recent months.

The example of China seems to suggest that inflation was a serious contributing element to the fall of the Kuomintang on the Chinese mainland. One of China's leading economists after a careful survey of the problem came to the conclusion that—

> * * * It is beyond the power of the Chinese nation or the Chinese Government at present to stop either the civil war or the inflation. Chaotic economic conditions are favorable to the Communists, and the longer the war drags on, the stronger their position will be. In fact, they are capitalizing on the social unrest which arises from such economic instability, and can play a waiting game. No terms short of complete capitulation on the part of the Government will now be acceptable to them * * *.[4]

In short, in substantial part, due to inflation, not only did free private enterprise disappear but individual freedom and democratic government. Despite drastic direct controls (e. g., scores of price-ceiling violators and the like were beheaded), despite extremely high interest rates, and despite generous assistance from abroad, hyper-inflation continued to undermine the Chinese economy from within until the people themselves threw overboard the regime that had heroically kept millions of Japanese soldiers at bay for a decade. In addition they repudiated a spiritual and political leader of most ancient and eminent lineage and world renown. The basic economic reason was internal. The blame cannot be shifted to "foreign devils." It lay directly on the Chinese that tolerated a go-easy "too little and too late" procedure with respect to taxes, Government expenditures, and monetary controls. By timid, procrastinating and ineffectual fiscal, budgetary and credit policies Chinese business and governmental leaders, whether through inaction or ignorance, themselves unleashed the evil genie of uncontrollable inflation, themselves destroyed whatever full enterprise and democracy existed, and became the foremost architects, in fact, of Chinese communism.

[4] D. K. Lieu, China's Economic Stabilization and Reconstruction, Rutgers University Press, New Brunswick, N. J., 1947, p. 131.

APPENDIX A

Summary of Recommendations of Witnesses Appearing During Committee Hearings January 22, 24, 25, 26, 29, 31, and February 2, 1951, on the January 1951 Economic Report of the President

GENERAL RECOMMENDATIONS

There was general agreement with the basic recommendations first stated in the hearings by the Council of Economic Advisers that all programs and policies, whether of taxation, Government expenditures, price and wage controls, allocations, or forced savings, should be considered as parts of an over-all interrelated body of instruments aimed at carrying out certain definite goals of national policy. First priority should, therefore, be given to answering such questions as "What are the goals?" "How do they relate to each other as to size and magnitude?" (See testimony of Leon H. Keyserling, Chairman, Council of Economic Advisers, January 22, 1951, hearings.)

There was, further, consistent emphasis throughout the hearings that no one of the recommended policies or courses of action would in itself solve the problems facing the Nation, particularly the problem of inflation. The various controls and programs will have to be interrelated and designed to fit together with each program or policy doing its part of the job of mobilizing resources to promote national security and stabilizing the price level. In connection with this recommendation of emphasis on over-all programing, there was general agreement that the No. 1 problem is that of satisfying military or security requirements. Next in order of importance is that of promoting an increase in production and productivity so as to expand the supply of goods and services out of which the competing claims of consumers, business, and government can be satisfied. Finally, there is a crucial problem of preventing an inflation which would have disastrous effects to the economy, thus defeating the first two programs.

FEDERAL BUDGET

Expenditures

All witnesses placed considerable emphasis on fiscal policy in connection with both the division of resources from consumers and business to defense purposes, and the control of inflation. There was widespread emphasis by the witnesses on the need for the maximum economy possible in governmental expenditures, particularly in nonessential programs. Almost without exception this was emphasized, both by witnesses from the executive branch and by economists participating in the committee roundtables. In no case were recommendations made as to specific items that could be reduced but some witnesses (see particularly testimony of Professor Musgrave, January 31, 1951, hearings) suggested that no new programs should be inaugurated and that existing civilian programs should be reconsidered in the light of the emergency to see if some of them could not be eliminated

or reduced. Professor Spahr suggested an elimination of Government lending programs and Government assistance programs whose functions could be taken over by private lending institutions or by private or local charities. Most of the witnesses did not expect any great cut in the budget as a result of such reductions except where these reductions are more or less automatic, such as unemployment insurance where expenditures go down as employment goes up. It was generally suggested that probably not more than a billion or two could be saved but that even this was vital. Professor Smithies made the suggestion that Congress should give the military requests strict scrutiny and there seemed to be some other concurrence in this view. Marriner S. Eccles even suggested in his testimony that the military budget should have a ceiling placed on it, if at all possible, of about $50 billion, including foreign aid as well as domestic military programs.

Taxation

Every witness before the committee emphasized that the defense mobilization could not be carried through successfully nor could inflation be held in check unless there was an immediate and heavy increase in Federal taxes. It was emphasized that the success of direct controls as well as monetary measures was dependent upon a heavy tax program. In general, though not unanimously, the position of the witnesses can be summarized by the phrase, "Pay-as-we-go." The Council in its recommendation seemed to imply, as did some of the witnesses, a balancing of the conventional budget rather than the consolidated cash budget. There was general agreement that tax policy should be designed with a view to its economic effects upon diversion of resources and the control of inflation as well as the requirements for balancing the budget. The programs suggested generally seemed to be designed to close the inflationary gap and to be of a magnitude which would about balance the conventional budget and give the Treasury a cash surplus after taking account of the excess of trust-account receipts over trust-account expenditures.

The one exception to this seems to be V. Lewis Bassie. He placed emphasis on the danger of raising taxes so much in order to control inflation that (1) the burden on many families would become unbearable, and (2) production would be restricted.

Many recommendations were made as to specific changes in taxes that Congress should consider, most of the programs being designed to raise between 15 and 20 billion dollars of additional revenue. Among the suggestions were:

1. Higher capital gains taxes and a lengthening of the period for which those assets must be held in order to come under the capital-gains provision.
2. Some change in the provision of the individual income tax which allows splitting of incomes by married couples for tax purposes.
3. Increases in individual income tax rates, particularly on incomes between $2,000 and $10,000.
4. Elimination of the exemption from Federal income taxes of interest on State and local securities.
5. Higher taxes and better audits of returns covering nonwage income such as dividends, interest, and professional income.

6. A reduction in the personal exemption from $600 to perhaps $500 per capita, with perhaps some additional reduction in the case of families if the income-splitting provision is not eliminated.

7. Cancel the standard deduction and all nonbusiness deductions up to the present standard deduction with only extraordinary amounts of such deductions above the present standard deduction being allowed.

8. Increase excise taxes, particularly on luxury goods, scarce commodities such as consumer durables—automobiles, etc.—and advertising.

9. A general sales tax with specific amounts of exemption per capita which would operate as a tax on expenditures rather than a tax on incomes. An alternative to this was the suggestion that a general sales tax be levied which would differentiate between low and higher price lines with exemptions on the low-price lines and heavy taxes on luxury price lines. For example, low-price clothing might be exempt but luxury lines, such as expensive suits above a certain price, might be subject to a heavy tax.

10. Increase the regular corporate income tax rate.

11. Strengthen the excess profits tax.

12. Reduce exemption for depletion of mineral and other resources.

13. A specific tax of perhaps 15 percent on undistributed profits of corporations with a specific credit for dividends paid to stockholders.

14. A new levy of perhaps 10 percent on unearned income in excess of $500 per capita.

In connection with the tax increase several suggestions were made, particularly by Professor Shere, for a compulsory savings program to be made a part of the program. Professor Shere suggested that, for example, there might be a 3 percent pay roll tax on all pay rolls which would raise about $4 billion and which would be refundable upon death or retirement. This would be worked through the OASI program by broadening its coverage and increasing the rate. If this were not acceptable for technical reasons then the individual income tax could include a provision for earmarking a certain proportion of the increased taxes as a refundable compulsory loan which likewise would be repayable to the individual upon death or retirement.

Practically all other witnesses emphasized, however, that a new compulsory savings program should not be used at the present or proposed levels of the budget as at these levels we should be able to balance the budget through straight increases in the conventional types of taxes. In particular, Professor Goode suggested that forced savings, if used, should be in addition to the suggested tax program to balance the budget and should be worked, as Professor Shere suggested, through social security. Professor Smithies also suggested that compulsory savings would be needed if the budget rises beyond presently foreseeable levels as, for example, in a full war program. Practically all of the witnesses, however, did suggest that the Treasury should make very effort to increase voluntary savings by designing Treasury securities attractive to nonbank investors and by aggressive selling campaigns.

MONETARY POLICIES

There was general agreement that neither direct controls nor tax policy could contain the forces of inflation unless successful use is made of monetary restrictions. This was emphasized by those now in charge of the direct control programs as well as other witnesses. Mr. Marriner Eccles of the Federal Reserve Board recommended that either (*a*) the Board of Governors of the Federal Reserve System be permitted to unpeg the Government bonds and hence force the banks to restrict credit even at the cost of an increase in interest cost to the Government, or else (*b*) that the Board of Governors of the Federal Reserve System be given new powers to replace their traditional open-market operations, including the power to require specific reserves in the form of Government securities for each bank or class of financial institutions.

Economists participating in the round table, including Mr. Lindow of the Irving Trust Co., Dr. Albert Hart, Mr. Foulke, and Dr. Seltzer, emphasized that while the effects on the problems of debt management of removing the peg on Government securities were too severe to be considered at this time, nonetheless some sort of control should be given to the Board of Governors of the Federal Reserve System to restrict volume of money and credit. This could be done through specific reserves to be held in the form of Government securities or some similar device.

Mr. Lindow, as well as others, suggested widening the area within which the Federal Reserve System could exercise selective rather than general credit controls. In other words, Congress might authorize control over various types of credit along the same lines as the present controls over consumer and real-estate credit exercised by the Board of Governors; the Board of Governors should be given the power and responsibility to ration credit just as the Office of Defense Mobilization can ration consumer or business commodities. On the subject of debt management there was wide agreement on the advisability of shifting as much as possible of the Federal debt into the hands of nonbank investors. Mr. Lindow recommended that more use be made of deposit-type securities similar to the present E bonds. Approval was given to the Treasury program for automatic extension of the present savings bonds at maturity at a statutory rate of interest.

One witness, Dr. Spahr, recommended the abolition of irredeemable paper currency, the repeal of the authority of the Board of Governors of the Federal Reserve System to issue notes against Government securities, the repeal of the authority of the Board of Governors of the Federal Reserve System to purchase securities directly from the Treasury, the funding of the debt into long-term securities eligible only for nonbank holders, and the removal of all Government controls over the rate of interest.

DIRECT CONTROLS

The position of practically all of the witnesses on the subject of direct controls is perhaps best summed up by Dr. Galbraith, who was directly concerned with such controls in the last war. In brief, he

suggested that such controls are part, but only part, of the larger strategy of dealing with inflation and the reallocation of resources between consumers, business, and Government. The success of direct controls such as those over prices and wages depends particularly on (1) heavy taxes, (2) economy on nondefense spending, and (3) an increase in voluntary savings. He recommended, and several of the witnesses seemed to agree, that direct controls of wages and prices should concentrate (1) on stabilizing basic living costs, (2) on general wage and price ceilings on the basic core of industries of critical importance, where the labor force is highly organized, such as steel, automobiles, etc., and (3) on ceilings on the prices of raw materials.

Dr. Galbraith, and other witnesses who had experience with controls in the last war, emphasized in their recommendations that we must use the allocation powers set up under the Defense Production Act to allocate raw materials to lower-price lines so as to shift production from luxury and high-price lines of consumer goods to basic lower-price lines important in the cost of living. This is crucial to the success of price control. It was used in Canada and England in the last war but not to any extent here. There was a further recommendation that price ceilings be removed from high-price line merchandise and luxury goods as soon as allocation powers and tight price controls have been set up for basic low-price items crucial to the cost of living for the mass of our citizens.

There was a recommendation from witnesses who had been concerned with these programs in the last war that the Defense Production Act be revised to remove the requirements that in each industry ceilings on prices and wages must be imposed simultaneously. It was pointed out that price controls could be used very successfully on a selective basis if it is not necessary to put on wage controls in the identical industry. Administratively, simultaneous wage and price control for selective industries is impossible so that this requirement of the act in effect makes it necessary to apply wage and price controls to all industries and to all price lines in each industry and all products regardless of whether this is viewed as necessary or desirable. There was further recommendation that the Defense Production Act be revised to allow the Office of Price Stabilization to require quality standards for price controls (see testimony of Dr. Campbell, January 29, 1951, hearings).

On certain essential consumer commodities—the prime example given was meat—it was pointed out that price is essentially demand dominated. Controls over cost have little effect on these products, and, as pointed out by Dr. Heflebower, Dr. Rowe, and others, price controls on these products either do not work or work very poorly. Allocation control may help and should be used whenever possible. It was recommended that subsidies on these items should not be used and, further, that consideration be given to rationing these commodities, perhaps through rationing of the money that each individual could spend on each group of commodities rather than the amount each individual could purchase.

On wage controls it was recommended that no allowance be made for the impact of increased taxes, whether excise or individual income taxes, on take-home pay in setting wage ceilings. Some witnesses urged that adjustments, however, be made in wage ceilings for other changes in consumer prices (see particularly testimony of Professor

Wallace and of Cyrus Ching, Chairman of the Wage Stabilization Board, January 24, 1951, hearings). Mr. Ching recommended the elimination or revision of section 402 (b) (3) of the Defense Production Act. Mr. DiSalle, as well as Professor Ellsworth, recommended that consideration be given to the possibility of a central Government monopoly of the purchasing of imports of critical raw material such as wool, copper, tin, etc. This was intended to reduce the cost of such items, to improve the allocation between essential and non-essential uses, and to aid in the successful operation of domestic price controls.

FOREIGN ECONOMIC PROGRAMS

Professor Ellsworth made a number of specific recommendations in regard to the foreign-aid programs and in relation to control of their inflationary effects. He recommended—

1. Careful scrutiny to see that the Nation gets real value for each foreign aid expenditure.
2. Use of the point 4 program as an economic weapon to counter communistic economic weapons. He felt this would economize on the budget since it would be cheaper than other forms of military or economic weapons.
3. He would remove the present restriction requiring that certain loans or grants to foreign countries be spent in whole or in part within the United States. This would reduce inflationary pressures by shifting part of the expenditures to foreign markets.
4. We should proceed at once to reestablish a Combined Raw Materials Board with a unified purchasing program in world markets for raw materials for ourselves and friendly nations.
5. We should establish at once a United States Government monopoly over the purchase and import into the United States of critical raw materials.
6. We should extend the controls on exports.
7. We should abolish duties on importation of scarce raw materials such as copper, wool, etc.
8. We should lower the tariff on importation of products from friendly nations, thus reducing the need for economic assistance and increasing domestic supplies while reducing inflationary pressures.
9. Eliminate the requirement that ECA shipments be carried to the extent of 50 percent in American bottoms—this would reduce foreign-aid program expenditures.
10. Reduce subsidies to the American merchant fleet so that they are just sufficient for minimum national security purposes.
11. Bring in increased food supplies, particularly beef, from abroad by changing the administration of certain sanitary and other types of restrictions.

APPENDIX B

Summary of Recommendations of Outstanding Organizations of Businessmen, Labor, Farmers, and Consumers

The Joint Committee on the Economic Report, in connection with its hearings on the January 1951 Economic Report of the President, addressed a series of questions on the problem of inflation to various economic interest groups. Excerpts from the replies of these organizations are arranged below under the same subjects used to present the materials in appendix A.[1]

GENERAL RECOMMENDATIONS

* * * main reliance for mobilizing and stabilizing the economy should be placed on (*a*) expansion of production and (*b*) indirect measures to restrain demand.

Under the heading of "Indirect measures to restrain demand" we included curtailment of nonessential Government expenditures, high taxes, tight credit policies, both general and selective, a voluntary savings program, and a debt management policy that would reinforce the credit control and savings programs (Committee for Economic Development).

* * * if we put our minds and backs to it, we can over a series of years go a long way toward eliminating the need for controls by means of more and better production * * * [for example] the editors of Factory estimate that general use of modern equipment would save over 650,000 man-years of unnecessary labor in materials handling. * * *

To have a chance of handling this [inflationary] problem with a tolerable degree of economic, let alone political success it is necessary to bring Government controls designed to stem inflationary forces—a whole battery of them—into play. Otherwise, the inflation would be ruinously violent. Tax controls, credit controls, and controls by allocations and priorities all have a place in the struggle to hold inflation within tolerable limits. And while I am sure that most of those who urge them vastly underrate the enforcement difficulties involved, direct price and wage controls may also have some constructive place, too.

But to have a chance of being tolerably effective the program of controls must, it seems to me, meet two conditions, neither of which is now fulfilled. First, it must be built on a general design which, among other things, relies on slippery and complicated controls only after the more simple and effective controls have been fully exploited. Second, it must be tempered to the probability that we are going to be forced to live in an armory or arsenal state for many years—at least a decade and perhaps much longer (McGraw-Hill Publishing Co.).

A stabilized economy is essential to the success of our mobilization effort. Without it, we would fail to direct an orderly flow of defense and civilian production. * * * We should see annual productivity increases of some 2–3 percent in the years ahead. The experience of World War II showed that the workweek can be lengthened to an average of 45 hours, with overtime pay for work performed bevond the standard hours. The civilian labor force can be expanded through the employment of women and the handicapped (Congress of Industrial Organizations).

In the long run, and in many instances in the intermediate period, shortages are traceable to a large degree to a shortage of manpower. For this reason, every effort should be made to enlarge the labor supply (Chamber of Commerce of the United States).

It is important to recognize, however, that the success or failure of direct controls largely depends on the development of a well-rounded and comprehensive anti-inflation program. An equitable and effective system of taxation, a savings program, control of bank credit, and other anti-inflation measures are indispensable for any effective system of direct controls (American Federation of Labor).

The second major weapon [against inflation] is increasing production * * * perhaps our most important weapon. Lengthening the workweek to 44 or 48 hours at straight time and before overtime is paid, would make a tremendous difference in this direction (Smaller Business Association of New England, Inc.)

[1] The full statements as submitted by these organizations appear in the printed hearings at the end of the verbal testimony.

In a national emergency such as we now face, it is imperative that our total production capacity be increased and balanced to support the task ahead. * * * We believe that a major safeguard against inflation is abundant production (the National Grange).

FEDERAL BUDGET

Expenditures

* * * we should try every possible and equitable means to pay as we go (Congress of Industrial Organizations).

* * * the chamber should encourage realistic endeavors to apply the principle of "pay as we go" (Chamber of Commerce of the United States).

* * * a surplus should be provided in the Federal cash budget in the first half of calendar 1951 and a balance in the second half (Committee for Economic Development).

I have no bill of particulars to offer as to where the nondefense expenditures of the Federal Government can be cut. * * * An aggregate reduction of at least 3 to 5 billion dollars is perfectly possible and should by all means be accomplished (Machinery and Allied Products Institute).

Government economies should come not from cuts in essential services but in the main from savings in procurement. Cost-plus and cost-minus contracts should be eliminated (Consumers Union of the United States, Inc.).

[We recommend] strict Government economy in all departments not materially and directly furthering the defense effort (the National Grange).

Government expenditures not essential to national defense must be reduced to the minimum (National Association of Manufacturers).

* * * it is first absolutely essential to cut out all unnecessary expenditures on the part of the Government in all its departments (Smaller Business Association of New England, Inc.).

Defense spending economies can be effected * * * through extension * * * in advertised bid methods of procurement. In the field of nondefense spending economies can be effected through curtailment or complete elimination of Government subsidy programs to business as well as to agriculture and of so-called social welfare programs (National Federation of Independent Business).

* * * that every effort should be made to establish a balanced Federal budget and to finance the cost of national defense, as far as it is possible to do so, on a "pay as you go" basis. The first step should be to reduce the total amount of Government expenditures below that shown in the proposed budget for fiscal 1952. * * *

Government expenditures for domestic, nondefense purposes, can be cut, and such areas as public welfare and public health, housing and community development, agriculture and stabilization of farm prices, and central services of general Government are suggested as good starting points for reducing the budget. Also, some economies can probably be effected in the Government's outlays for promotion of defense production and economic stabilization, and for economic assistance under the international security program (American Bankers Association, Inc.).

We are committed by resolution to "insist that all nonessential Federal expenditures be eliminated; and that all expenditures be reduced to the minimum necessary for the national interest, essential world aid, and adequate national defense." Specifically, we urge that Congress make a 20-percent reduction in the administrative expenses of the activities of Government, including those in the Department of Agriculture, not directly connected with the national defense (American Farm Bureau Federation).

* * * an important part of the wage earners' standard of living depends on the level of nondefense Government outlays, expenditures for educational and health facilities, school-lunch programs, day-care centers, low-cost housing, low-cost public power, rural electrification for nonurban dwellers. * * * we don't believe these nondefense services can stand cutting. We are heartily supporting an adequate military defense budget. But we note that this has suddenly boomed to $94 billion of new obligational authority requested for fiscal 1952. That includes the proposed $60 billion for military functions. We believe this part of the budget, so quickly put together, deserves rigorous scrutiny to determine whether savings are possible (Brotherhood of Railroad Trainmen).

Taxation

If the defense program remains within the bounds now projected I am unconditionally in favor of paying for it as we go * * * it would be sound policy not only to balance the Federal budget currently, but to overbalance it by a very sizable margin. Such an overbalance would do more to depressurize the economy during this difficult stage than any other single measure (Machinery and Allied Products Institute).

[We recommend] increased taxation to (*a*) finance defense so far as practicable on a pay-as-we-go basis; (*b*) drain off purchasing power in excess of goods and services available to meet demand (The National Grange).

* * * we should try to finance our defense expenditures both actual and proposed so as to maintain a balanced budget and finance the cost of national defense on a "pay as we go" basis.

* * * primary emphasis should be on lowering the personal income tax exemptions from $600 to $500 and raising the rates slightly * * *. All citizens and income earners should share the load * * *. If still more revenue is needed, excise taxes can be increased and the base broadened * * *. Finally, and as a last resort, if even more revenue is needed a general sales tax should be levied across the board, excepting food.

Corporate income taxes tend to be passed on so they tend to feed inflation * * *. Corporate taxes of over 50 percent tend to restrict investment [and] * * * the expansion of production * * * (Smaller Business Association of New England, Inc.).

We believe that the cost of national defense should be financed on a pay-as-you-go basis * * * (*a*) To the extent required to balance the budget, there should be a siphoning off of current savings not required for maintaining or expanding minimum human and plant resources needed for the emergency program; (*b*) the tax program should be designed to cut down the production, distribution, and consumption of dispensable or luxury goods and services. * * * Income, inheritance, corporation, excise, and other taxes should be adjusted to scrape off the fat (Consumers Union of the United States, Inc.).

The total cost of the military program as well as other Government expenditures, must be covered by taxes * * *. Taxes imposed to cover expenditures must curtail spending; not curtail savings and investments * * *. This means that the program must be financed largely through excise or sales taxes with no group being protected from carrying its share of the burden (National Association of Manufacturers).

* * * New taxes should be of the kind that curtail consumer spending by taxing the recipients of income or profits arising from the defense program. While some readjustments in personal income taxes are probably inevitable, increases in these taxes, too, should be made with a view to curtailing consumer spending, rather than merely raising revenue. If the largest volume of revenue is to be raised and excessive purchasing power curtailed, tax increases should be designed to apply principally to the increased income generated by the defense program (American Bankers Association, Inc.).

* * * both corporation and individual income taxes [should] be increased at the end of 1950 to take effect January 1, 1951, and * * * excises [should] be increased during 1951 (Committee for Economic Development).

In real terms—goods and services—there's no getting away from paying as we go. * * * It is good economic theory, too, to solve the inflationary problem presented by military spending with a pay-as-we-go tax policy. * * * Higher taxes at some point destroy incentives. * * * There's no precise way of fixing the point at which taxes undermine incentives. * * * We could probably pay for a $35 billion to $40 billion military program through taxes. But we probably can't pay entirely for a program that runs to $70 billion or more (with another $25 billion of nondefense activities on top of it) (McGraw-Hill Publishing Co.).

As to what taxes we ought to rely on, that depends in part on the prospective need for increased revenues. If we need another $10 billion, we are inclined to think that about 60 percent ought to be raised from excise taxes, 30 percent from personal income taxes, and about 10 percent from the corporate income tax (Chamber of Commerce of the United States).

* * * The remedy for inflation, however, does not lie in preventing the receipt of justified income, but rather in neutralizing its inflationary pressure. The stabilization policy, therefore, should include an adequate and equitable tax policy, a savings program and credit controls, as well as direct price and wage controls and rationing, if necessary. * * * We should enact an equitable tax program, based on the principle of ability to pay. * * * Taxes should bear heaviest on individuals with high incomes and corporations with large profits (Congress of Industrial Organizations).

* * * [we support] the President's program to pay for the current defense expenditures on a pay-as-you-go basis * * * the additional $16 billion of

revenue "must be secured from personal and corporate income taxes because increases in such taxes yield the necessary revenue, would most effectively serve to check inflation, and would be most equitable" (American Federation of Labor).

* * * we favor a "pay as you go" tax program * * * contingent on—(*a*) that the weight of the tax load be not so great as to promote the same inflation as would follow from deficit financing, and, (*b*) that the weight of the tax will be not so great or so inequitably distributed as to destroy small and independent business * * * strongly urge Congress to close the loopholes in present tax law * * * membership has recommended repeatedly that cooperative business enterprises be compelled to pay taxes in the same manner as their unincorporated and corporate enterprise competitors (National Federation of Independent Business).

* * * it is not only impossible to maintain a balanced budget and finance the cost of national defense out of the current revenues but it would be undesirable to do so * * * [because of] the suffering among middle- and low-income groups which will ensue if it is attempted to collect by way of taxes now all of the funds that would be necessary to operate the Government on a "pay as we go" basis * * * additional tax legislation should be directed at eliminating wholly any individual profit on the part of corporations and large business enterprises generally out of war and defense necessities (the National Farmers Union).

* * * we cannot accept the notion * * * that you can look only to the middle and lower income, particularly the lower income groups, for the bulk of the additional $13 billion needed to balance the 1952 budget (cash basis). * * * Consideration also should be given to the impact of additional taxes on production incentive among sorely pressed lower income wage earners. * * *

We recommend that a more extensive sampling and a more careful audit of individual proprietors' returns be made.

Income from dividends and interest should be subjected to withholding taxes the same as wage income. * * *

We are in accord with the President's proposal to raise the regular corporate rate to 55 percent. * * * the base provided for in the excess-profits tax is too high and * * * the ceiling limitation imposed is too low. * * *

* * * Congress and the Treasury were too generous in providing the depletion and depreciation allowances for extractive industries and the accelerated amortization of new facilities. * * *

* * * We are opposed to any kind of a general sales or expenditures tax (Brotherhood of Railroad Trainmen).

The American Farm Bureau Federation definitely is convinced that we must maintain a balanced Federal budget and finance the cost of national defense on a pay-as-we-go basis. * * * Although we are convinced that the Congress can make substantial savings in the President's budget, we recognize the fact that substantially heavier taxes will be required to balance the budget. To this end we are prepared to support:

(*a*) An increase in personal income taxes to raise at least $4 billion;

(*b*) An increase from 47 to 55 percent in the effective rate of the combined corporation normal and surtax rate;

(*c*) A reduction from $1,000 to $500 in the maximum standard deduction individual taxpayers are allowed to take without itemizing;

(*d*) Heavy excise taxes (for the duration of the emergency) on luxury goods and on goods which are made of materials of strategic importance or which are in short supply;

(*e*) An amendment to the Internal Revenue Code to increase from 6 to 12 months the length of time assets must be held before income from their sale can be reported as a capital gain;

(*f*) An amendment to section 3411 of the Internal Revenue Code to provide that the tax (3½ percent of the selling price) imposed on electrical energy for domestic or commercial consumption shall be collected from publicly owned electric systems and those owned by cooperative or nonprofit corporations to the extent that such systems sells electricity for domestic or commercial consumption;

(*g*) Legislation to provide that savings in the form of unassigned surpluses of cooperatives shall be taxed in the same manner as profits of other corporations, and to extend the application of this principle on an equitable basis to other cooperatively owned businesses such as mutual savings banks, loan associations, etc. We will, however, vigorously oppose any effort to tax

cooperatives on savings returned to the patron as cash, or clearly shown on the books of the cooperative to be the property of the patron;

(*h*) Legislation to make the income from all future issues of Federal, State, and local bonds taxable on the same basis as other income.

We are opposed to a general Federal sales, or manufacturer's excise tax. As an alternative to such a tax, we would prefer to reduce personal exemptions from $600 to $500 (American Farm Bureau Federation).

The money supply can be reduced through increased taxes and a vigorous savings campaign. However, to be effective savings bonds must be offered [at a rate] which will be attractive to the people (Smaller Business Association of New England, Inc.).

With reference to the desirability of a forced savings plan, we must come to it eventually but should certainly not do so until we have exploited to the limit possibilities of increased voluntary saving (Machinery and Allied Products Institute).

We strongly favor efforts by the Government to induce the people to save. However, such saving must be voluntary. Enforced saving can amount to property confiscation, and even public discussion of it as a possibility drives money into hiding (American Bankers Association, Inc.).

* * * an individual bond purchase campaign, voluntary, will be sufficiently effective so far as savings are concerned (the National Farmers Union).

Increased personal savings would ease some of the present inflationary pressure and should be encouraged. * * * In any case, increased taxes appear to us to be preferable to enforced savings (American Farm Bureau Federation).

If savings are to be employed as a technique of restricted purchasing, a compulsory program will have to be adopted (Consumers Union of the United States, Inc.).

* * * we are opposed to any forced savings plan for there can be no guaranty against future deterioration of the purchasing power of the dollar.

We are against deferred compensation for current labor in any form. * * * (Brotherhood of Railroad Trainmen).

MONETARY POLICIES

Present controls over business and consumer credit are as effective as credit controls alone can be in holding down demand, in the absence of other, more effective controls over the country's economy (American Bankers Association, Inc.).

With some additional enforcement machinery * * * and with the increasing application of allocations for the diversion of critically short materials into needed lines of production * * * present credit controls probably will be sufficient (the National Farmers Union).

No program to stabilize the economy and control inflation can be effective unless it includes measures for limiting the expansion in the money supply and bank credit (Committee for Economic Development).

There is considerable opposition among our members to indirect controls such as consumer and business credit controls * * * [but] indirect controls are favored over direct price controls and wage controls and rationing (National Federation of Independent Business).

The private credit system—commercial banks, installment credit, etc.—must be prevented from adding to inflation. * * * The Federal Reserve System must again take control of the money and credit system and using the interest rate and whatever powers necessary to restrict credit to loans which will not feed the inflation (National Association of Manufacturers.)

It is not yet clear whether real estate and consumer credit controls are adequate * * * General credit controls are preferable to selective controls * * * If credit is too free and easy, the best general technique for limiting its flow is through an increase in reserve requirements, effective rediscount rates, and open market operations.

We are opposed to enforce savings plans. We believe that if the interest rate were more flexible, and if the Government showed proper determination to stop the increase in the money supply, the American people would automatically increase their savings and invest them in Government bonds or other savings instruments. * * * A flexible interest rate would quickly bring into balance the supply and demand for capital (Chamber of Commerce of the United States).

Existing selective credit controls have proved inadequate to restrain excess consumer demand. * * * Higher interest rates would reduce the present inflationary pressure by drying up some of the excess funds that are now competing for scarce goods. They would do this (1) by enabling the Federal Reserve System to sell a part of its huge portfolio of Government bonds to private banks and investors, (2) by discouraging a further shift of non-bank-held Government bonds to the banking system, (3) by discouraging a further expansion of private credit, and (4) by encouraging our citizens to practice thrift and to increase their savings in this period of excessive demand (American Farm Bureau Federation).

[We recommend] controls which channel credit into expansion of our production facilities; which restrict borrowing for nonessential purposes (the National Grange).

Even more stringent credit curbs should be instituted on installment buying, housing, and general building except defense building not only to combat inflation but also to save scarce materials (Smaller Business Association of New England, Inc.).

I should not be averse to some further increase in the severity of these regulations [W and X], though we need have no illusions that in the present state of public psychology this would accomplish any miracles * * * This is no place to discuss the merits of the Treasury and Federal Reserve Board's positions [on pegging long-term Government's on a 2½ percent yield], but I should like to point out that in the absence of effective control over the money market by the central bank even greater reliance must be placed on Federal fiscal policy in the battle against inflation (Machinery and Allied Products Institute).

* * * raising reserve requirements and moving interest rates up fractionally are ineffective in the control of business credit—in view of bank and business holdings of Government bonds and unlimited profit prospects. * * *

Consumer credit control is neither an effective nor equitable way of rationing a limited amount of durable goods (Brotherhood of Railroad Trainmen).

Where credit is rationed to business, big firms, which can supply collateral relatively easily, get lower rates. The present type of credit controls are not an adequate method of meeting necessary curtailments * * * (Consumers Union of the United States, Inc.).

The credit controls imposed by regulations X and W have been inevitably inequitable. Such controls, like sales taxes, place a special burden on low-income families who can least afford to carry it.

* * * Regulations X and W make it almost impossible for the low-income groups to purchase homes, automobiles, or household appliances. They tend to force low-income buyers out of the market, while allowing those with ample cash reserves to buy as much as they choose (Congress of Industrial Organizations).

Although some credit controls on consumer buying may be necessary, these restrictions cannot and should not be considered a primary weapon against inflation * * *

This is particularly true with regard to housing. The American Federation of Labor feels that the issuance of regulation X represents a completely illogical and unsound approach to the control of housing in a defense economy (American Federation of Labor).

DIRECT CONTROLS

* * * direct price and wage controls are essential (the National Farmers Union).

Price controls will still be necessary so long as goods which are important in the cost of living are in scarce supply, and they will have to be continued as long as the supplies are scarce * * * Price freezing on the basis of profit margins is unsound because it encourages inefficiencies in the same way as a cost-plus contract * * * Farm support should be eliminated except in distress cases and where they are needed for long-run conservation purposes (Consumers Union of the United States, Inc.).

* * * direct price and wage controls will be necessary for probably at least 2 years while we are expanding the production of basic materials, machine tools, etc. * * * Direct price and wage controls should be applied across the board * * * prices and wages should be set at present levels * * * Prices should be frozen and adjusted by percentage margins * * * The base for wages should be set at the end of some reasonably stable period like the last

few months in 1949 * * * from that base increases should be allowed only to adjust wages to the cost of living (Smaller Business Association of New England, Inc.).

Direct price and rationing controls will be necessary as long as Government purchases continue to provide such a huge guaranteed market to business.

We do not necessarily agree that because prices are controlled wages should similarly be controlled. The difference is that a price is established unilaterally by the producer while a wage rate is subject to bargaining between the employee (producer) and the employer (purchaser) (Brotherhood of Railroad Trainmen).

* * * in 1947 only 15 percent of our members favored reimposition of wage and price controls, while in September 1950, 44 percent favored imposition of these controls (National Federation of Independent Business).

* * * immediate steps should be taken to halt further price rises. Wherever possible, ESA should order roll-backs. And the Defense Production Act should be amended without delay to [provide] * * *

1. Food price subsidies which would permit effective controls over retail food prices while, at the same time, assuring fair returns to the farmers.

2. The necessary authority to regulate trading and margins on the commodity exchanges.

3. Effective grade labeling, the establishment of specifications and standards for different kinds of goods and services, the placement of quantity ceilings on highest priced items produced and sold.

4. An increase in the limit on the total amount of outstanding loans to businesses for expansion purposes and the grant of authority to the Government to build and operate plants, whenever necessary, for the defense effort. * * *

* * * Wage stabilization policy should be considered only as one part of an over-all stabilization program. An equitable wage policy should be sufficiently flexible to permit for adjustment based on inequities, substandard wages, cost-of-living increases, and improved productivity and industrial progress (Congress of Industrial Organizations).

If inflationary pressure is not controlled at its source, either the controls will break down or we shall suffer the evils of suppressed inflation. Among the dangers of direct controls one of the greatest is that they will be regarded as a substitute for more fundamental and constructive measures (Committee for Economic Development).

Price and wage controls have now been started, and their value as inflation restraints depends upon the effectiveness of their administration (American Bankers Association, Inc.).

* * * any price controls to be effective will have to operate very much across the board. * * * If prices are frozen it is better to be guided by margins rather than by levels * * * the margin principle is the only one that is likely to minimize impossible inequities and bottlenecks and deterrents to production (Chamber of Commerce of the United States).

If the institution of price control were to be followed up promptly and firmly with a broadly based pay-most-of-it-as-you-go tax program, and if consequently the dominant topic of economic conversation were to shift from the prospect of higher prices to the prospect of painful taxation, price control might prove to have been of some use in stemming inflation. * * * When all the angles are considered, it may be that, in practice, a wage formula that ties wage rates to the cost of living may prove relatively acceptable. Its economic acceptability is, of course, directly proportional to the degree of success in controlling the cost of living.

To limit their inflationary potential, however, increases in wages resulting from this kind of contract might well be paid in United States savings bonds—or some other form of bond that would not be cashable until after the emergency. This would check the wage-price spiral which could become the vehicle of runaway inflation.

A system of flexible controls—controls which would stabilize prices, particularly industrial prices, but still allow them to rise to cover rising costs—has a reasonable prospect of success. * * * Price and wage controls can work—particularly in the fields of food, clothing, and services—only if backed up by strong tax, credit, and monetary policies (McGraw-Hill Publishing Co., Inc.).

[We recommend] use of price, wage, and rationing controls only when * * * [fiscal and credit controls] prove inadequate to bring purchasing power and supplies of goods and services into approximate balance. Price, wage, and rationing controls should be used together, not separately (the National Grange).

* * * we should explore the possibility of a much wider resort to margin controls than was had under the wartime OPA * * * while it may be necessary to level up workers to a bench-mark position established by new wage increases in certain sectors of the labor force, I should certainly not favor automatic cost-of-living escalation beyond that point (Machinery and Allied Products Institute).

* * * the first step toward bringing order out of chaos should be the enactment by Congress of a new and workable price-control law which will permit effective stabilization of the cost of living.

It goes without saying that it would be the height of injustice to impose wage stabilization upon the Nation's workers before the cost of living is securely anchored. * * *

To succeed, any wage stabilization program must be adaptable to changing conditions and needs, must provide for prompt adjustment where adjustment is needed, and must avoid the use of rigid arbitrary formulas which have no justification other than administrative convenience. [It] must offer the workers of America the assurance that full justice has not fallen victim to empty legalism—that grievances will be given a fair hearing, and that genuine inequities will be quickly corrected (American Federation of Labor).

We are opposed to price, wage, and ration controls. * * * The real cures for inflation are increased production, strict Government economy, pay-as-we-go taxation, effective credit controls, and sound management of the public debt. We should concentrate our efforts on these real cures, and remove existing wage and price controls as quickly as possible (American Farm Bureau Federation).

Limitation and material orders are obviously necessary in order to obtain materials for defense and to prevent hoarding.

Consumer rationing will undoubtedly be forced upon us to achieve anything like equitable distribution of scarce articles * * * (Smaller Business Association of New England, Inc.).

Priorities and allocations should be used to assure the steady flow of materials needed for the military program (National Association of Manufacturers).

Priorities or allocations of raw materials for essential defense and civilian production are also necessary (American Bankers Association, Inc.).

* * * consumer rationing of such commodities as meat inevitably will be necessary to back up price control (the National Farmers Union).

* * * [we are] in favor of immediate price control and rationing of meats * * * food price controls ultimately become ineffective if not accompanied by a rationing program (Brotherhood of Railroad Trainmen).

Where rationing is required, it must be compulsory and enforced by direct public participation at the local level (Consumers Union of the United States, Inc.).

Broad-scale rationing of consumer goods now doesn't seem to be needed (McGraw-Hill Publishing Co., Inc.).

FOREIGN ECONOMIC PROGRAMS

* * * I should like to see the joint committee take account of the dire necessity for making provision in any plans for economic and fiscal action in the next 2 years, for a large economic aid program for other countries, a program which will require large-scale public investment by the United States Government in order to pave the way for future investment in the same areas of the world by private investors (the National Farmers Union).

APPENDIX C

The Derivation of the Estimates of the Inflationary Pressures in the American Economy as Summarized in Part I

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THE PROBLEM

In mid-1950 international events caused a sharp reappraisal of defense requirements by the United States Government. It became apparent that our Armed Forces had to be increased and additional equipment provided to enable this Nation to defend itself against aggression at any time and to carry its part of the burden of maintaining world peace under the United Nations. When the change in defense requirements occurred in June of 1950, the number of unemployed was estimated to be about 3.4 million persons, or 5.2 percent of the total civilian labor force. Industrial production, as measured by the Board of Governors of the Federal Reserve System, had reached 199 (1935–39=100, seasonally adjusted) compared to a low of 161 in July of 1949. Wholesale prices had increased in June of 1950 to 157.3 (1926=100) compared to a low of 151.2 in December of 1949. Similarly, the Consumers' Price Index, which reached 166.5 in February of 1950 (1935–39=100) had risen to 170.2 by June of 1950. Finally, gross national product, which had been as low as $253.8 billion (annual rate seasonally adjusted) in the fourth quarter of 1949, had risen to $270.3 billion in the second quarter of 1950.

Thus, before any of the increase in Government expenditures was even contemplated—in fact, while a reduction in defense spending was taking place—the American economy was rising to higher levels of employment, production, and prices. In fact, in terms of employment and in terms of capacity the economy was rapidly approaching maximum utilization of the resources available. This was the economic setting in which the Nation suddenly faced the problem of drastically increasing the share of the national output and manpower devoted to national defense.

The present economic situation differs significantly from that which prevailed when World War II broke out in Europe in September 1939. In the year 1939 out of a total labor force of 55,600,000 about 9,480,000 were unemployed. At the wartime peak, during 1944, the total labor force had risen to 65,890,000, and unemployment was down to 670,000. Within 5 years there was an expansion in the labor force of 10,290,000, and in total employment (including the Armed Forces) of 19,100,000. The Department of Labor now estimates that the present potential labor force is about 69,100,000 if the peak wartime rates of partici-

pation in the labor force were applied to the 1950 population in terms of sex and age. Thus, according to the estimates of the Department of Labor, our present maximum potential expansion in the labor force is only about 54 percent of that which occurred in World War II, or 5,600,000, and in total employment about 45 percent of World War II, or about 8,600,000.

In 1939, the Federal Reserve Board index of industrial production averaged 109 for the year and reached 243 during the war period. In 1939 disposable personal income amounted to about $70 billion compared to the current level of a little more than $200 billion. In 1939 corporate profits after taxes were about $5 billion compared to a rate in the third quarter of 1950 of over $24 billion. In 1939 prices were comparatively low; agricultural prices, particularly, were substantially below a balanced relationship with other parts of the price structure. Price increases then raised both production and capacity. At full employment levels such as now exist, price increases are simply inflationary and are likely to obstruct rather than increase balanced production.

It is clear that the Nation now faces a substantially different situation from that which prevailed at the beginning of the last war. In addition to purely economic circumstances there were technological reasons that caused increases in military output to be slow in coming after 1939 because of the necessity of building plant and equipment. This time American industry has a vastly increased capacity and recently acquired know-how for making military equipment. Thus the change-over to military output can be appreciably more rapid than in 1939–44. Therefore, inflationary pressures will build up in the economy more rapidly in proportion to the sums appropriated now than was the case in 1939–44.

Requirements of the highest political importance now make it necessary to impose on top of a full-employment economy a much larger burden of national defense expenditures than had previously been borne except in time of war. Nor is this to be a short-term affair. Any realistic appraisal of the situation indicates that public policy can only be based upon the assumption that this is to be a continuing program under which defense expenditures, when once increased to some higher level required by the international situation, will be kept at this higher level for a long period of time, perhaps a decade or two. Policies, therefore, should be framed in the light of a continuing program rather than against the background of a short emergency. This would be true even if full-scale war develops since an intercontinental war of the scale which is now possible may last indefinitely.

On the economic front, this shift in Government programs poses a complex and difficult problem, particularly so when one considers our national objectives or goals. These, roughly in order of priority, may be listed as follows:

1. To divert to national security programs such manpower resources and matériel as military, diplomatic, and political considerations require.

2. To increase productive capacity of the economy to the extent and at a rate practical within the limits set by present

resources, basic consumer needs, and, most of all, defense requirements, so that—

(*a*) Productive capacity is available to meet any war emergency; and

(*b*) Productive capacity may increase over several years sufficient to permit carrying the defense program and, at the same time, satisfy normal civilian demands without inflation.

3. To maintain as high a level of civilian consumption as is possible—in any case to meet basic consumer requirements vital to maintaining productive efficiency.

4. To prevent an inflation which would—

(*a*) Seriously reduce the value of current and past savings;

(*b*) Interfere with production and disrupt economic balance;

(*c*) Place unnecessary economic burdens on the consuming public; and

(*d*) Create such discontent and discord that the danger of internal security would be compounded with that from an external enemy.

5. To maintain a sound balance between programs so as to attain these goals, and, also, distribute the burdens and costs of the defense mobilization equitably among the population.

The greatest danger created by this change in national policy is essentially that of inflation. The results of failure to control inflation are likely to cause widespread distress.

The best available data indicate that even at the present time possibly as many as 40 percent of family units in this country receive money incomes so low or so stable that rapid inflation of prices would result in severe hardship. Millions of families headed by retired persons, civil servants, teachers, unskilled workers, farm laborers, and small farmers did not participate fully in the advancement in incomes that accompanied the increase in prices from 1939 to 1949. Hence many millions of our population have already suffered severe penalties as a result of the past inflation in our price structure.

Further inflation, even though modest, will subject millions of our citizens to severe additional hardships. If by any chance it be of the "run-away" variety, such as happened in Germany after the First World War, there would ensue a rapid decline in production, a demoralization of incentives to work, to save, and to be thrifty; a rapid concentration of income and wealth in the hands of a few; bankruptcy for the middle-income groups who now account for the bulk of both savings and private property, and rapid disappearance of millions of small businesses and independent family farms which are the bulwark against monopoly and communism as well as the source of innovation and growth.

If through inflation the citizens find the purchasing power of their $48 billion in savings bonds wiped out, their insurance policies and their billions of dollars of deposits in our banks made worthless, then most laborers, farmers, and businessmen will have small economic cause for further loyalty to our system of free enterprise and political

freedom. Only the profiteers, monopolists, and speculators, who contrive to "beat" the inflation and, like Stinnes in postwar Germany, end up in control of most of the Nation's wealth, will feel any economic cause for supporting the system. We shall have set the stage for the dissolution of the Republic just as inflation in Germany set in motion the forces that brought about the downfall of the Weimar Republic and the rise of the Nazi regime.

The masters of the Kremlin are counting on this country being foolish enough to destroy itself internally, thus saving them the necessity of conquering it by military arms. Inflation is the great danger the United States faces, and is the best weapon of international communism. Unless this internal danger is met, defense against Communist aggression will crumble. In the few months that have elapsed since June 25, 1950, this internal enemy has exacted a severe toll. By December 1950, wholesale prices had increased 10.4 percent and consumers' prices by 4.7 percent. (See table XI, p. 84.)

The tasks of this technical memorandum are: (1) to estimate the magnitude of present inflationary pressures and their location in the economic structure; (2) to call attention to the diversity and size of programs that can be used to stabilize the price structure whilst insuring needed production to satisfy military and civilian demands, and spreading equitably the required sacrifices defense imposes on the Nation.

The inflationary problem created by present increases in defense expenditures can be broken down into four related questions:

1. What is the probable size of the inflationary pressures; that is, how much more will the Government, business, and consumers try to purchase than will be available from our productive system at stable prices? As a corollary, how much can the output of goods and services be expanded?
2. How much of a rise in prices is likely to occur as a result of these inflationary pressures if present controls prove inadequate?
3. How can prices be stabilized and the inflationary effects of the defense program neutralized?
4. What is the likely effect of increased defense activity on budget receipts and the deficit?

The answers to these questions can be obtained only by making a thorough review and analysis of current economic conditions and prospects. In particular, it is necessary to take the following six steps:

1. Estimate the effects on Government expenditures of the increased tempo of defense outlays over the fiscal years 1951 and 1952.
2. Estimate the probable supply (gross national product) at constant or stable prices.
3. Estimate the demand for goods and services likely to be generated by increasing Government expenditures in an economy already largely fully employed.
4. Evaluate the effects of these economic developments on prices.
5. Determine the amounts by which taxes would have to be increased if adequate not only to meet increased defense expenditures and eliminate the Government deficit, but to make a maximum contribution toward restraining price increases.

6. Indicate controls other than taxes which might prevent inflation.

All analyses necessarily make assumptions. Those relevant here are: (1) that this emergency period of international disturbances, tension, and possible war is likely to continue over a decade or more; (2) that every measure must strengthen free private enterprise and the American system of political institutions; (3) that general indirect monetary, fiscal and credit controls are preferable to direct controls over prices, wages, and consumption which interfere with individual freedom of choice.

One caveat should be set forth: Every policy or program, whether by Congress, an administrative agency, a private business firm, or a consumer, involves a forecast or assumption conerning further developments. The adoption of certain budget appropriations and tax rates involves forecasts concerning the future level not only of business and of prices, but of incomes and tax yields. Such forecasts are implicit in every investment transaction or contract. This memorandum, in estimating the relative size and composition of the "Nation's economic budget," necessarily and explicitly and consciously makes assumptions that all must make who suggest policies of any sort for the present and immediate future. Painstaking effort has been made to combine the best available data with the most reasonable set of assumptions, in order to arrive at results of maximum probable likelihood.

Estimate of Current Inflationary Potential

SECTION I—GOVERNMENT EXPENDITURES

During the fiscal year 1950, the Federal Government paid out $43.2 billion, about 41 percent for present national defense and 31 percent for past wars and emergencies. These categories included about $12.4 billion for military services, $9.3 billion for veterans, $4.7 billion for international programs, $600 million for atomic energy and $4.3 billion for interest on the national debt. In his budget message the President has asked for additional appropriations for defense and for the Mutual Defense Assistance Pact to bring the total appropriations for military services and international security in fiscal 1951 to $63.2 billion. The previously estimated expenditures for the fiscal year 1951 as contained in the President's January 1950 budget message estimated expenditures for military services in fiscal 1951 at $13.8 billion; veterans, $7.1 billion; and for all international programs, $4.9 billion.

During the first quarter of the current fiscal year—that is, June–September 1950—the average number in the armed services was about 1,500,000. For the second quarter of the fiscal year, that is, October–December 1950, the figure was 2,100,000. According to statements made by the President and by Secretary of Defense Marshall the armed services will number approximately 3,500,000 by June 1951.

In translating any mobilization pattern into actual cash expenditures, several factors have to be considered. In the first place, allowance has to be made for the strictly personal expenditures such as military pay, food, clothing, and other perishables, travel allowances, etc., which must be made as personnel is inducted into armed services.

Secondly, allowance has to be made for nonpersonnel connected expenditures such as for new equipment, arms, cantonments, and the like. This is a difficult operation, but certain guideposts are available. The President in his January 1951 budget message estimated military expenditures for fiscal 1952 at $41.5 billion, compared to $21.2 billion in fiscal 1951, and $12.4 billion in fiscal 1950.

Allowance must also be made for the fact that on many items large appropriations are authorized to make possible the letting of contracts or issuance of letters of intent that may not result in Government expenditures of any size until months or years later. Thus World War II actual expenditures lagged far behind appropriations and contract authorizations. For example, for the fiscal year 1941 the War Department alone was authorized to spend over $12 billion, but actually succeeded in spending less than $4 billion, or only 31 percent of its appropriation. In fiscal year 1942 the War Department had an appropriation of over $78 billion, but spent only a little over $14 billion. New appropriations for the War Department in 1943 were just about in line with expenditures at a little over $42 billion, but in 1944 appropriations again exceeded expenditures by almost $10 billion. Similar experiences were shown for other services.

For the four fiscal years 1941 through 1944 the War Department had total appropriations and net contract authorizations of almost $192 billion, but reported expenditures (on a daily Treasury statement basis) of a little over $109 billion. For the total of all war activities programs, exclusive of the RFC and its affiliates, during the above mentioned four fiscal years, appropriations and net contract authorizations totaled about $321 billion, while the expenditures totaled about $191 billion. In other words, at the beginning of the fiscal year 1945 almost $130 billion in appropriations and net contract authorizations, or almost 42 percent of the $321 billion made available by Congress, had not yet been paid out.

In the present period of building up the size and effectiveness of the Defense Establishment, procurement can go forward at a much more rapid pace than was achieved from 1939 to 1944. At that time we had very few business organizations equipped or experienced to produce the multitude of items required by the armed services. Now we have vastly increased capacity, trained manpower, and the industrial know-how for the output of military equipment. The defense establishment itself is better equipped for rapid expansion of procurement programs. As a result, high levels of output can be reached quicker.

So far about $44.2 billion has been appropriated (excluding foreign military aid and other defense-connected expenditures), or over three times the 1950 fiscal expenditures for military services. Actual cash expenditures of the military services on a daily Treasury statement basis for the first 5 months of the current fiscal year were in fact lower than in the same 5 months of the previous fiscal year. Thus current fiscal year military expenditures may expand by only about one-third of the increased appropriations so far made, that is, from $12.5 billion in fiscal 1950 to about $21.0 billion in fiscal 1951, with an annual rate in the fourth quarter of the current fiscal year (April to June 1951) of about $28.0 to $30.0 billion. In the fiscal year 1952 military expendi-

tures may be expected to expand further, and on the basis of present budget planning may well total $41.5 billion.[1]

At the present time, pay, clothing, food, and other personnel costs, plus operations and maintenance of equipment and installations, amount to about $5,600 per individual in uniform. For the numbers expected to be in the armed services over the next 2 years, this implies a cost of $13.5 billion in the 1951 fiscal year and $19.6 billion in fiscal 1952. When 3,500,000 are in uniform, these costs will amount to about $19.6 billion per year. (See columns 1 and 2 of table I.)

TABLE I.—*Estimated defense expenditures for military services for the fiscal years 1950 through 1952, and by quarters from July 1, 1950, to June 30, 1952*

[Billions of dollars, annual rates seasonally adjusted except column (1) which is in millions]

Fiscal year or quarter	Number in Armed Forces [1] (1)	Expenditures, personnel connected [2] (2)	Procurement and all other [3] (3)	Total [4] (4)
1950	1.5	8.4	4.1	12.5
1951	2.4	13.5	7.7	21.2
1952 [5]	3.5	19.6	21.9	41.5
1950—July–September	1.5	8.4	3.8	12.2
October–December	[6] 2.1	[6] 11.8	4.7	16.5
1951—January–March	[6] 2.7	[6] 15.1	8.8	23.9
April–June	[6] 3.3	18.5	13.5	32.0
July–September	[6] 3.5	19.6	18.5	38.1
October–December	[6] 3.5	19.6	21.0	40.6
1952—January–March	[6] 3.5	19.6	23.1	42.7
April–June	[6] 3.5	19.6	25.0	44.6

[1] Data include about 150,000 who are excluded in table III which is based on Bureau of Census data and concepts. The census excludes these 150,000 because they were outside continental United States in 1940 and who are not enumerated in the census of 1940.
[2] Includes expenditures for pay, food, clothing, operations and maintenance, etc.
[3] Includes major procurement, research and development, civilian components, administration, retired pay, military public works, industrial mobilization, and all other.
[4] Total for fiscal 1950 is the actual figure reported by the Bureau of the Budget; for subsequent periods, data are estimates.
[5] Corresponds approximately to the President's budget and to middle assumption in table II, p. 58.
[6] Estimate.

Objection to these estimates might be raised on the grounds that rising costs will increase expenditures per person in service. The figures in table I, however, already allow for about a 5-percent increase in prices after June 1950. Furthermore, cost increases can be restrained by vigorous action by the Government to restrain inflation and by hard-headed procurement policies and administration which result in: (1) Tight figuring on Government contracts; (2) recapture of any excessive profits on such contracts; and (3) the cost reductions due to economies of scale and continuity of operations on individual items.

In addition to personnel-connected and operational costs outlined so far, military spending covers major procurement, research and development, industrial mobilization, civilian components, acquisition and construction of real property, administration, classified projects, and all others. For the fiscal years 1947–50 these items accounted for only about 33 percent of total military expenditures. The proportion spent on these items will rise rapidly during the current and following fiscal years to about 55 to 60 percent in the April-June quarter of 1952.

[1] Corresponds approximately to middle assumption in table II, p. 58.

Such an increase would represent almost a sevenfold multiplication of major procurement and other expenses from about $3.8 billion (annual rate, seasonally adjusted) in the July-September quarter of 1950 to $25.0 billion in the final quarter of fiscal 1952—April-June 1952. (See column 3, table I.) Between these two periods, expenditures for procurement and other items would rise slowly until January 1951, then rise very rapidly. This pattern was followed in World War II with two exceptions: (1) the time covered was 4 years instead of 2; and (2) between 15 and 20 percent of the increase was due to price rises taking place between 1939 and early 1942. After January 1942, prices of munitions appear to have declined—gradually at first, and then more rapidly to the extent of 15 to 20 percent by 1944.[2]

Procurement and renegotiation organization is in far better shape than in 1939–41, so that munitions should show economies of scale and of increased productivity much more quickly. Therefore, by late in 1951, the increase in money expenditures on defense should begin to be less percentagewise than the increase in physical units.

These estimates of the probable pattern of military expenditures may be optimistic concerning both the international situation and the assumed efficiency and diligence of the Defense Department, the civilian agencies, and the Congress, in preventing inflation and securing increased productivity and economies of scale. If the international situation requires greater increases in military expenditure than estimated in table I, the figure may reach the high estimate in table II, page 58.

On the other hand, if the former assumption is sound (no full-scale war this year) but the latter concerning efficiency in procurement and price negotiation proves to be too optimistic, there will have developed "within our gates" an enemy of greater menace to freedom and independence than any possible external aggressor, namely, uncontrolled inflation. At this critical juncture, the United States simply cannot afford the luxury of military inefficiency in procurement and negotiation. The creation by the Congress of a "watchdog" committee, headed by Senator Lyndon B. Johnson, and that committee's investigations so far, are effective expressions of the determination of Congress that every effort shall be made to bring about the efficiencies assumed in this analysis.

It may happen that changes in the international situation will make possible a reduction in military expenditures either by lowering the sights or by slowing up the rate at which mobilization is pushed toward the longer term goals. In this case, expenditures in fiscal 1952 might well approximate the lowest assumption shown in table II, page 58.

So far, the analysis has referred exclusively to requirements of the domestic Military Services. The threat of Communist aggression is pointed at all the free nations—not merely at the United States. The other threatened peoples have substantial resources of manpower, productive plant, raw materials and military bases. From an economic standpoint these resources, too, will need to be mobilized to help defend the free peoples against Communist aggression. This memorandum in no way presumes to touch upon vital political and military decisions as to who, when, what, or how much.

[2] See Worsley, Thomas B., Wartime Economic Stabilization and the Efficiency of Government Procurement; National Security Resources Board, 1949, pp. 323-325; table 7, p. 360, and table 8, p. 361.

But it does assume that the United States will cooperate in an international mutual defense program of some sort, regardless of how such a program is formulated or administered.

A corollary assumption is likewise made; that the program of mutual defense assistance will continue so long as the threat of Communist aggression menaces this country and its allies abroad, which may be 5, 10 or even 20 years.

In the third place, the assumption is made that some economic aid to foreign nations through ECA will be necessary, though at a reduced scale. Military mobilization will involve greater sacrifices at times from some of the peoples of other countries than from our own citizens because of lower levels of output, World War II devastation not yet repaired, and scarcity of certain types of real capital. In such circumstances it would be false economy to deny all further economic aid where its continuance in some amount is essential to success of the military program.

If the military and political problems connected with a foreign military assistance program can be solved, any assistance given to our allies among the free peoples of the world to enable them to make their contribution to the common defense probably will yield more military and political strength than the same amount spent in this country. Each dollar spent in domestic markets for defense brings only that dollar's worth of resources. Every dollar of mutual defense assistance spending, if carefully used, should result in mobilizing in addition to the immediate dollar's worth of military power, further manpower, production, and materials from the resources of other nations. For example, use of European steel capacity could expand immediately the potential output of arms plus civilian goods—thus giving the United States valuable assistance pending expansion of our own steel capacity.

If these three propositions be assumed to be reasonable, how shall the total of expenditures on international affairs be estimated? One approach is to scale the international expenditure item to fit the limits set by: (1) published statements of policy by the administration and Congress; and (2) the probable volume of such foreign assistance as can be extended in view of the resources of the American economy and defense requirements. A reasonable estimate at the moment is that total expenditures for international affairs, including both international aid and mutual defense assistance pact programs, might approximate $4.8 billion for the fiscal year 1951 and $7.5 billion for fiscal 1952.

Other items of defense expenditure, such as outlays for veterans, for interest on the public debt, for atomic energy, and for other defense-connected matters are shown as estimated by the Bureau of the Budget.

There will be a certain amount of automatic contraction in non-defense expenditures. Housing mortgage operations may well result in a net inflow to the Treasury. In the agricultural sector, price rises may enable the Commodity Credit Corporation to sell remaining surpluses with a net inflow of funds to the Treasury. Similarly, unemployment claims will decline as employment rises, while the new Social Security bill will increase revenues of the trust funds without expanding sufficient y the cash expenditures for old-age pensions and assistance programs to offset add d revenue. In fact, the high level of business activity the high level of prices, the higher wage rates,

and the low level of benefits may cause many who are contemplating retirement to postpone it, and many of those who are already retired to resume work during the current and following fiscal years.

Estimates of the ways in which cash expenditures in the fiscal years 1951 and 1952 may change from fiscal 1950 are shown in table II.

TABLE II.—*Consolidated Federal cash budget, fiscal years 1950–52*

[Billions of dollars]

Description	Bureau of the Budget			Budget assumptions for 1952 [1]		
	1950 actual	1951 estimate	1952 estimate	Low	Middle	High
Receipts from the public:						
Direct taxes on individuals	18.1	22.3	26.8			
Direct taxes on corporations	10.9	13.6	20.0			
Excise taxes and customs	8.0	8.8	8.8			
Others	3.9	4.6	5.7			
Total cash receipts	40.9	49.3	61.3	[3] 60.0	[3] 60.0	[3] 60.0
Payments to the public:						
National defense and related activities	17.7	27.1	51.8	43.5	53.5	63.5
Military services	12.4	21.2	41.5			
International security	4.7	4.8	7.5			
Atomic energy	.6	.8	1.3			
Promotion of defense production	0	.3	1.1			
Civil defense	0	[2]	.5			
Economic stabilization and allocation	[2]	[2]	.3	.3	.3	.3
Past wars and emergencies	13.6	10.6	10.5	10.5	10.5	10.5
Interest	4.3	4.1	4.6			
Veterans	9.3	6.5	5.9			
Civil functions, total	11.9	11.3	11.4	10.7	10.7	10.7
Total cash payments	43.2	49.1	74.1	65 0	75.0	85.0
Excess of receipts from public		.2				
Excess of payments to public	2.2		12.8	5.0	15.0	25.0

[1] Assumes that change from low to middle to high budgets is in military services expenditures or that reductions in nonmilitary items are offset by increases in military expenditures.
[2] Less than $100,000,000.
[3] Bureau of the Budget estimate for 1952 rounded on conservative side.

Source: Bureau of the Budget, based on existing tax law; budget assumptions for 1952 by staff, Joint Committee on the Economic Report.

SECTION II—THE SUPPLY OF GOODS AND SERVICES

To estimate potential output of goods and services, or gross national product at constant prices, it will be necessary to estimate changes in the size, composition, and utilization of the labor force, to note the extent to which working hours may be lengthened, and assess changes in man-hour productivity.

A. Manpower potential

In 1939 the mobilization effort started with 9,480,000 persons, or 17.2 percent, unemployed, out of a total labor force of 55,600,000, including the Armed Forces, of whom about 370,000 [3] were in the United States. The Bureau of the Census, reporting on the labor force, indicates that in June 1950, out of a total labor force of 66,177,000, about 1,311,000 [3] were in the Armed Forces, and 3,384,000,

[3] The estimate by the Bureau of the Census of the armed services is approximately 150,000 below that contained in the reports of the Defense Establishment, which always counts those outside the continental United States even though these were not enumerated in the 1940 census. This figure of 150,000 is deducted by the Census Bureau each month from its current estimates for comparability with the 1940 data.

or 5.2 percent of the civilian labor force, were unemployed. At the peak of the last war effort in 1944, unemployment declined to a little over 1 percent of the civilian labor force. In the absence of all-out mobilization, unemployment might be reduced as low as 1 million, or roughly 1.6 percent of the civilian labor force. Thus employment might go up about 2.3 million above the June 1950 level.

In World War II extra labor power of 10,290,000 persons was obtained by employment of millions of women, aged, teen-agers, part-time workers, and by putting high-school and college-age youngsters into the Armed Forces. The number kept at work on civilian jobs, while lower in 1944 than it had been in 1939 by about 600,000 persons, in 1942 was even 1,200,000 greater than in 1939.

In the present circumstances such an expansion in the labor force cannot be achieved. The population has grown older. People 55 years and older increased from 19.6 million in April 1940 to 24.7 million in July 1949. Furthermore, the postwar high birth rate has brought about an increase of about 8,000,000 in the number of children under 10 years of age. Thus almost 20 percent of the population now consists of children of ages most needing home care, compared with only about 16 percent in 1940. This reduces the number of younger married women available for work, even with extensive provision for child care centers.

Thirdly, there are fewer teen-agers. The age group from 10 to 19 years has decreased in number by almost 2.3 million since 1940. Even the 19 to 26 age group is only 300,000 larger than in 1940, and the 26- to 29-year age group only up by 1.2 million (see chart 1).

Finally, those that can go into the labor force are by and large already there. Of the total noninstitutionalized population 14 years of age and over, about 59.8 percent are now in the labor force, compared with only 57.6 percent in 1940. The proportion of females rose from 29.8 percent before World War II to 34.5 percent at the present time. Even the proportion of males is fractionally higher—at 86 percent compared to the prewar 85.5 percent. Such percentages, even if the peak wartime rates of participation in the labor force are applied to the April 1950 population in terms of sex and ages, can be increased but little. In short, it may be practically impossible to increase the total labor force by more than 5.6 million beyond the figure reached in April 1950 (see chart 2).[4] At this date (February 1951) a large proportion of those are already at work.

As indicated in table III, the total labor force may reach about 66,300,000 in the second quarter of 1951, and total roughly 68,000,000 in the second quarter of 1952. If correction is made for projected increases in the armed services, the civilian labor force may be expanded to about 63.1 million by the second quarter of 1951, possibly 64.6 million in the second quarter of 1952.

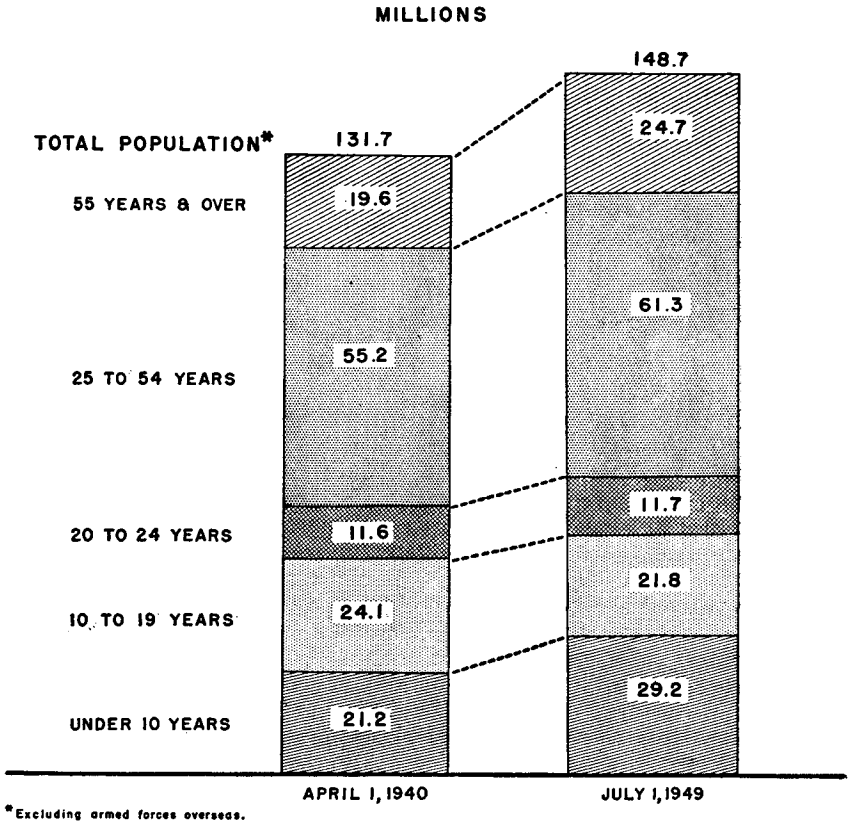
For decades a steady migration of young farm labor to industrial employment has taken place, particularly during periods of prosperity, high-level urban employment, and high wage rates. Such migration will probably be accelerated during the next few years, if the country continues to step up its mobilization plans to full sustainable capacity.

[4] See Manpower Potential for National Security, The Labor Market, August 25, 1950, Bureau of Employment Security, U. S. Department of Labor.

CHART 1

THE GROWTH OF THE POPULATION HAS BEEN UNEVEN

1. The population has grown by almost 20 million.
2. There are more people 55 years old and over.
3. There has been a loss in the number 10 to 19 yrs. (2.3 million).



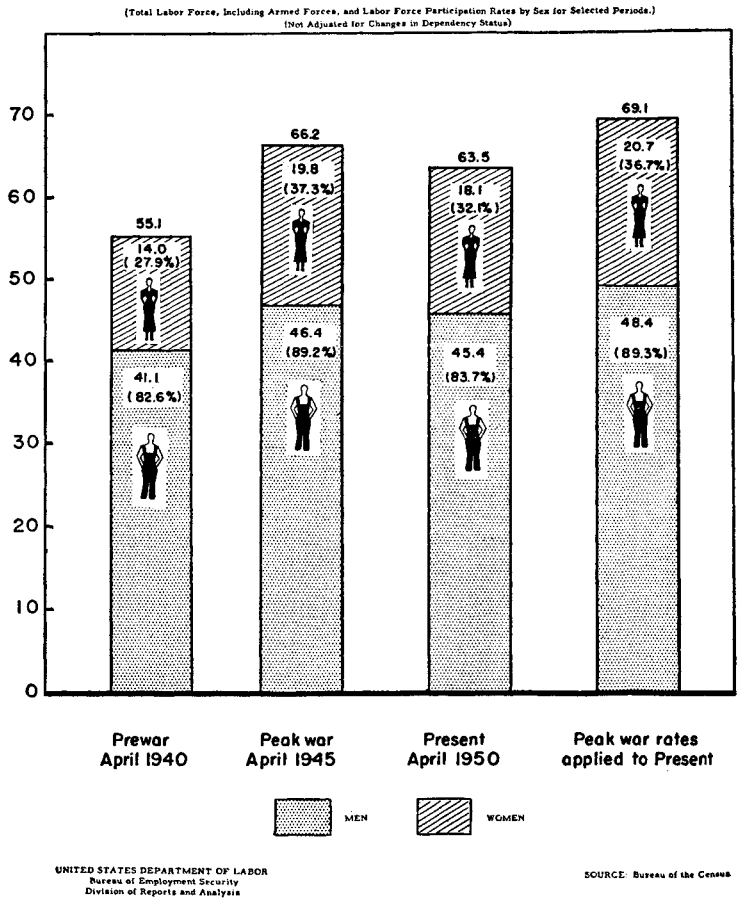
*Excluding armed forces overseas.

UNITED STATES DEPARTMENT OF LABOR
Bureau of Employment Security
Division of Reports and Analysis

SOURCE: Bureau of the Census

CHART 2

The Peak war Rates of Labor Force Participation could add 5 to 6 million workers to Present Labor Force.



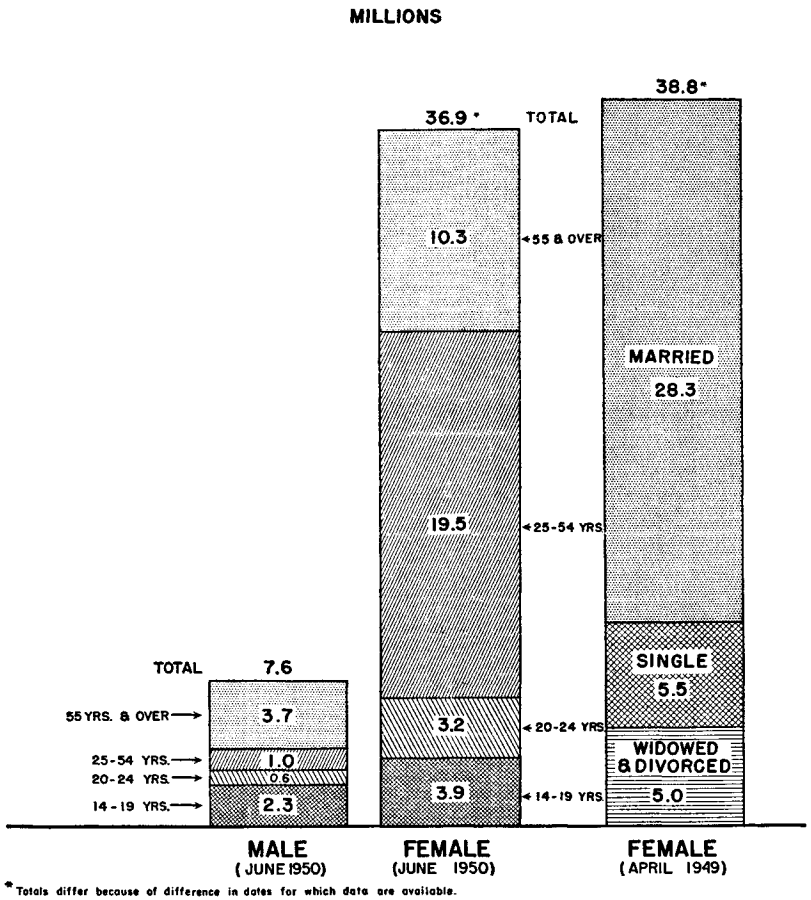
UNITED STATES DEPARTMENT OF LABOR
Bureau of Employment Security
Division of Reports and Analysis

SOURCE: Bureau of the Census

CHART 3

OF THOSE NOT IN THE LABOR FORCE -

- ALMOST HALF OF THE MALES ARE 55 YEARS AND OVER
- MOST FEMALES ARE BETWEEN 25 AND 54 YEARS AND ARE MARRIED



* Totals differ because of difference in dates for which data are available.

UNITED STATES DEPARTMENT OF LABOR
Bureau of Employment Security
Division of Reports and Analysis

SOURCE: Bureau of the Census

TABLE III.—*Labor force, employment, and unemployment, 1929–52*

Period	Total labor force (including Armed Forces) [1]	Armed Forces [1]	Civilian labor force					Unemployment as percent of total civilian labor force	Average hours worked per week
			Total civilian labor force	Employment [2]			Unemployment		
				Total	Agricultural	Nonagricultural			
	Thousands of persons, 14 years of age and over								
Monthly average:									
1929	49,440	260	49,180	47,630	10,450	37,180	1,550	3.2	--------
1930	50,080	260	49,820	45,480	10,340	35,140	4,340	8.7	--------
1931	50,680	260	50,420	42,400	10,290	32,110	8,020	15.9	--------
1932	51,250	250	51,000	38,940	10,170	28,770	12,060	23.6	--------
1933	51,840	250	51,590	38,760	10,090	28,670	12,830	24.9	--------
1934	52,490	260	52,230	40,890	9,900	30,990	11,340	21.7	--------
1935	53,140	270	52,870	42,260	10,110	32,150	10,610	20.1	--------
1936	53,740	300	53,440	44,410	10,000	34,410	9,030	16.9	--------
1937	54,320	320	54,000	46,300	9,820	36,480	7,700	14.3	--------
1938	54,950	340	54,610	44,220	9,690	34,530	10,390	19.0	--------
1939	55,600	370	55,230	45,750	9,610	36,140	9,480	17.2	--------
1940	56,030	390	55,640	47,520	9,540	37,980	8,120	14.6	--------
1941	57,380	1,470	55,910	50,350	9,100	41,250	5,560	9.9	--------
1942	60,230	3,820	56,410	53,750	9,250	44,500	2,660	4.7	--------
1943	64,410	8,870	55,540	54,470	9,080	45,390	1,070	1.9	48.5
1944	65,890	11,260	54,630	53,960	8,950	45,010	670	1.2	46.6
1945	65,140	11,280	53,860	52,820	8,580	44,240	1,040	1.9	46.1
1946	60,820	3,300	57,520	55,250	8,320	46,930	2,270	3.9	44.3
1947	61,608	1,440	60,168	58,027	8,266	49,761	2,142	3.6	43.5
1948	62,748	1,306	61,442	59,378	7,973	51,405	2,064	3.4	42.8
1949	63,571	1,466	62,105	58,710	8,026	50,684	3,395	5.5	42.1
1949—First half	62,732	1,483	61,249	58,060	7,940	50,120	3,189	5.2	42.5
Second half	64,411	1,450	62,960	59,359	8,112	51,247	3,602	5.7	41.7
1950—First half	63,776	1,347	62,429	58,555	7,233	51,322	3,874	6.2	42.0
Third quarter	65,600	1,400	64,200	61,500	8,100	53,400	2,700	4.2	40.6
Fourth quarter	65,100	2,000	63,100	61,100	7,500	53,600	2,000	3.2	42.8
1951—First quarter [3]	64,300	2,600	61,700	59,800	6,500	53,300	1,900	3.1	42.5
Second quarter [3]	66,300	3,200	63,100	61,500	8,000	53,500	1,600	2.5	43.5
Third quarter [3]	67,300	3,400	63,900	62,800	8,000	54,800	1,100	1.7	43.1
Fourth quarter [3]	66,800	3,400	63,400	62,400	7,400	55,000	1,000	1.6	43.7
1952—First quarter [3]	66,000	3,400	62,600	61,600	6,400	55,200	1,000	1.6	43.3
Second quarter [3]	68,000	3,400	64,600	63,600	7,800	55,800	1,000	1.5	44.3

[1] Data for 1940–50 exclude about 150,000 members of the Armed Forces who were outside the continental United States in 1940 and who were therefore not enumerated in the 1940 census. This figure is deducted by the Census Bureau from its current estimates for comparability with 1940 data.

[2] Includes part-time workers and those who had jobs but were not at work for such reasons as vacation, illness, bad weather, temporary lay-off, and industrial disputes.

[3] Estimated.

NOTE.—Labor-force data are based on a survey made during the week which includes the 8th of the month.

Detail will not necessarily add to totals because of rounding.

Sources: Department of Labor (1929–39) and Department of Commerce (1940–50).

Total output of goods and services can be expanded not merely by an increase in employment, but also by a shift of workers from nonessential jobs to more productive work, both occupationally and regionally. In June 1950, before the outbreak of hostilities in Korea, about 2.4 million wage and salary workers were employed on a full-time or a part-time basis in contract construction, about 9.4 million in trade, and about 6.7 million in finance and services. Some of these can be shifted to manufacturing, transportation, military service, and mining. The number in contract construction is now double the prewar figures; in trade, the number is 40 percent greater; and in finance and service, the number is over 45 percent greater.

Even at today's much higher level of economic activity, some diversion from these occupations should be possible. In contract construction, for example, regulation X, issued by the Federal Reserve Board in cooperation with housing finance agencies, may reduce private residential construction in 1951 by one-third or more from the 1950 level. To take another illustration, about 3.4 percent of all workers employed in civilian activities were private household workers in late 1950, and 23.7 percent were employed in trade, finance, and service outside of private households. This amounted to a total of 6.4 million workers, of which possibly a million or so might be shifted to more vital industries.

A further source of employment, in terms of man-hours actually worked, is in reducing part-time employment. A survey of part-time workers was made by the Bureau of the Census in 1950 covering the week of August 6 to 12. It shows that 7,898,000 persons were at work part time in that week. Of these, 23.4 percent worked less than 14 hours during the week; 28.5 percent worked from 15 to 21 hours; 23.9 percent worked from 22 to 29 hours; and 24.3 percent worked from 30 to 34 hours. Of the nearly 8,000,000 persons working part time, about 2,600,000 usually work full time at their present jobs. Of the remaining 5,300,000 who usually work part time at their present jobs, 1,100,000 prefer and could accept full-time work, while the other 4,200,000 would not prefer or could not accept full-time work. If, for example, those who prefer and could accept full-time work could be fully employed, it would add about 1,100,000 to the full-time labor force, and this, in turn, would be the equivalent to adding about one-half million to the total employment. If, in addition, some of the 4,200,000 who do not prefer or could not accept full-time work could be induced to work full time, some additional increase in full-time employment would be possible. If, in addition, a substantial proportion of the 1,200,000 who usually work full time in their present jobs and who worked part time in August because of economic factors (including slack work, lay-offs, job turn-over, labor shortages, and repairs to equipment) could be kept full time at their jobs, it would add significantly to total output. (For detail see table IV.)

There are limits to the degree to which part-time workers can be shifted to full-time occupations. Of the 1,100,000 persons with part-time jobs who preferred full-time work, 28 percent were teen-age boys and girls. About 40 percent of those who were involuntarily working at part-time jobs in August were women, compared with 25 percent of the full-time workers' group. Similarly, the teen-agers mentioned above made up 28 percent of this group of involuntary part-time workers, but only 8 percent of the full-time group. About two-fifths of all workers in the group were in service industries and about one-fourth were in domestic service work. These facts illustrate the kind of problems that might come up in increasing the utilization of part-time employees. It is clear that the high proportion of teen-agers in this group means merely that these teen-agers were on vacation from school and would have accepted temporary full-time work for a few weeks instead of part-time jobs. On the other hand, many of them would not have been available a few weeks after the survey was taken when school was once more in session.

TABLE IV.—*Persons working part time, classified by full-time or part-time status, by hours worked: week of Aug. 6–12, 1950 (persons 14 years of age and over)*

[In thousands]

Full-time or part-time status	Hours worked during survey week				
	Total	1 to 14	15 to 21	22 to 29	30 to 34
Persons at work part time	7,898	1,840	2,250	1,887	1,921
Usually work full time at present job	2,574	283	549	685	1,057
Worked part time because of economic factors [1]	1,245	141	275	293	536
Worked part time for other reasons	1,329	142	274	392	521
Usually work part time at present job	5,323	1,556	1,701	1,202	864
Prefer and could accept full-time work	1,112	335	327	239	211
Do not prefer or could not accept full-time work	4,211	1,221	1,374	963	653
	Percent distribution				
Persons at work part time	100.0	23.4	28.5	23.9	24.3
Usually work full time at present job	100.0	11.0	21.3	26.6	41.1
Worked part time because of economic factors [1]	100.0	11.3	22.1	23.5	43.1
Worked part time for other reasons	100.0	10.7	20.6	29.5	39.2
Usually work part time at present job	100.0	29.2	32.0	22.6	16.2
Prefer and could accept full-time work	100.0	30.1	29.4	21.5	19.0
Do not prefer or could not accept full-time work	100.0	29.0	32.6	22.9	15.5

[1] These factors include slack work, lay-off, job turn-over, material shortages, and repairs to plant and equipment.

Source: Current Population Reports, Labor Force, U. S. Department of Commerce, Bureau of the Census, series P-50, No. 28, Nov. 17, 1950, p. 5.

Another way of increasing employment in the economy is to reduce the amount of unemployment due to local dislocations in the labor market. In November 1950 there were 56 areas [5] classified as tight or balanced labor supply, or with a ratio of unemployment to labor force of under 3 percent. This compares to only five areas in this classification 1 year before. On the other hand, of those areas in the E classification, a very substantial labor surplus, or unemployment of 12 percent or over, there were no major areas compared to 18 areas in November 1949, 4 in July 1950, and 2 in September 1950. Taking the two classifications of heaviest unemployment, which would include all areas with 7 percent or more unemployment, there were 68 major areas in September 1949; 77 major areas in November 1949; only 44 in July 1950; and only 8 in November 1950. Of these 8, two were in New England, three were in the Middle Atlantic States, while one was in Hawaii (see tables V and VI).

Increases in the number of hours worked expanded by 8.7 percent between 1939 and 1943. In the first 9 months of 1950, the average hours worked per week per employed worker are estimated to have been about 5 percent below 1939. If the hours were lengthened to the hours prevailing in 1943, man-hours of employment could be expanded almost 15 percent. This would be difficult, of course, in industries which operate 24 hours a day, 7 days a week on continuous operations. In other cases, however, there is enough slack to achieve an industry-wide expansion in average hours per week of between 2 and 3 percent per year, that is, from about 42 in the first half of 1950 to about 43 in the first half of 1951, and 43.8 in the first half of 1952.

[5] Bimonthly Summary of Labor Market Developments in Major Areas, U. S. Department of Labor, Bureau of Employment Security, January 8, 1951.

TABLE V.—*Summary classification of major labor market areas, November 1950, September 1950, and November 1949* [1]

	Ration of unemployment to labor force	Number of major areas		
		November 1950	September 1950	November 1949
Total		152	152	139
Classification A	Under 3 percent	56	52	5
Classification B	3 to 4.9 percent	64	58	28
Classification C	5 to 6.9 percent	24	33	29
Classification D	7 to 11.9 percent	8	7	59
Classification E	12 percent and over	0	2	18

TABLE VI.—*Summary classification of major labor market areas by region, November 1950* [1]

Region	Total	A	B	C	D	E
Total	152	56	64	24	8	0
New England	17	7	5	3	2	0
Middle Atlantic	24	4	13	4	3	0
East North Central	32	19	10	3	0	0
West North Central	13	8	4	1	0	0
South Atlantic	25	9	9	6	1	0
South Central	25	8	12	4	1	0
West	15	1	11	3	0	0
Territory of Hawaii	1	0	0	0	1	0

[1] Explanation of classification codes:

Code	Ratio of unemployment to labor force	Definition of code
A	Under 3 percent	Tight or balanced labor supply.
B	3 to 4.9 percent	Slight labor surplus.
C	5 to 6.9 percent	Moderate labor surplus.
D	7 to 11.9 percent	Substantial labor surplus.
E	12 percent and over	Very substantial labor surplus.

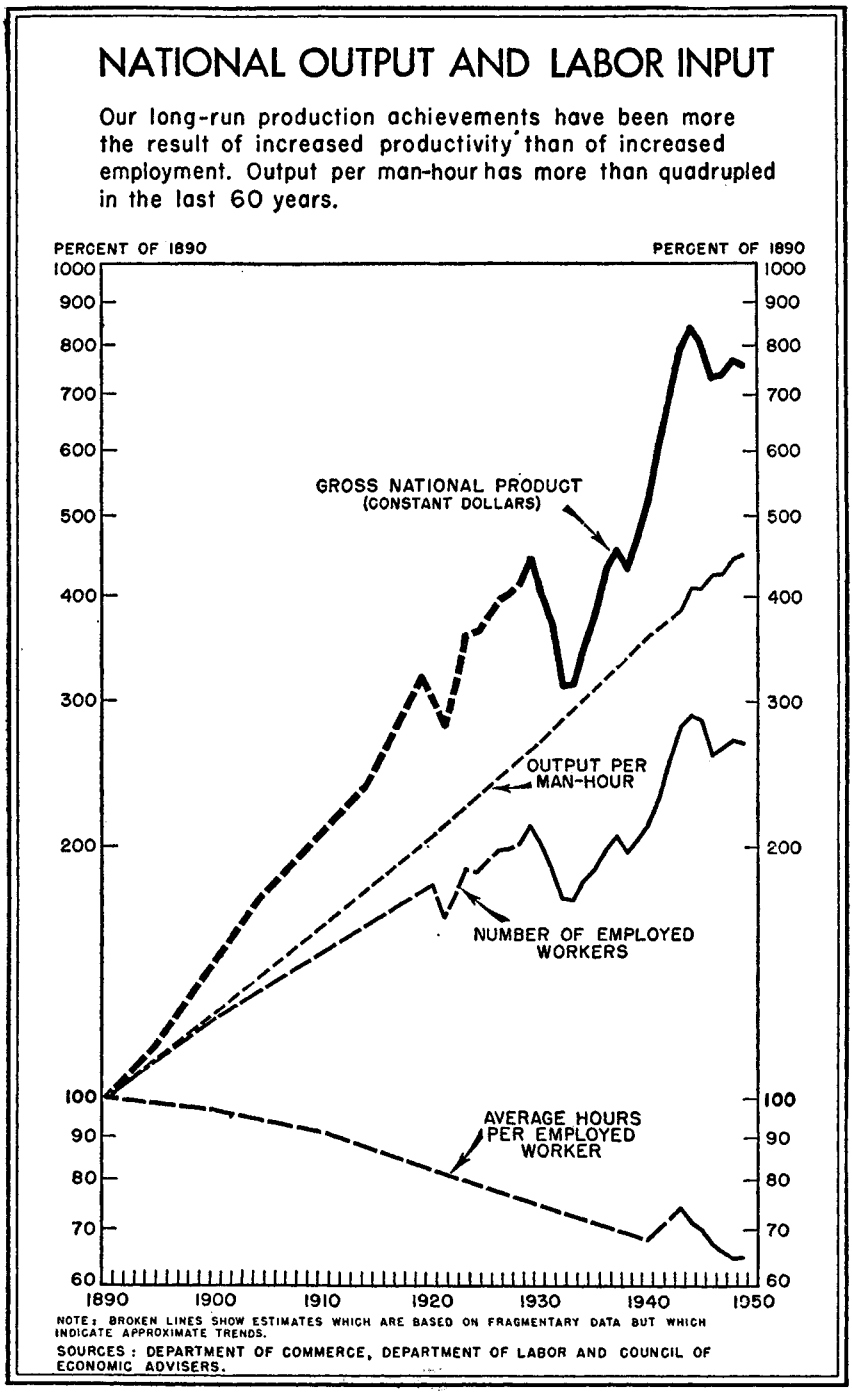
Source: Bimonthly Summary of Labor Market Developments in Major Areas, U. S. Department of Labor, Bureau of Employment Security, Jan. 8, 1951, pp. 6 and 7.

If hours worked per week are increased by overtime and work on holidays, with pay at time-and-one-half or double time, inflationary pressures will be increased faster than output.

B. Productivity

As the Council of Economic Advisers pointed out in their Annual Economic Review in January 1950, particularly in the chart reproduced below as chart 4, gross national product measured in constant dollars has increased over the last 60 years to about seven and one-half times the 1890 level, while output per man hour has risen to almost four and one-half times that of 1890. On the other hand, total employed workers in 1949 amounted to only a little over two and one-half times the 1890 number while hours worked have declined about 36 percent. Thus, while man-hours of employment in 1949 were but 70 percent higher than in 1890, output was about 650 percent higher.

CHART 4



During the war productivity apparently increased at the rate of about 2½ percent per year. In the early part of the war, increases in productivity were higher, then the averages fell off, but began to rise rapidly again at the end of the war. At first much of the productive effort was switched from services and production in industries of low productivity per man-hour to mass production of war goods made under conditions of high productivity. As the war effort lengthened the Nation resorted increasingly to older workers, to women, and to teen-agers. The result was a natural slowing down in the increase in productivity and, in many industries productivity actually declined.

The lessons for the present period would seem to be—

(1) In view of the long-term character of the present program, heavy reliance must be placed on a sustained increase in productivity as a source of increasing output;

(2) In the early period of mobilization, changes in the character of the output of the Nation may result in increase in productivity no smaller than that normally experienced; and

(3) Increasing resort to marginal or submarginal workers and plants may slow down productivity below the long-term average rate, even with adequate replacement of absolute plant and equipment, and skillful training of the labor force.

Some indication of the possibilities and problems involved in maintaining the rate of increase in productivity can be illustrated from the field of agriculture. Chart 5 shows that total United States farm production in 1950 was about 21 percent above 1941, with gains for various products ranging from 5 percent in food grains and milk to 49 percent in oil seeds. This increase in total output is a result not only of an increase in the total input of productive resources but, as shown in chart 6, the direct result of rapid increase over the last 10 years in output per unit of input.

In part, this increase of output is due to the phenomenal expansion in the last 20 years in the quantity of fertilizer used. As chart 7 indicates, prices for fertilizer have remained reasonably stable, but the quantity used has expanded enormously, having more than doubled since 1940.

Output per man-hour has increased since 1941 by about 28 percent. (See chart 8.) This is partly a result of increased use of fertilizer, as indicated above, but also of a substantial increase in the utilization of farm power and machinery, along with better crop practices, better land use, and improved varieties of seed and livestock.

Our agricultural plant is in much better shape today to expand output under conditions of labor scarcity than it was in 1941. For, as is clearly shown in chart 9, the past decade has been one of exceptional increase in the utilization of power machinery, with the volume of farm power and machinery increasing almost 55 percent between 1941 and 1950. In that period the number of automobiles on farms increased from 4.3 to 5.8 million; tractors from 1.7 to 3.8 million; trucks from 1.1 to 2.2 million; milking machines from 210,000 to 710,000; combines from 225,000 to 650,000; and mechanical corn pickers from 120,000 to 410,000. These changes are shown graphically in chart 10.

CHART 5

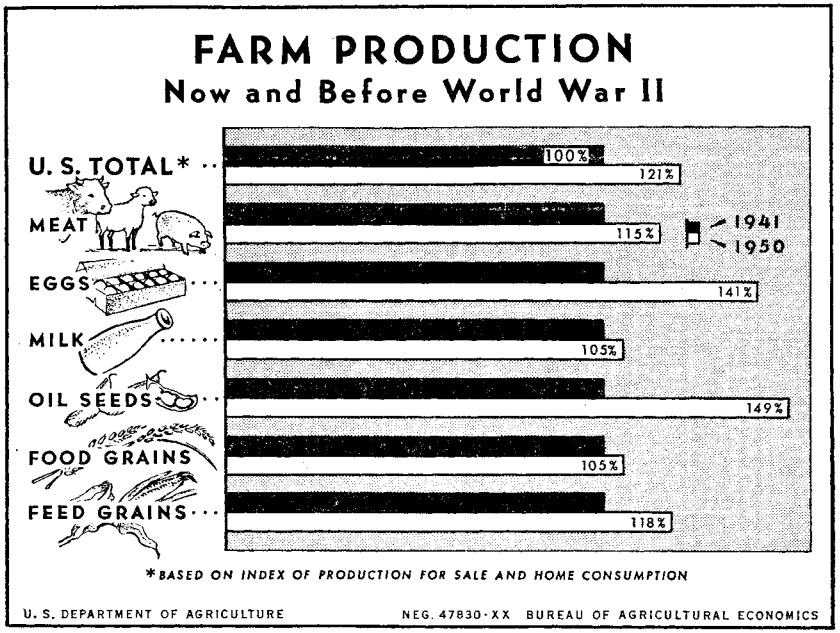


CHART 6

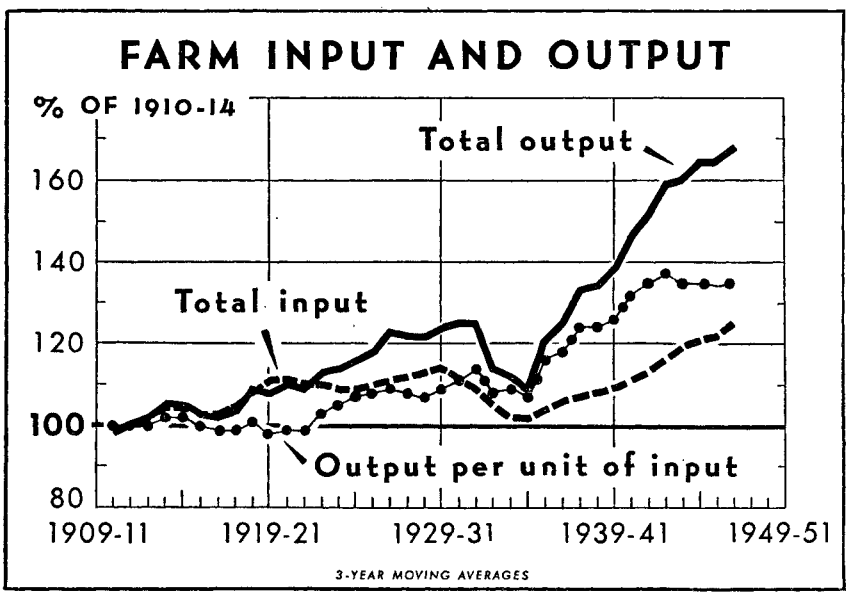


CHART 7

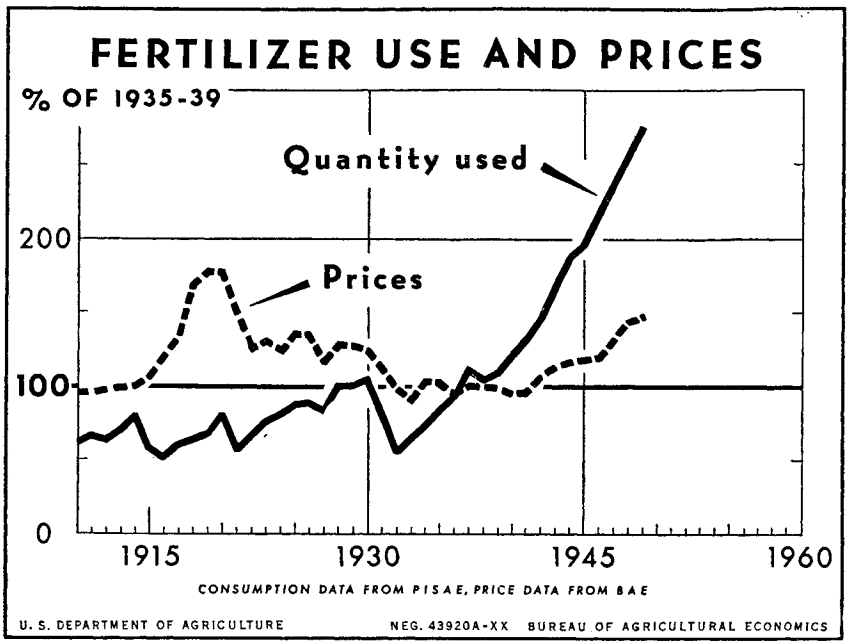


CHART 8

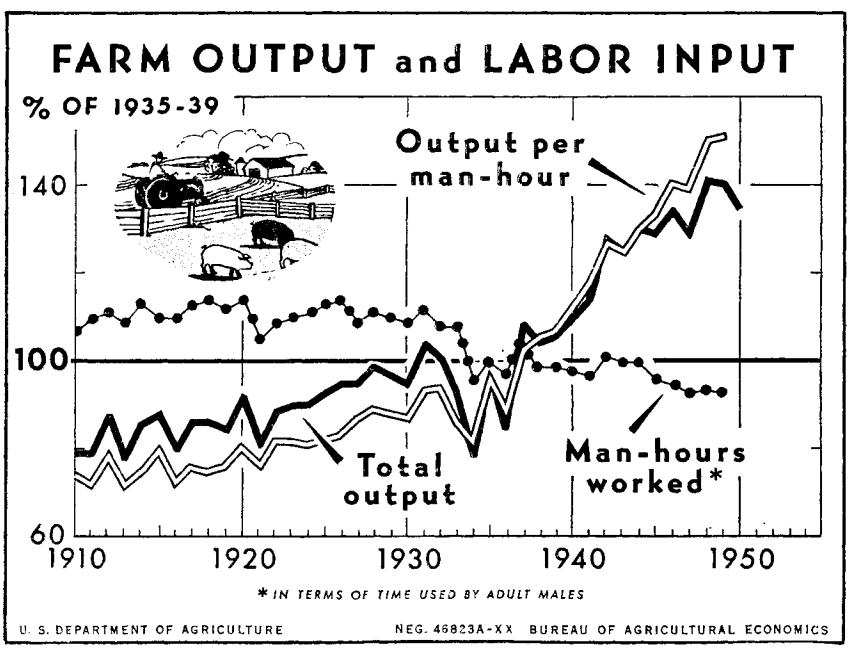


CHART 9

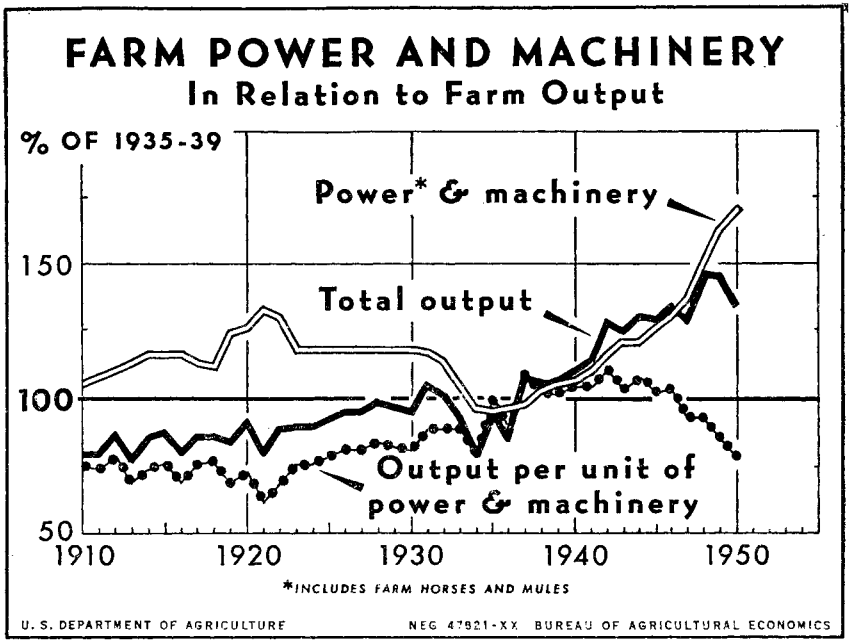
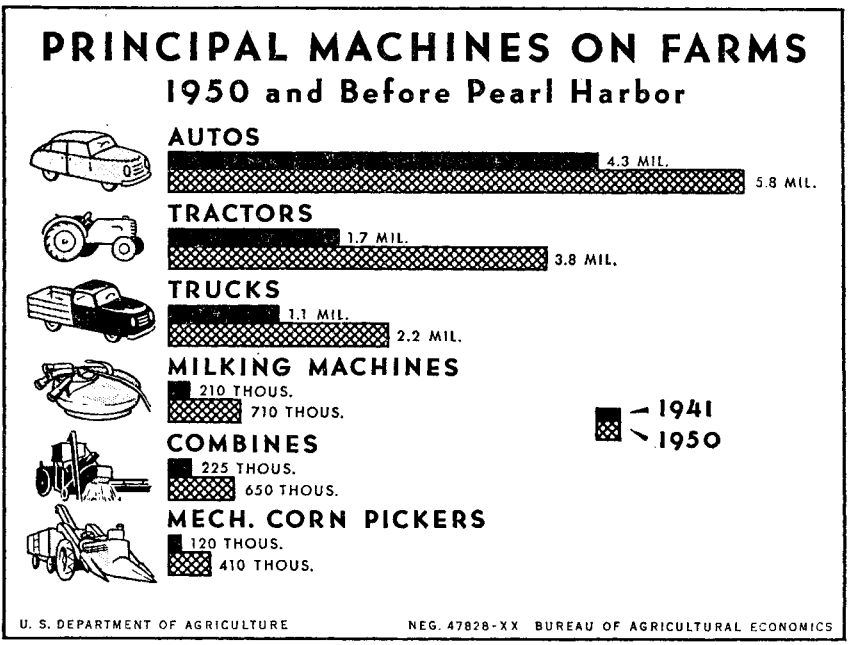


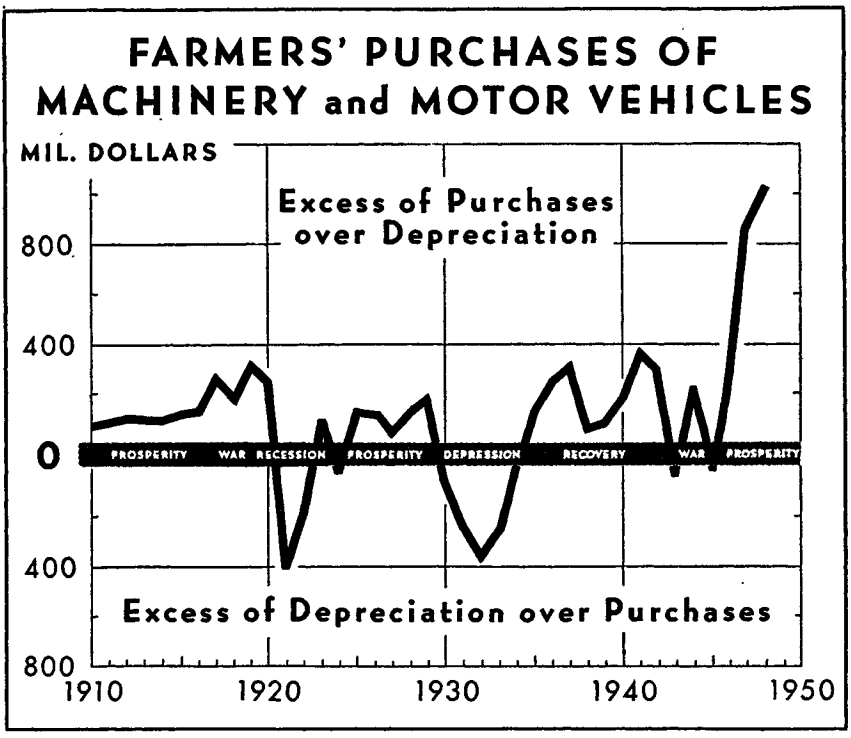
CHART 10



The ability of farmers to purchase machinery and motor vehicles at a rate substantially in excess of requirements for replacement of depreciation on previously acquired equipment is neatly depicted on chart 11. While purchases during the war barely balanced the requirements of depreciation, since 1945 purchases have far exceeded depreciation.

This illustration from the field of agriculture points clearly to problems likely to arise in other areas if a reasonable rate of increase in productivity is to be maintained during a long period of defense

CHART 11



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mobilization. The rate of investment in plant and equipment must be such as to continue present rates of increase in output per man-hour. While certain types of plant and equipment can be cut back as has already been done in the National Production Authority order curtailing commercial construction, investment in other fields, as, for example, aluminum and steel, will have to be maintained. Such channeling of investment will become of increasing importance as defense requirements make necessary reductions in the net private domestic investment that can be permitted.

All things considered, an increase in productivity of between 2½ and 3 percent should be possible for the fiscal year 1951 (July 1, 1950, through June 30, 1951). In the following fiscal year a further increase of between 1 and 2 percent should be possible. As shown in table

VII, the resultant indexes would rise from 96.1 (1950=100) to 100 by fiscal year 1950, to 102.8 in fiscal year 1951, and to about 104.0 in fiscal year 1952.

C. Gross national product in constant prices

A summary of the estimates concerning manpower and productivity is given in table VII which will merit careful scrutiny. Let the fact be reemphasized that these do not purport to be forecasts of what will actually happen. Rather, they are an indication of what is possible within this period, in the light of the manpower potential available, the possibilities of increasing average weekly hours, and the potential increase in productivity.

TABLE VII.—*Gross national product in constant prices, employment, average weekly hours, and productivity, fiscal years 1949 to 1952*

Fiscal year or quarter	Total employment		Average weekly hours		Productivity index [2] (1950=100)	Gross National product in constant prices [1 2]	
	Actual (millions of persons)	Index (1950=100)	Actual	Index (1950=100)		Actual (billions of dollars)	Index (1950=100)
1949	60.7	100.5	42.5	101.7	96.1	259.2	98.4
1950	60.4	100.0	41.8	100.0	100.0	263.4	100.0
1951	[3] 63.2	[3] 104.6	[3] 42.4	[3] 101.4	[3] 102.8	[3] 288.0	[3] 109.3
1952	[3] 65.5	[3] 108.4	[3] 43.6	[3] 104.3	[3] 104.0	[3] 310.0	[3] 117.7
QUARTERS [3]							
1950—First: July to September	61.2	101.3	41.6	99.5	98.5	256.2	97.3
Second: October to December	60.5	100.2	41.8	100.0	99.5	256.9	97.5
Third: January to March	58.5	96.9	41.5	99.3	100.5	267.9	101.7
Fourth: April to June	61.3	101.5	42.5	101.7	101.5	272.4	103.4
1951—First: July to September	62.9	104.1	40.6	97.1	102.0	279.4	106.1
Second: October to December	63.1	104.5	42.8	102.4	102.5	286.3	108.7
Third: January to March	62.3	103.1	42.5	101.7	103.0	291.0	110.5
Fourth: April to June	64.4	106.6	43.5	104.1	103.5	295.0	112.0
1952—First: July to September	65.6	108.6	43.1	103.1	103.7	303.0	115.0
Second: October to December	65.3	108.1	43.7	104.5	103.9	309.0	117.3
Third: January to March	64.6	107.0	43.3	103.6	104.1	213.0	118.8
Fourth: April to June	66.7	110.4	44.3	106.0	104.3	316.0	120.0

[1] Deflated by Consumers Price Index of U. S. Bureau of Labor Statistics.
[2] Adjusted for seasonal variations.
[3] Estimated.

SECTION III—THE DEMAND FOR GOODS AND SERVICES

So far this analysis has been directed at estimating the magnitude of the increase in output that can be achieved; the probable distribution of that output between consumers, business, and government; and the problems involved in reaching these goals. If incomes of consumers, business and government increased just sufficient to enable each sector to purchase the volume of goods and services available to it at June 1950 prices, then no problem of inflation would arise that could not be restrained effectively by existing controls. If business attempted to advance prices, the Office of Price Stabilization could easily prevent it because there would be no "hot money" claiming goods and services.

The inflationary problem arises as a critical danger in a period of defense mobilization precisely because this balance between incomes

and supplies of goods and services to the various sectors is not automatically achieved. This section analyzes the shifts in demands which lead to inflationary pressures too great to be restrained merely with direct controls over wages, prices and production even when working with maximum effectiveness.

There are two categories of sources of inflationary unbalance between the supply and demand for goods and services. The more obvious and less dangerous sources may be called primary; the less obvious, but potentially more menacing sources, may be called secondary.

The primary inflationary pressures arise because of an unbalance between the incomes of consumers, business, and government and the supplies of goods and services available to each. If government expenditures for 1952 total $75 billion, and private incomes (including consumers and business) account for about 80 percent of total incomes from gross national production, there will be left for the government (Federal, State, and local) only 20 percent. If only 75 percent of total output of goods and services is available to the private economy (consumers plus business), and 25 percent goes to government, the private sector of economy would have an inflationary excess of purchasing power amounting to 5 percent of total incomes. It is this primary excess demand that is estimated later in this section.

In addition to the above primary excess demand, additional, cumulative, spiraling effects can get under way (and will, if adequate tax and monetary policies are not adopted at once) which will reinforce the inflation, ballooning prices to far higher levels than the primary inflationary pressures warrant.

Thus at the beginning of the present mobilization period in July 1950, economic activity as measured by incomes, employment, physical output, prices, and consumer spending was already rising. Business, labor, agriculture, and consumers were in a position to plan programs for some months in advance on the basis of rising economic activity. In this situation the first impact of the defense program was to give additional and, indeed, complete assurance to all sectors of the economy that: (1) Demand for goods and services would continue to rise rapidly, and (2) increased military expenditures by the Federal Government might soon restrict the output of goods and services for the civilian economy. Thus the first impact of the defense program was a sharp rise in primary market prices, a sudden surge of forward buying by consumers and by business, and the opening of negotiations for wage increases.

Furthermore, the output of goods and services in constant prices increased sharply from the second to the third quarter, although as yet actual Government expenditures from the Treasury were not appreciably increased. In fact, Government expenditures on defense for the first 5 months following the invasion of South Korea by the Communist forces were actually lower than in the same 5 months of the previous fiscal year. There was, however, an immediate increase in defense obligations. In the third quarter, the defense establishment obligated about $9,000,000,000, of which nearly $6,000,000,000 represented procurement or orders and letters of intent.[6] Furthermore, Government-owned facilities such as synthetic rubber plants were

[6] Survey of Current Business, U. S. Department of Commerce, Office of Business Economics, November 1950, p. 1.

reactivated and a substantial increase occurred in contracts placed for stockpile buying.

These initial reactions on the business system of the mere announcement of increased defense outlays illustrate vividly the first two sources of increased demand, namely, (1) anticipations by businessmen and by consumers of future levels of economic activity; and (2) increased expenditures by business, agriculture, and consumers induced by increased obligational authority though no increase in Government expenditures occurred for 6 months or more.

Labor during the fall and winter months became increasingly restive. As the Survey of Current Business put it in the issue for November 1950:

> Recent wage rate advances resulted in an increase in gross hourly earnings for all manufacturing industries by almost 2 cents from mid-August to mid-September. This represented the largest month-to-month advance in the last 2 years and brought average hourly earnings to 1.48. Average weekly earnings of all production workers advanced to $60.53 in mid-September, an increase of 21 cents over mid-August and nearly $5 higher than in September a year ago.[7]

As wage and salary payments rose in response to increased physical activity, increased employment and higher average hourly earnings, consumer expenditures rose. This stimulated further price increases in the wholesale and retail markets which resulted in renewed demands for further wage increases. Thus on the labor side, the wage-price spiral was given increased momentum. This represents the secondary, or cumulative, self-generating inflation.

Collateral effects of the defense program appeared in the field of gross private domestic investment. Business and agricultural units, expecting higher prices and shortages, built up inventories and expanded capacity. Gross private domestic investment rose in the third quarter of 1950 by $1½ billion, to a total of $48.4 billion, a figure nearly 15 percent higher than the total in the first quarter of 1950 (seasonally adjusted at annual rates). In the fourth quarter of 1950 gross private domestic investment rose further to $57.0 billion. Further increases in investments in plant, equipment, and inventories will probably occur to the limits allowed by materials, manpower, and Government regulations.

A further secondary source of inflationary demand was the liquidation of financial assets by individuals and corporations in order to buy physical goods and services, or assets, as a hedge against further price increases. During the second half of 1950 there were substantial withdrawals from savings accounts and unusually large redemptions of United States Savings Bonds. Between July and December 1950 time deposits declined by a net of $500 million in spite of a seasonal increase between November and December of $200 million. For the 5 months, July through November 1950, sales of United States savings bonds—series E, F, and G—exceeded redemption by $22 million. However, the sales included $621 million in a special sale in October in excess of normal limits of large F and G bonds. If these are eliminated, redemptions exceed sales by $599 million. On series E bonds alone, for the 4 months of July through October, redemptions exceeded sales by $367 million.

Additional impetus was given to the inflationary spiral by a rapid expansion of credit, both to consumers and business. Consumers

[7] Survey of Current Business, November 1950, p. 2.

tried both to avoid the effects of inflation and to "beat the gun" in anticipated scarcity of consumer goods and services. Regulations W and X, controlling consumer credit and housing credit, were tightened. Nonetheless, between June and December 1950, total consumer credit outstanding showed an increase of $2,349 million to a new peak of $20 billion. Similarly, between June and December 1950, loans of all commercial banks rose by $7.9 billion, or about 17.6 percent.

To sum up, under existing conditions the development of a self-generating, secondary inflation out of increased defense expenditures involves the following general processes:

1. A sharp rise in the level of economic activity expected by business and consumers.
2. Spending out of borrowings and incomes by consumers and business induced by—
   (*a*) Large appropriations, obligational authority, and military orders.
   (*b*) Anticipations of further increases in the Government defense budget.
   (*c*) A rise in profit levels and income levels.
   (*d*) Determination "not to be caught" as individuals when general shortages or price freezes occur.
3. Increased consumer incomes due to higher wages, increased employment, higher dividends, and higher prices.
4. Further increases in consumer spending in line with increased incomes.
5. Higher prices as a result of bidding of consumers, business, agriculture, and Government for available goods and services.
6. Wage increases to compensate for increases in the cost of living.
7. Further price increases, further increases in the velocity of circulation of money, further increases in borrowing, in buying, etc.

Perhaps no one factor tends to pyramid this inflationary process faster than business investment. This is due to the fact that increased business investment, like Government spending, will absorb goods and services and create additional incomes via wages, salaries, dividends, etc., without immediately making available an increase in final output. For example, the steel industry absorbs manpower and materials for a period of 15 months to 2 years before increased steel output from new mills becomes available. In the meantime, increased investment, while admittedly highly desirable both socially and economically, feeds the inflationary fires within the economy.

The problem of translating these considerations into a quantitative estimate of the demand for goods and services in the economy if secondary inflationary pressures are allowed to operate can be attacked in a number of ways. With historical data we might derive an average value for the ratio of the increase in gross national expenditures (or demand) to changes in Government expenditures for goods and services. Another way would be to develop a simple but reasonably complete mathematical model of the relationships between the various changing elements in the economy, such as business investment, Government expenditures, consumer expenditures, and prices. Another method would be simply to apply to the current situation the relative changes in demand that occurred in other similar periods

of rapidly increasing Government expenditures. The final method is to carry through an estimate of demand by estimating separately various demand elements such as wages and salaries, personal incomes, etc. Under many circumstances the various methods are likely to give significantly different results, but in the context of the present problem certain simplified procedures are at hand that permit an appraisal of the minimum dimensions to which demand might rise if secondary inflation or cumulative effects are not checked.

In the first place, a reasonable estimate can be made concerning the largest single component of consumer incomes, to wit, wages and salaries. If an increase in employment and in hours worked per week equivalent to that shown in table VII occurs, then the increase in average annual earnings per employee will run about 10 percent per year. This includes an allowance for increases in wage rates, increased average weekly hours and average annual hours, overtime payments, and shift differentials. It would also include some allowance for premium payments above standard rates for certain scarce skills.

The resultant increases in wages and salaries are indicated in table VIII. Note that in fiscal 1950 wages and salaries amounted to $136.4 billion. Conservatively estimated, this total may rise to $156.2 billion in fiscal 1951 and to $179 billion in fiscal 1952.

In fiscal 1950 wages and salaries accounted for about 65 percent of personal income. On this basis, personal income can be expected to reach $236 billion for fiscal 1951 and $264 billion for fiscal 1952, with a peak annual rate, seasonally adjusted, in the fourth quarter of fiscal 1952 (April to June 1952) of $273 billion. If present tax rates effective under the tax bill passed by Congress in September are applied, and savings continue their historic relationship of 5 percent of personal income, consumers will have available to spend on goods and services, and may try to spend about $203 billion in fiscal 1951 and $224.8 billion in fiscal 1952, with an annual rate for the fourth quarter of fiscal 1952 of $232.1 billion. These levels may be compared to $198.9 billion spent by consumers in the first quarter of the current fiscal year, July to September 1950.

TABLE VIII.—*Estimate of total wages and salaries*

Fiscal year or quarter	Index of (fiscal year 1950=100)			Wages and salaries seasonally adjusted annual rate (billions of dollars)
	Average annual earnings per worker	Employment	Wages and salaries seasonally adjusted annual rate	
1950	100.0	100.0	100.0	136.4
1951—July–September	105.9	102.9	109.0	148.5
October–December	108.3	104.0	112.5	153.5
January–March	110.8	105.2	116.4	158.8
April–June	113.0	106.3	120.1	164.0
Yearly average	109.5	104.6	114.5	156.2
1952—July–September	115.9	107.3	124.7	170.1
October–December	119.2	107.9	128.9	175.9
January–March	122.0	108.8	133.2	182.5
April–June	124.8	109.6	137.2	187.5
Yearly average	120.5	10.84	131.0	179.0

From the Government expenditure figures [8] already presented, the total Federal Government take of goods and services may be as high as $59.0 billion in fiscal 1952, compared to $21.2 billion in the first quarter of the fiscal year (July to September 1950). Expenditures of State and local governments are not only rising but under the impact of civil defense programs are likely to continue to expand to about $22.0 billion in fiscal 1952.

The only segment of the demand for gross national product which has not yet been estimated under this procedure is business spending, whether for foreign or for private domestic investment. The former is small and will be assumed to remain relatively constant. An examination of the historical data with respect to the latter, that is, gross private domestic investment, shows that, although it changes much more violently than any other segment, rarely does it change in absolute amounts or in billions of dollars more than half of the absolute change in combined expenditures by consumers and government. If this relationship holds true in the present period, the level of gross private domestic investment which was $37.3 billions in fiscal 1950 and which promises in fiscal 1951 to jump by more than a third to $53.5 billion may rise further in 1952 to about $61.5 billion.

Despite controls over building materials and steel, the level of business investment may stay high. In the first place, industry is operating in many industries at rates exceeding normal rate of capacity, i. e., above the "peak" economic rate. Furthermore, Government programs as set up under the Defense Production Act and the tax amortization deductions permitted in recent tax legislation will tend to provide incentive to increased investment, especially for concerns subject to excess profits taxes. The lack of dependability of supplies and anticipated price increases will cause business to increase their inventories to the maximum allowed under present inventory rules of the National Production Authority. As a general rule, retained earnings after taxes and dividends will remain at current extraordinarily high levels. Credit, especially for so-called defense production, is freely available. Business spending for plant, equipment, and inventories will consequently be as high as controls over inventories and construction will allow.

To sum up,[9] incomes from gross national product could rise from $284.3 billion in the first quarter of fiscal 1951 (July to September 1950) to $385 billion in the fourth quarter of fiscal 1952 (April to

[8] See table II, p. 58.

[9] The detailed estimates and the calculations of possible price rises under a secondary inflation are as follows:

Item	July–September 1950	April–June 1952	Fiscal year	
			1951	1952
Total wages and salaries	148.5	187.5	156.2	179.0
Personal income	224.9	273.0	236.0	264.0
Personal taxes (plus savings)	26.0	40.9	33.0	39.2
Consumer demand	198.9	232.1	203.0	224.8
Government demand	40.4	91.9	52.2	81.0
Federal	20.9	69.3	31.2	59.0
State and local	19.5	22.6	21.0	22.0
Business demand	44.5	61.0	50.0	58.0
Total demand (current prices)	283.9	385.0	305.2	364.0
Total supply (June 1950 prices)	279.4	316.0	288.0	310.0
Price index (June 1950=100)	101.6	121.8	106.0	117.4

June 1952). These figures represent demands in current dollars under conditions of self-generating inflation. On the average, these estimates of gross national product correspond to an estimated total demand (consumers plus business plus government) of $305.2 billion in fiscal 1951 and $364 billion in fiscal 1952. These figures imply a possible minimum inflation due to uncontrolled secondary effects of at least 20 to 25 percent by June 1952 even with price and wage controls striving to keep primary inflation in check. In other words, if no new fuel is put under the boiler at all (i. e., all wages and prices are frozen as much as possible at current levels) the fuel now there will drive the inflation thermometer up further by the amount estimated.

These estimates of the further effects of "hot money" already loose in the economy presuppose present direct economic controls, present tax laws, and persistence of normal relationships between various sectors of the economy. Precise accuracy is, of course, impossible but there are ample grounds for maintaining that these estimates, far from being "scare" figures, understate the dangers which this Nation faces from secondary or cumulative inflationary pressures already let loose even if further primary pressures are checked.

Two sources of secondary inflation have been completely ignored: (1) Abnormal shift of liquid assets of individuals and business into goods and services; and (2) further excessive increases in the velocity of circulation and volume of available money and credit. As of September 30, 1950, manufacturing corporations alone had cash amounting to $12.9 billion. All non-bank corporations and associations on December 31, 1950, held $60.5 billion of Federal securities while individuals held $67.2 billion. These Government securities are equivalent to cash. The total of these three items of liquid assets alone amounts to $140.6 billion A shift of as little as 10 percent of these assets to the ownership of goods and services would add $14.1 billions to the monetary demand bidding for that which the Nation can produce.

For every billion dollars of United States Government securities sold to the Federal Reserve System under the present pegging operations, bank reserves can be increased sufficiently to support additional loans by the banks of $4 billion to $6 billion. Clearly the estimates of possible secondary inflationary demand made above may well be excessively conservative, especially so if further secondary inflation is allowed to accelerate the current "flight from the dollar."

Primary inflation

How large are these primary inflationary demands resulting from an unbalance between incomes (demand) and supplies available to each sector of the economy: Consumers, business, and government?

To make precise estimates requires much better data and more detailed knowledge of the interrelationships between various segments of the economy than is at present available. However, it is possible to translate various likelihoods into rough magnitudes.

As is well known, at any stated level of prices and output, incomes from gross national production are equivalent to expenditures for gross national output. Total incomes, therefore, in this primary demand estimate consist of the total supply of goods and services estimated in table VII, page 73, revalued at current prices. Since our objective is to stabilize the price level at as near the current level as is feasible, total demand can be calculated upon the basis of the

income flows that result from producing the output shown in table VII at the prices currently prevailing in the December 1950 to January 1951 period. This would mean a dollar volume of gross national product of at least $325 billion.

Since total incomes derived from gross national production will also be equivalent to this $325 billion, how much will have no physical counterpart and hence be "hot money" in the pockets of consumers and of business likely to bid up prices? Basically, this depends upon how much of the physical output the Government takes. Wages and profits will be earned on the production both of civilian items and of defense items, yet consumers will spend their incomes (except for savings) mostly for consumable goods, and businessmen will spend their earnings and borrowings mostly for capital goods. Since the Government will be taking an increasing share of the gross production rising from the present levels of about 7 percent to one of about 16 to 20 percent by the end of fiscal 1952, there is bound to be more consumer funds than there will be consumer goods available and likewise an excess of potential business spending over the supply of capital goods available.

In making the estimates of primary demands, no allowance is made for taxes other than those provided for in the January 1951 tax schedules. If normal relations persist between the various incomes from the gross national product, the primary consumer demands in quantitative terms are estimated to be as shown in table IX, page 82. If gross national product be $325 billion, the corresponding national income may well be about $273.3 billion after making adjustments for capital consumption allowances, for indirect business tax and nontax liability, business transfer payments and Government subsidies, less current surplus of Government enterprises. If the national income is adjusted for elements of business income and Government income that do not flow to individuals, the estimate of personal income approximates $244.5 billion. At present tax rates this would mean disposable personal income of about $220 billion for fiscal 1952 and about $207.7 billion for fiscal 1951.

Not all of this disposable personal income would be spent on current goods and services. In periods of high prosperity and full employment consumers have shown a tendency to save an average of about 5 percent. During fiscal 1951 they apparently will save slightly less than this because of their rush to obtain durable and other goods, while the getting was good. For fiscal 1952, however, it may be conservative, in view of the lack of durable goods and other controls, to estimate that they will save no more than the 5 percent usually set aside for savings in other periods of full employment. If so, personal savings will be at least $11 billion in fiscal 1952 and about $8.9 billion in fiscal 1951. Therefore consumer demand for goods and services could amount to $198.8 billion for fiscal 1951 and $209 billion for fiscal 1952.

How much will be the demand of business for capital goods? This is much more difficult to estimate than consumer demand. On the basis of the post World War II relationship of profits adjusted for changing inventory values to total business activity, corporate profits might be about $44 billion in fiscal 1952 compared to about $41 billion in fiscal 1951. (See table X, p. 83.) In 1951 inventory profits may total about $4 billion but if prices are stabilized at about current

levels, nothing further needs to be added for inventory profits in 1952. At current corporate tax rates, corporate profits tax liability would amount to about $24 billion in fiscal 1952. At recent ratios of dividend payments to corporate profits after taxes, dividend payments can be expected in fiscal 1952 to approach $7.5 billion compared to the $10 billion which it is estimated corporations will pay out in fiscal 1951 and the $7.8 billion they actually paid out in fiscal 1950.

If to the resulting undistributed profits totals remaining after tax liability and dividend payments, there are added the capital consumption allowances available to corporations for spending and the amount of dissaving that they ordinarily make at current levels of activity (dissaving means a borrowing of corporations as a group from individuals or financial institutions) total business demand in 1952 may total about $51.3 billion compared to $47.7 billion in fiscal 1951 and to an actual $35.9 billion in fiscal 1950.

The demand of Government for goods and services is, of course, equivalent at current prices to Government expenditures as set forth in table II, page 58 (except for those items in the Federal budget which represent transfers of income to business and individuals and which have been included in the estimates of business and consumer demand. These include transfer payments, such as unemployment compensation and old-age assistance, net interest paid to individuals and business, and some small items to foreign loans, errors and omissions in translating from the Federal budget concepts to gross national product concepts used by the Department of Commerce.) In table II, the low assumption implies expenditures by the Federal Government of $65 billion, the middle assumption $75 billion, and the high assumption $85 billion. If these are adjusted for the income transfers indicated above, Federal demand for goods and services would amount to $49 billion (low), $59 billion (middle), and $69 billion (high). In addition, State and local governments, on the basis of past trends, can be expected to demand about $22 billion in goods and services regardless of what assumption is made as to Federal expenditures.

To sum up the total of all demand (consumer plus business plus Government), the total demand would be $331.3 billion (low), $341.3 billion (middle), and $351.3 billion (high).

SECTION IV—ESTIMATES OF EXCESS DOLLAR DEMAND

It is now possible to estimate the inflationary excess of demand likely to be generated under present economic controls over the supply of goods available at constant prices. Sections I and II provide estimates of the supply of goods and services likely to be available in terms of constant prices through fiscal year 1952. Section III provides an estimate of the money demand likely to be generated by increased economic activity and defense spending in that period even if present controls are fully effective. For each sector of the economy, an estimate of the inflationary excess is obtained by subtracting the supply or gross national product at constant prices from the amount of available dollars.

How much is consumer inflationary pressure likely to be? Its magnitude will depend on the amount of Government expenditures. If Government expenditures are low, the supply of goods and services to consumers will be high, so that the amount of excess dollars will be

low. If Government expenditures are high, the consumer supply of goods and services will be low and the inflationary excess high. As elsewhere in this report, "low" is defined in quantitative terms in table IX and the other tables on the basis of total Federal Government outlay in fiscal 1952 of $65 billion. A total of $85 billion is assumed to be "high," while $75 billion is assumed to be the middle estimate. Table IX shows that on these three assumptions, the inflationary consumer demand is estimated at $3 billion (low), $10 billion (middle), and $16 billion (high).

TABLE IX.—*Excess consumer inflationary demand on the basis of existing tax program, fiscal years 1950, 1951, 1952*

[Billions of dollars]

Description	1950 actual	1951 estimate	1952 estimates		
			Low [1]	Middle [2]	High [3]
Gross national product (current prices)	260.8	[4] 298.4	[4] 325.0	[4] 325.0	[4] 325.0
Less:					
Capital consumption allowances	19.6	22.0	26.0	26.0	26.0
Indirect business tax and nontax liability	22.1	24.8	25.0	25.0	25.0
Business transfer payments	.7	.7	.7	.7	.7
Statistical discrepancy	−.6	0	0	0	0
Plus: Subsidies less current surplus of Government enterprises	.2	0	0	0	0
Equals: National income	219.2	250.9	273.3	273.3	273.3
Less:					
Corporate profits and inventory valuation adjustment	30.9	41.0	44.0	44.0	44.0
Contribution for social insurance	6.2	7.3	8.0	8.0	8.0
Excess of wage accruals over disbursements	0	0	0	0	0
Plus:					
Government transfer payments	14.7	12.3	10.0	10.0	10.0
Net interest paid by Government	4.7	4.9	5.0	5.0	5.0
Dividends	8.0	10.0	7.5	7.5	7.5
Business transfer payments	.7	.7	.7	.7	.7
Equals: Personal income	210.2	230.5	244.5	244.5	244.5
Less:					
Personal tax and nontax payments	18.9	22.8	24.5	24.5	24.5
Federal	16.4	20.0	21.4	21.4	21.4
State and local	2.5	2.8	3.1	3.1	3.1
Equals: Disposable personal income	191.3	207.7	220.0	220.0	220.0
Less: Personal savings	9.5	8.9	11.0	11.0	11.0
Equals: Consumer demand	182.0	198.8	209.0	209.0	209.0
Supply (prices at beginning of period) expenditures for gross national product	262.7	288.0	325.0	325.0	325.0
Less:					
Gross private domestic investment	37.3	48.5	51.0	48.0	44.0
Net foreign investment	−1.1	−3.5	−3.0	−3.0	−3.0
Federal purchases of goods and services	23.7	32.4	49.0	59.0	69.0
State and local government purchases of goods and services	18.9	19.7	22.0	22.0	22.0
Equals: Consumers' supply	183.9	190.9	206.0	199.0	193.0
Consumer inflationary excess: Excess of consumer demand over supply	[5] −1.9	[6] 7.9	3.0	10.0	16.0

[1] Assumes Federal consolidated cash expenditures of $65 billion.
[2] Assumes Federal consolidated cash expenditures of $75 billion.
[3] Assumes Federal consolidated cash expenditures of $85 billion.
[4] Assumes prices stabilized at approximately Jan. 25, 1951, levels, with wholesale prices some 11 to 13 percent above June 1950 levels, and retail prices 6 to 8 percent above June 1950 levels.
[5] For fiscal 1950 the inflationary pressure was negative, prices declining by about 1 percent.
[6] For fiscal 1951 the inflationary pressure will result in a substantial rise in prices of 6 to 8 percent; a larger price rise than indicated by the primary inflationary excess demand shown above because secondary spiralling effects have been permitted.

Source: The U. S. Department of Commerce, Bureau of the Budget, and the staff of Joint Committee on the Economic Report.

How much will the inflationary pressure from business grow? How much will business demand for capital goods exceed the supply of such goods? That, too, will depend on whether Government expenditures are low, medium, or high. The supply-and-demand estimates are summarized in table X, which shows that excess business demand will total $3.3 billion at "low" levels of Government expenditures, $6.3 billion at the "middle" level, and $10.3 billion at the "high" level.

In the Government sector, demand and supply are equivalent in the sense that Government will spend the assumed amounts either wholly or in large part out of tax receipts. At present tax rates the receipts of the Federal Government would be too low by $5 billion at "low" levels of Government expenditures, $15 billion at "medium" levels, and $25 billion at "high" levels. If the inflationary pressures are not effectively removed, price rises will occur, and Government expenditures will in all three cases rise above those shown in tables IX and X.

TABLE X.—*Business inflationary spending on the basis of existing taxes, fiscal years 1950, 1951, 1952*

[Billions of dollars]

Description	1950 actual	1951 estimate	1952 estimates		
			Low [1]	Middle [2]	High [3]
Demand (current prices):					
Corporate profits before taxes and inventory valuation adjustment	30.6	[4] 41.0	[4] 44.0	[4] 44.0	[4] 44.0
Less:					
Corporate profits tax liability	12.8	24.5	24.0	24.0	24.0
Inventory valuation adjustment	.3	−4.0	0	0	0
Dividends	8.0	10.0	7.5	7.5	7.5
Plus:					
Capital consumption allowances, etc	19.8	22.0	26.3	26.3	26.3
Dissaving	6.6	15.2	12.5	12.5	12.5
Equals: Business demand	35.9	47.7	51.3	51.3	51.3
Supply (prices at beginning of period):					
Expenditures for gross national product	262.7	288.0	325.0	325.0	325.0
Less:					
Federal Government purchases of goods and services	23.7	32.4	49.0	59.0	69.0
State and local government purchases of goods and services	18.9	19.7	22.0	22.0	22.0
Consumer expenditures	183.9	190.9	206.0	199.0	193.0
Equals: Business supply	36.2	45.0	48.0	45.0	41.0
Business inflationary pressure: Excess of business demand over supply	−[5] 3	[6] 2.7	3.3	6.3	10.3

[1] Assumes Federal consolidated cash expenditures of $65 billion.
[2] Assumes Federal consolidated cash expenditures of $75 billion.
[3] Assumes Federal consolidated cash expenditures of $85 billion.
[4] Assumes prices stabilized at approximately January 25, 1951, levels with wholesale prices some 11 to 13 percent above June 1950 levels, and retail prices 6 to 8 percent higher.
[5] For fiscal 1950 the inflationary pressure was negative, prices declining about 1 percent.
[6] For fiscal 1951 the inflationary pressure will result in a rise in prices of 6 to 8 percent; a larger price rise than indicated by the primary inflationary excess demand shown above because secondary spiralling effects have been permitted.

Source: The United States Department of Commerce, the Bureau of the Budget, and the staff of the Joint Committee on the Economic Report.

What price rises would be likely to result from such inflationary pressures? A first approximation to such an increase is afforded by extending the trend of prices since June 1950. Between June and December 1950, the index of consumers' prices increased by 4.7

percent, while the index of wholesale prices rose by 10.4 percent. Had prices been allowed to continue to rise unchecked at such rates consumers' prices by June 1952 would be 20.2 percent above June 1950. The wholesale price index on the same basis would be 48.5 percent above June 1950. Detailed figures are shown in table XI below.

TABLE XI.—*Wholesale and consumer price trends, June 1950 to June 1952*

Item	June 1950	December 1950	June 1951	December 1951	June 1952
Wholesale prices:					
All commodities (1926=100)	157.3	173.7	[1] 191.7	[1] 211.6	[1] 233.6
June (1950=100)	100.0	110.4	[1] 121.9	[1] 134.5	[1] 148.5
Consumer prices:					
All items (1935–39=100)	170.2	178.4	[1] 186.5	[1] 195.4	[1] 204.6
June (1950=100)	100.0	104.7	[1] 109.6	[1] 114.8	[1] 120.2

[1] Estimated value if rate of price increase since Korea is not diminished.

Even if Federal Government expenditures could be successfully restricted to a total of $65 billion in fiscal 1952, the combination of a $3 billion excess of consumer demand with an equal excess of business money demand will propel wholesale and retail prices upward at present rates of increase even under full and efficient operation of present controls and taxes. While the total primary pressure is somewhat smaller than that created since last June, price rises are likely to be no less. To propel an automobile after it has been started takes less additional power. The momentum of secondary or cumulative effects of the price rises that already are embedded in the price and cost system has scarcely been slowed down.

To take but one factor, gross private domestic investment, which amounted to only $41.7 billion (annual rate, seasonally adjusted) in the first quarter of 1950, was up to $48.4 billion in the third quarter and skyrocketed to $60.2 billion (annual rate, seasonally adjusted) in the fourth quarter of 1950. Such capital investments had their primary impact on the prices of raw materials. But they have a much larger delayed multiplier effect via wages and raw material purchases on the incomes of consumers, on retail prices, on bank credit, and the state of business in general. These delayed effects of the 1950 investment splurge are just beginning to make themselves felt.

Imported commodities, notably raw materials, have shown exceptionally large jumps in prices. Rubber increased from 28 cents a pound on June 23 to more than 48 cents on July 19, and on November 24 was selling for 63½ cents. Tin, at $1.35 a pound in November, was up almost 80 percent from June 23 levels and wool tops were selling for between $3.10 and $3.20 a pound compared to $1.33 a pound back in 1946 and only about $2.20 a pound in July 1950.

Note that these exceptional increases in prices occurred even before military expenditures increased to any appreciable extent. For the first 5 months of the current fiscal year the Defense Department actually paid out, on a daily Treasury statement basis, less than in the first 5 months of the previous fiscal year. But the Defense Establishment did assume obligations in the July–September quarter of 1950 of almost $9 billion, of which nearly $6 billion represented procurement orders and letters of intent.

If Federal Government expenditures approximate the middle assumption of these estimates, i. e., about $75 billion (the President's cash budget figure is $74.1 billion) the total of $16.3 billion ($10 billion consumer excess demand plus $6.3 billion excess business demand) would be large enough to cause prices to rise by almost twice the rate experienced since June 1950.

Careful inspection of charts 12, 13, 14, and 15, portraying the recent price history, clearly shows the course that prices will take, unless a bold and determined program of economic stabilization is enacted and enforced. Such price increases might increase actual Government expenditures above anticipated or budget levels by possibly 10 to 50 percent, or by, roughly, $6 billion to $30 billion during fiscal 1952 in excess of the figures estimated in table II.

ELIMINATING THE INFLATIONARY POTENTIAL

During the 1950 fiscal year, the Federal Government paid out $43.2 billion in cash, of which about $17.7 billion went into national defense and related activities.[10] Appropriations for national defense for the fiscal year 1951 so far have totaled about $56 billion. Not all of this will be spent in the current fiscal year—probably only about $27.1 billion—while in fiscal year 1952 defense expenditures are budgeted at $51.8 billion.

These inflationary potentials for fiscal 1951 and fiscal 1952,[11] in the absence of further increases in taxes, etc., will exist even if there be a Federal cash surplus of about $0.2 billion in fiscal 1951. In fiscal 1952 there would be a cash deficit of $12.8 billion.

But the Federal budget will be inflationary during the next 2 years as defense expenditures expand even though the "cash" budget is balanced. For the inflationary potential depends on the expectations of business and consumers rather than on the past, that is, upon anticipated Government buying as foreshadowed by appropriations and contract authorizations rather than current cash expenditures. Thus in 1952 the new defense obligational authority will amount to about $74.5 billion in addition to unexpended appropriations and authorizations from fiscal 1951, although actual defense expenditures within the fiscal year 1952 are budgeted at $51.8 billion. At the end of fiscal 1952, outstanding unexpended authorizations and appropriations for national defense and related activities may total almost $52 billion,[12] and total obligational authority $94.4 billion.[13]

Various suggestions have been made that the budget for fiscal 1952 as presented in the President's message to Congress in January 1951 could be reduced from his total cash expenditure figure of $74.1 billion by from $3 billion to $9 billion. Obviously the larger the cuts that can be made in Federal expenditures without endangering national security, the better. Unfortunately, the exact magnitude of the economies that will, in fact, be achieved cannot be estimated at this time since Congress has not yet had an opportunity to fully investigate the budget. Out of the $74.1 billion of cash payments to the public

[10] Includes military services, international security, atomic energy, promotion of defense production, and civil defense, as classified in table II, p. 58.
[11] See table IX, p. 82, and table X, p. 83 above.
[12] Includes military services, international security, atomic energy, promotion of defense production, and civil defense as classified in table II.
[13] Budget message of the President, January 1951.

CHART 12

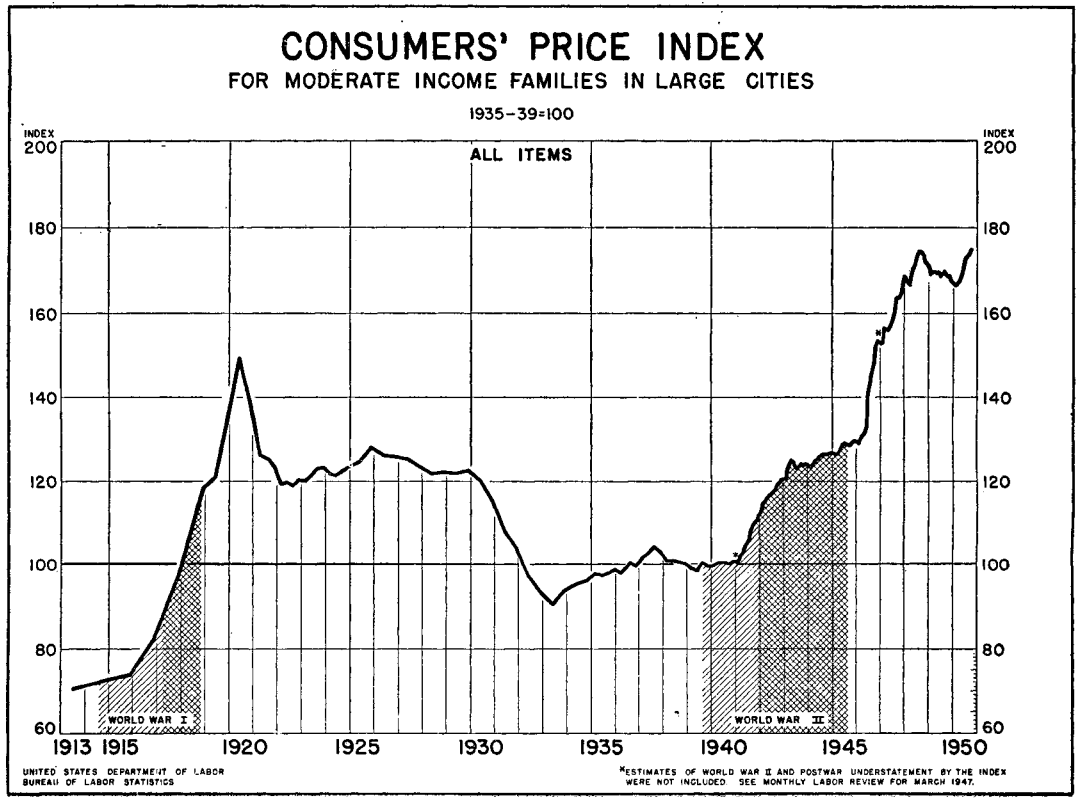


CHART 13

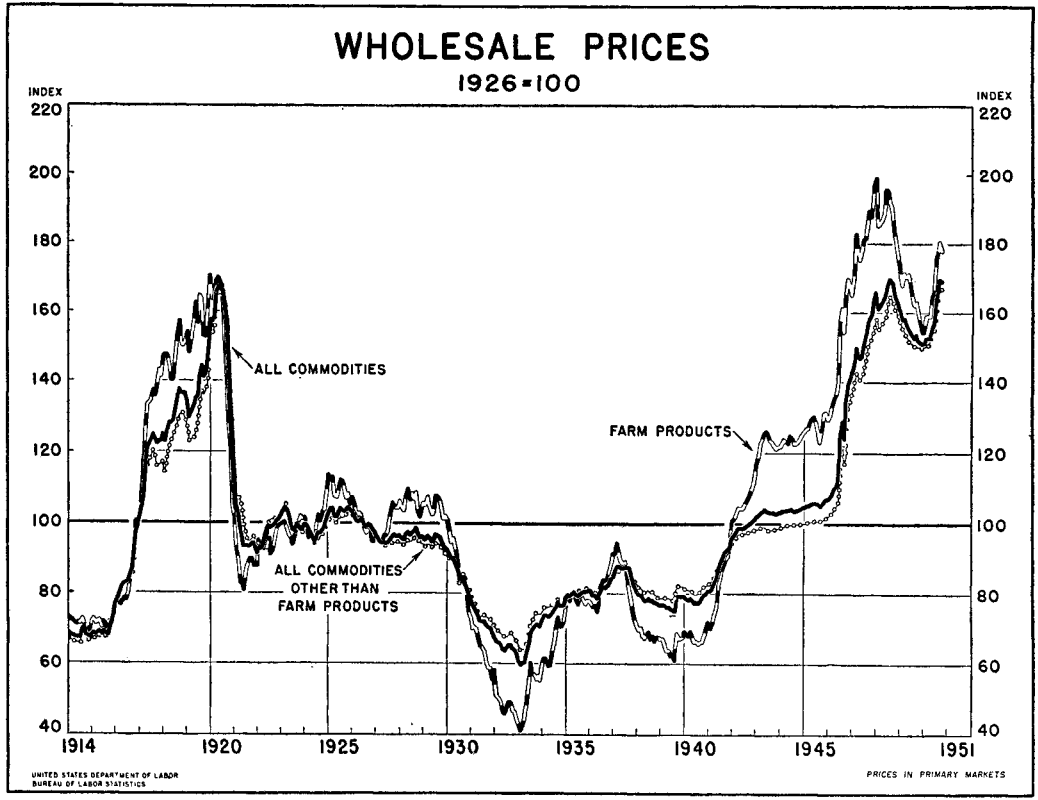


CHART 14

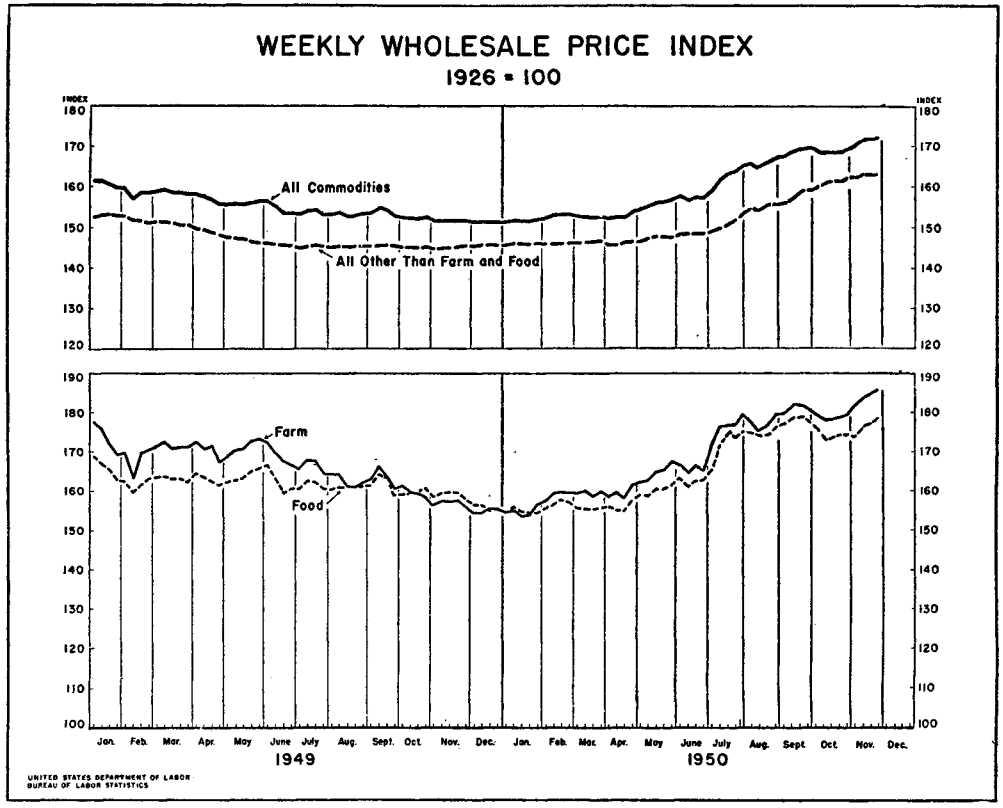
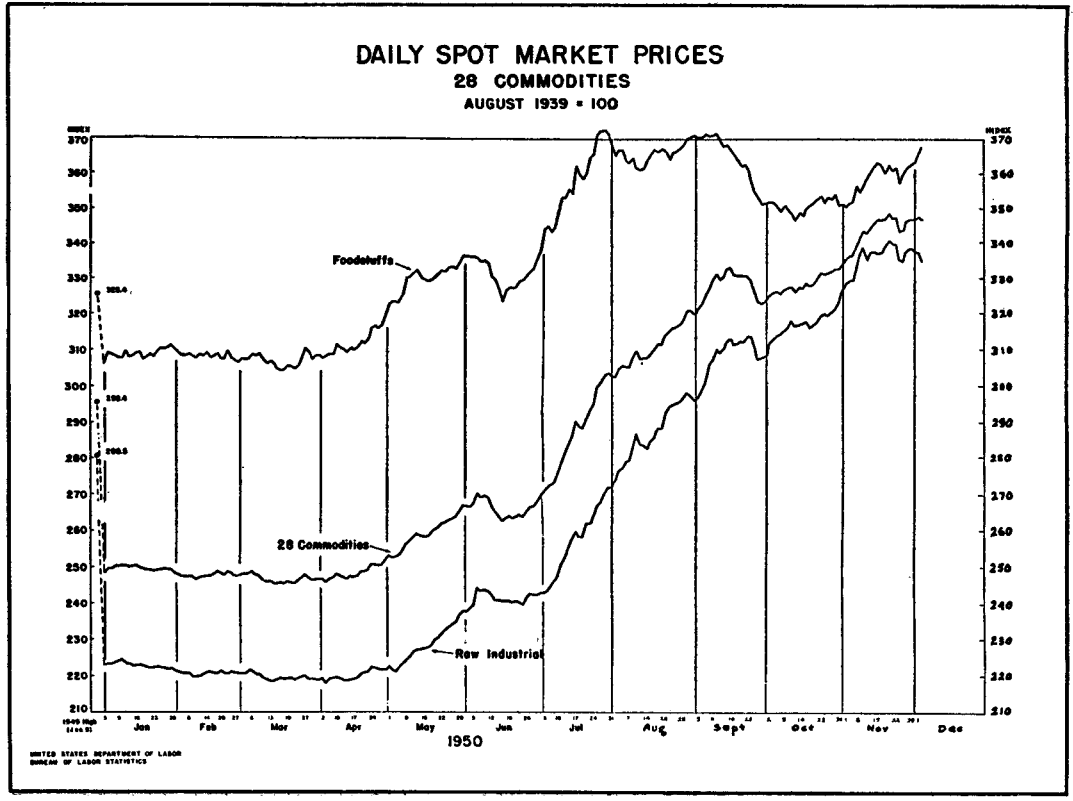


CHART 15



provided for in the budget, 56 percent is for the military services directly and an additional 13.9 percent is for other activities related to national defense. Interest on the public debt and veterans' services is estimated in the budget to require an additional 14.2 percent. This leaves for strictly civil functions as they are ordinarily understood only about 15.4 percent of the total budget. It is further significant that although the budget recommends enactment of an additional $94.4 billion of authority to incur new obligations, about $57.3 billion of this, or 60 percent, will not be spent until some time after the close of the fiscal year 1952. Similarly, during the fiscal year 1952 $34.5 billion, or 48 percent, of estimated budget expenditures will come from authority enacted for 1951 or earlier years. Witnesses before this committee in its hearings on the President's January 1951 Economic Report unanimously urged that cuts in nonessential spending be pushed to the absolute maximum. Nonetheless, there seemed to be some belief that Prof. Albert G. Hart [14] correctly estimated the situation when he suggested that the maximum cuts might be on the order of $2 billion or $3 billion rather than figures two or three times that amount.

In four roundtables before this committee, 22 economists unanimously stressed the importance of early action on taxation as the most important and most necessary action that could be taken to control inflation. Tax increases take time to draft and enact and, further, time to be effective in reducing consumer and business purchasing. Hence, if effective action is to be taken which will reduce excess consumer purchasing power in the summer and fall of 1951, action must be taken now. To wait until late in the present session of Congress, when expenditure totals are known with reasonable precision, would mean no control over inflation of an effective character prior to January 1952, if then. Such a delay might well mean a continued increase in prices as rapid as that between June and December 1950. Even if expenditures were held to "low" assumption of this report ($65 billion Federal cash expenditures) which would mean a $9.1 billion cut in the President's budget, and even if there be efficient administration of direct controls over prices and wages, such continued price increases would inevitably raise the total Federal outlays for military procurement alone by $5 billion or $6 billion. The Senate Committee on Appropriations has already reported that the price rise between June and December 1950 ate up about $3 billion of military appropriations.[15] Sheer economy demands that

[14] Hearings, January 31, 1951.

[15] United States S. Rept. No. 2684, 81st Cong., 2d sess., report on second supplemental appropriation bill, 1951. The Committee on Appropriations reported as follows:

"The committee has been profoundly disturbed by the untimely increasing prices of commodities affecting national defense and feels that it is the responsibility of the Department of Defense to leave nothing undone to translate into orders at the earliest possible time, the appropriations which are made in this bill. The committee requested of the Department of Defense specific information with respect to the variations in price for military matériel and equipment since immediately before the outbreak of the Korean War. This report filed with the committee by the Office of the Secretary of Defense when analyzed carries the startling information that inflation has cut the value of the dollars of the sums appropriated for defense since pre-Korea by approximately $3,000,000,000."

tax action be taken quick enough to prevent such a kiting of defense expenditures through unchecked price increases.

To secure armament, materials and labor will have to be taken out of the economy away from the production of goods consumers and businessmen buy, into the production of goods the Government needs. If the Government fails to impose a tax-take equivalent to this real sacrifice, price controls eventually will break down and consumers will be compelled to make the sacrifice through increased prices. A million-dollar airplane purchased in 1940 with borrowed funds has already cost the American people not merely the $1 million of manpower and materials that went into the plane in 1940, but, in addition: (1) $333 thousand of interest on the million dollars, assuming the sum was borrowed from individuals through "E" Bonds; (2) a decline in the value of savings held by individuals amounting to tens of billions of dollars because of the failure to "pay-as-you-go" for World War II; and (3) since the original bonds cannot be paid off in 1950 as they come due and have to be renewed, this bomber may eventually cost vast additional sums for interest by the time the bonds are paid off at some remote future date.

In the following pages an attempt is made to evaluate quantitatively the economic effects of tax levies that might relieve inflationary pressures at low, medium, and high levels of Federal cash expenditures. It is important to note that in trying to estimate the deflationary impacts of specific tax increases one must take into consideration a complicated and, at present, largely unsolved problem. Taxes that prevent consumers or business from spending, or that come directly out of such spending, are fully effective in bringing down excess buying power. If taxes come out of savings which do not bid in the market for goods and services, they raise revenue for the Government but have little or no deflationary effects. It is highly important, therefore, to design the tax levies to the best extent of our knowledge so that their impact has the desired economic effect in this inflationary period. At present, current knowledge of the incidence of various types of taxes is such that the estimates presented in table XII represent no more than guesses, though they be the best now available.

If these estimates come even moderately close to actual likelihood (and it is felt that they do) then the magnitude of the program which has a chance of coming reasonably close to removing the inflationary pressures from excess consumer and business money demand (thus helping to keep prices at approximately January 25, 1951, levels and making other defense and control programs work) can be summarized in brief as it is done in table XIII–A and XIII–B. Note that these tables virtually recapitulate all estimates and epitomize the reasoning given thus far. Note too that in each case inflationary pressures are checked only because of the assistance of direct controls in increasing consumer and business savings.

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TABLE XII.—*Proposed Federal Government fiscal legislation and its economic effects, Federal fiscal year 1952*

[Billions of current dollars]

Description	Net additional Government funds and private liabilities	Estimated economic effects—				
		On corporate undivided profits	On personal income	On consumer demand	On individual voluntary savings	Gross national product
LOW—$65 BILLION						
Individual: Income taxes	2.0			−1.7	−0.3	
Business:						
Excise taxes	1.0			−1.0		+1.0
Corporation income taxes	2.0	−1.3	−0.7	.3	−.4	
Total	5.0	−1.3	−.7	−3.0	.7	+1.0
MIDDLE—$75 BILLION						
Individual: Income taxes	8.0			−7.2	−.8	
Business:						
Excise taxes	2.0			−2.0		+2.0
Corporation income taxes	5.0	−3.1	−1.9	−.8	−1.1	
Total	15.0	−3.1	−1.9	−10.0	−1.9	+2.0
HIGH—$85 BILLION						
Individual: Income taxes	11.6			−10.4	−1.2	
Business:						
Excise taxes	4.0			−3.9		4.0
Corporation income taxes	10.0	−6.3	−3.7	−1.7	−2.0	
Total	25.6	−6.3	−3.7	−16.0	−3.2	4.0

TABLE XIII–A.—*Estimated inflationary pressures at low, middle, and high levels of Federal Government expenditures in fiscal 1952*

[Billions of dollars]

Description	Federal cash expenditures		
	Low	Middle	High
Federal cash expenditures	65	75	85
Total inflationary pressure [1]	6.3	16.3	26.3
Consumer:			
Demand	209.0	209.0	209.0
Supply	206.0	199.0	193.0
Inflationary excess	3.0	10.0	16.0
Business:			
Demand	51.3	51.3	51.3
Supply	48.0	45.0	41.0
Inflationary excess	3.3	6.3	10.3

[1] See table IX, p. 82, and table X, p. 83.

TABLE XIII–B.—*Estimated additional taxes and controls needed to remove inflationary pressures*

[Billions of dollars]

Description	Low		Medium		High	
	Tax liability	Deflationary effect	Tax liability	Deflationary effect	Tax liability	Deflationary effect
Effect on the consumer inflationary excess demand of—						
Increased personal taxes	2.0	1.7	8.0	7.2	12.0	10.3
Increased excise taxes	1.0	1.0	2.0	2.0	4.0	4.0
Increased corporate taxes	2.0	.3	5.0	.8	10.0	1.7
Total	5.0	3.0	15.0	10.0	26.0	16.0
Effect on the business inflationary excess demand of—						
Increased corporate taxes	2.0	1.3	5.0	3.3	10.0	6.3
Direct controls: Additional savings	----------	2.0	----------	3.0	----------	4.0
Total	----------	3.3	----------	6.3	----------	10.3

The Nation's economic budget

Programs for nullifying the inflationary excess demand which might develop at various levels of Federal cash expenditures, affect the entire economy. On the one hand they affect the distribution of goods and services between consumers, business, local government, and Federal Government. On the other hand, such programs affect the flow and use of income among these same sectors of the economy. Economists and statisticians have developed a form of table which pictures the balance between the various incomes and expenditures in the economy which they call the Nation's economic budget. The results of this study are summed up in such a Nation's economic budget in table XIV. This table shows on the left the distribution of incomes from national production while on the right are given the ways in which these incomes are spent for national production.

TABLE XIV.—*Nation's economic budget* [1] *(fiscal years)*

[Billions of dollars]

From national production	1950	1951 [4]	1952 [4]			For national production	1950	1951 [4]	1952 [4]		
			Low	Middle	High				Low	Middle	High
INDIVIDUAL CONSUMERS						INDIVIDUAL CONSUMERS					
Disposable personal income	191.3	203.7	217.5	210.2	204.8	Durable goods	25.9	31.0			
Less: Personal savings	−9.5	−4.9	−10.5	−9.2	−7.8	Nondurable goods	98.1	106.8			
						Services	57.8	61.0			
Total	181.8	198.8	207.0	201.0	197.0	Total	181.8	198.8	207.0	201.0	197.0
BUSINESS						BUSINESS					
Corporate undivided profits	10.4	10.5	11.2	9.4	6.2	New construction	19.1	47.0	50.0	47.0	43.0
Capital consumption allowances, etc	19.3	22.0	26.3	26.3	26.3	Producers' durable equipment	20.1				
Dissavings	7.3	15.2	10.5	9.3	8.5	Change in business inventories	−1.1	4.0	1.0	1.0	1.0
						Net foreign investment	−1.1	−3.3	−3.0	−3.0	−3.0
Total	37.0	47.7	48.0	45.0	41.0	Total	37.0	47.7	48.0	45.0	41.0
STATE AND LOCAL GOVERNMENT						STATE AND LOCAL GOVERNMENT					
Personal tax and nontax receipts [2]	2.6	2.8	3.0	3.0	3.0	Purchases of goods and services	18.6	19.7	22.0	22.0	22.0
Business tax and nontax liabilities [2 3]	14.3	14.6	15.0	15.0	15.0						
Contributions for social insurance	.8	1.0	1.0	1.0	1.0						
Less:											
Transfer payments	−2.9	−2.9	−3.0	−3.0	−3.0						
Net interest paid	−.3	−.3	−.3	−.3	−.3						
Plus:											
Federal grants-in-aid	2.4	3.0	3.0	3.0	3.0						
Current surplus of Government enterprises	.6	.6	.6	.6	.6						
Dissaving (+) or savings (−)	1.2	.9	2.7	2.7	2.7						
Total	18.6	19.7	22.0	22.0	22.0	Total	18.6	19.7	22.0	22.0	22.0
FEDERAL GOVERNMENT						FEDERAL GOVERNMENT					
Personal tax and nontax receipts [2]	16.4	19.8	23.3	29.4	33.0	Purchases of goods and services	23.3	32.4	49.0	59.0	69.0
Business tax and nontax liabilities [2 3]	20.0	36.2	37.0	41.0	48.0						
Contributions for social insurance	5.4	6.3	7.0	7.0	7.0						
Less:											
Transfer payments	−11.8	−9.4	−7.0	−7.0	−7.0						
Grants-in-aid to State and local governments	−2.4	−3.0	−3.0	−3.0	−3.0						
Net interest paid	−4.4	−4.6	−5.0	−5.0	−5.0						
Subsidies less current surplus of Government enterprises	−.8	−.6	−.6	−.6	−.6						
Dissaving (+) or savings (−)	+1.0	−12.3	−2.7	−2.8	−3.4						
Total	23.3	32.4	49.0	59.0	69.0	Total	23.3	32.4	49.0	59.0	69.0
Grand total	260.5	298.4	326	327	329	Grand total	260.5	298.4	326	327	329

[1] This form of the Nation's economic budget is based on the Department of Commerce's concepts and data. A reconciliation to Federal budget concepts is given in table XVI.
[2] Personal income for fiscal year 1951 assumed to be $227.8 billion and for 1952, $244.5 billion.
[3] Corporate profits before taxes and inventory valuation adjustment assumed to be $45 billion in fiscal year 1951, and $44 billion in 1952.
[4] Assumes prices stabilized at the Jan. 25, 1951, level.

THE GOVERNMENT BUDGET

A final question presents itself. If direct controls and monetary and fiscal policies are adopted adequate substantially to hold the inflationary pressures in check that under present legislation are inevitable next year, will such taxes likewise balance the Federal budget and implement a pay-as-we-go policy? The answer is briefly shown in table XV. Note that the general conclusion which one almost unavoidably reaches here is that such a program if it is to be at all adequate to help make our present price and wage controls work will have to be one which will more than balance the Federal cash budget. Even with a large Government surplus of revenues in 1947 and 1948 prices rose sharply. Similarly the abrupt price jump that took place in the second half of 1950 occurred while the Government was operating in the black. The fact that the program here suggested falls somewhat short of enabling the Government to continue to do so greatly reemphasizes the fact that this is not a maximum but a minimum program.

In short, if Government expenditures are to exceed $70 billion, a minimum of $15 billion in new taxes must be raised, the sooner the better. Excessive demand is like yeast. An extra $10 billion in taxes levied in the first quarter of 1951 will do more to check inflation than $12 or $15 billion in the fourth quarter. By that time rising prices will again kite defense expenditures in the same way that the price rise from April to December 1950 absorbed nearly $3 billion of defense appropriations. Such emasculation of our tax and defense dollar if allowed to continue will explode in financial disaster and catastrophic inflation.

TABLE XV.—*Estimated additional taxes and the Federal budget, fiscal year 1952*

[Billions of dollars]

Description	Assumptions		
	Low	Middle	High
Cash consolidated budget:			
Cash expenditures	65	75	85
Cash receipts (existing law)	60	60	60
Cash deficit (existing law)	5	15	25
Proposed additional taxes:			
Increase in individual income taxes	2.0	8.0	12.0
Increase in excises	1.0	2.0	4.0
Increase in corporation taxes	2.0	5.0	10.0
Total (liability basis)	5.0	15.0	26.0
Total collections in fiscal year 1952	4.2	13.3	24.9
Cash deficit (proposed legislation)	.8	1.7	1.1
Conventional budget deficit	4.5	5.4	4.8

The data presented in table XV on the Federal budget are derived from the Nation's economic budget shown in table XIV. In order to clarify, for those interested, the translation from table XIV to table XV, a reconciliation is presented in table XVI below. This shows how the estimates of Federal receipts and expenditures on a cash budget basis are obtained from the various items in the Nation's economic budget.

TABLE XVI.—*Reconciliation of consolidated cash budget[3] with Nation's economic budget (fiscal years)*

[Billions of dollars]

Item	1950	1951 [1]	1952 [2]		
			Low	Middle	High
Receipts:					
Direct taxes on individuals (budget)	18.1	22.3	26.3	32.4	36.0
Personal tax and nontax liability	16.4	19.8	23.3	29.4	33.0
Social security contributions	1.8	2.3	3.0	3.0	3.0
Excess (+) or deficiency (−) of tax receipts over tax liabilities, etc	.1	.2	0	0	0
Direct taxes on corporations (budget)	10.9	13.6	22.5	24.5	29.5
Business tax and nontax liability	19.1	36.2	38.0	41.0	48.0
Less: Indirect business tax and nontax liability	8.3	9.2	10.5	11.5	13.5
Excess (+) or deficiency (−) of tax receipts over tax liabilities, etc	+.1	−13.4	−5.0	−5.0	−5.0
Excise taxes and customs (budget)	8.0	8.8	10.0	11.0	13.0
Others (net of refunds) (budget)	3.9	4.6	5.4	5.4	5.4
Total (budget)	40.9	49.3	64.2	73.3	83.9
Expenditures:					
Goods and services	23.3	32.4	49.0	59.0	69.0
Transfer payments	11.8	9.4	7.0	7.0	7.0
Net interest paid	4.4	4.6	5.0	5.0	5.0
Grants-in-aid to State and local governments	2.4	3.0	3.0	3.0	3.0
Subsidies less current surplus of Government enterprises, etc	.6	.6	.6	.6	.6
Loans abroad, errors and ommissions, etc	.6	−.9	.4	.4	.4
Total (budget)	43.2	49.1	65.0	75.0	85.0
Excess (+) or deficiency (−) of cash receipts over expenditures	−2.2	+.2	−.8	−1.7	−1.1

[1] Assumes personal income of $227.8 billion and corporate profits before taxes of $45 billion.
[2] Assumes personal income of $244.5 billion and corporate profits before taxes of $44 billion.
[3] In the President's budget this is called "Receipts From and Payments to the Public."