

PROBLEMS IN
A MOBILIZED ECONOMY



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THE FEDERAL RESERVE BANK OF PHILADELPHIA

1950

FEDERAL RESERVE BANK
OF PHILADELPHIA

A Review of 1950
And of Some of the Economic
Problems which Emerged

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FEDERAL RESERVE BANK
OF PHILADELPHIA

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The year 1950 was one of decision. Two critical choices were made by the people of the United States. By our action in Korea, we indicated our willingness to lead the free peoples of the world in efforts to stop the steady onset of totalitarianism. On the home front, we decided to budget, permanently if necessary, the goods and services required for thorough defense. A constantly mobilized economy will present grave new problems. The beginnings of these are discussed in this Annual Report for the year 1950.

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PROBLEMS IN A MOBILIZED ECONOMY

THE YEAR 1950 was one of decision. It was important not only for the events it brought, but for those it portended. The outbreak of fighting abroad, this time in Korea, once again posed a threat to our way of life. The reaction in the United States, and the rest of the free world, was not long in appearing. We resolved to defend our freedom against the threat of aggression, and to gear our economic system for national defense. Whether our economic system should be converted to an all-out war effort or to a partial effort for a prolonged period is uncertain. At present, national policies are pointed toward the latter objective.

The basic task of any economic system—whether free enterprise or socialistic, whether in war or in peace—is to make full use of the limited amounts of labor, raw materials, and plant to produce the goods and services people want most. In a system of free enterprise such as we have in the United States, the free market mechanism plays an important role. Most of the goods and services produced are sold—in markets; most of the things we consume are bought—in the marketplace. Goods and services produced flow from farm and factory to the wholesaler, the retailer, and finally to the consumer. Consumer and business purchases set up a return flow of money—money paid out in production—to the retailer, the wholesaler, and finally back to the producer. Goods are exchanged for money and money for goods at certain ratios or prices. The price mechanism records the interaction between the money flow and the goods flow. Too much money and too few goods mean rising prices and inflation; too little money results in falling prices and depression.

The flow of goods, both as to kind and quantity, is determined mainly by the decisions of millions of independent producers

within the limits of their capacity to produce. In making decisions, they are guided by numerous factors but the outlook for the price of their product, the volume of sales, and the cost of producing it are especially important. The flow of money is determined by the amount we have to spend and our willingness to spend it. The major source of the money flow is production itself, the total amount of income paid out being equal to the total value of goods and services produced. The money stream is influenced also by the operation of our banking system. Commercial bank loans and investments add to the borrower's deposit account. They pour new money into the spending stream. Total purchasing power available during a given period consists of both money income and the amount of new funds created by loans and investments.

In a partially mobilized economy, the basic task of using the limited supply of resources to produce the things people want most remains the same, but the character of our wants and needs changes. A larger part of the total output of goods and services must go for defense and a smaller part for civilian use. This is the economic side of the defense problem in real terms. Defense production turns out money income but it does not put any goods in civilian markets for this income to buy. In addition, credit expansion which tends to accompany the high level of production and employment pours new money into the spending stream. The problem in financial terms is to prevent the money stream from becoming excessive in relation to the limited supply of civilian goods—in other words, to prevent inflation.

The danger from foreign aggression is generally recognized, but not so many of us are aware of the threats created by economic mobilization itself. Success in preserving our essential freedoms requires not only a strong defense against foreign aggression but also against the inflation forces unleashed by the defense program. Likewise, effective action requires carefully planned strategy in meeting the economic problems at home as well as in meeting the military problems abroad. This report, in addition to reviewing briefly the significant business and financial developments in 1950, examines some of the problems of a mobilized economy and alternative methods of dealing with them.

1950—A CASE OF INFLATION

Economically speaking, 1950 wore two suits of clothes. For nearly six months, the country was treated to the spectacle of a high, unflinching demand for goods which was met on even terms by a constantly growing production. The pattern by which the economic fabric was cut was a balance between rising civilian demand and the ability of the economy to meet that demand. Then came the Korean War, and mufti was exchanged for Army khaki and Navy and Air Force blue. The fear of shortages put the whip to civilian demand, and it outraced production. The fabric was still of civilian texture, but it was cut to a pattern of inflation and semi-war.

Toward balance

In industrial America, the demand for houses, for consumer durable goods, such as automobiles, appliances, and furniture, and for business plant and equipment, provides the touchstone of prosperity. When industries such as the construction and automobile industries are working to meet a high level of consumer demand, they carry with them to prosperity a large number of corollary industries. A building boom stimulates the production of basic raw materials such as lumber, steel, copper, glass, and building hardware. It also provides a substantial fillip for industries producing home furnishings like furniture, floor coverings, draperies and home appliances such as ranges, heating units, refrigerators, and other necessities for household operation. A large demand for automobiles is passed on to manufacturers of parts and supplies such as forgings, electrical installations, tires, batteries, upholstery and other items, and to producers of basic items such as steel, lead, copper, fiber, and glass. Expanding production in these related industries adds to incomes which in turn react favorably on the construction and automobile industries.

At the outset of 1950 and during the first four months of the year, the economy was delicately poised between a high level of demand for all sorts of goods and our ability to produce those

goods. The principal obstacle to a return of prosperous conditions had been removed in 1949 when the liquidation which reduced business inventories about \$5 billion was checked. This development, together with work stoppages in that year, converted some areas of the economy from buyers' to sellers' markets. The recovery which became apparent with the revival of the building boom in the latter half of 1949 was carried over into 1950. In six months, approximately three-quarters of a million housing starts were recorded, the largest for any similar period on record. In many areas, new houses were sold before completion. Numerous communities throughout the Philadelphia Federal Reserve District participated in the building boom. In six months, building permits for new residential construction in the Philadelphia-Camden metropolitan area were more than double those of the first half of 1949. Despite the volume of construction, most new houses built in this area were sold before or during construction, according to a mid-year survey in which this Bank participated. Unlike the year before, there was no inventory of finished but unsold new houses. The demand for automobiles continued unabated during the first half of 1950. More than 3 million automobiles were sold at factories from January through June.

The buoyancy in the construction and automobile industries was counteracted in part by the fact that Federal expenditures, while slightly larger than in the first half of 1949, were brought nearly into balance with receipts, the net deficit for the period amounting to only \$315 million. Exports to June also fell 27 per cent below the similar period in 1949. Business expenditures for plant and equipment were 12 per cent smaller than in the previous period. There was nothing puny about the size of business expenditures for plant and equipment, or again of Government expenditures but, although large, they were not increasing and could not therefore be counted among the inflationary forces building up in the first half of the year.

The flow of goods as measured in physical units of output rose almost without interruption during the first half of 1950. This was particularly true of durable goods in general and of such basic

items as iron and steel, machinery, and transportation equipment. In June, the volume of industrial production, according to the Federal Reserve Board's index, was up 11 per cent for the half year. The most spectacular rise was registered by producers of automobiles, production being nearly half again as large in June as in the preceding December. Virtually all industries participated in the expanding activity. By June, construction activity was 49 per cent above a year earlier, the production of durable goods was nearly one-fourth greater, and the production of both minerals and nondurable goods was up about 14 per cent.

The extent to which the flow of goods coming off the production line keeps pace with or lags behind the demand for goods is measured by the movement of prices. When the flow of goods equals the demand for them, prices tend to stabilize. If, however, demand outruns production, prices rise. For four months in 1950, prices were fairly steady. At the wholesale level, the average of all prices included in the Bureau of Labor Statistics index advanced only 1.1 per cent. The largest increase was registered by farm products, but even this rise was only 2.8 per cent.

After April, the impact of the unrelenting pressure of demand upon the available supply of goods caused the price structure to give way a little. It was becoming increasingly difficult for producers to keep pace with the accelerating rate of demand, and wholesale prices in the next two months jumped nearly three times as much as in the first four months of the year. Food registered the greatest price increases, but the prices of manufactured articles also rose. The symptoms of inflation were beginning to appear.

Sources of buying power

The spending stream is fed by three tributaries: income, the use of savings, and credit. People normally spend 94 or 95 cents of every dollar of their income; in the first half of 1950 they spent about 94 cents.

Personal income rose during the first part of 1950, reflecting in part more people employed in the civilian labor force. After a brief reduction in the number of non-agricultural laborers at work in the first quarter of the year, the number of persons employed, except in agriculture, rose to more than 52 million in June—about 2½ million more than a year earlier. The work-week was lengthened, and in June, men and women averaged about 4 per cent more time on the job than a year earlier, and average hourly earnings rose about 5 cents. The combined effect of these three developments and mounting profits was an increase in personal income after taxes to an annual rate of \$196 billion, about \$9 billion higher than in the last quarter of 1949. This tributary of the spending stream was considerably larger than it had ever been before. A fatter pay envelope was augmented by the payment of a G.I. insurance dividend of nearly \$3 billion in the first quarter.

People also borrowed against future earnings to purchase homes, automobiles, and consumer durable goods at an increasingly rapid rate. Recordings of non-farm, residential mortgages of \$20,000 or less, were 35 per cent higher than in the first half of 1949. Member banks participated in the expansion of real estate credit, their residential property loans rising about \$700 million. In contrast with a decline in the first half of 1949, the volume of consumer credit outstanding rose steadily throughout the first six months of 1950. Instalment credit for the purchase of automobiles displayed the greatest vitality, but every category of instalment credit either advanced more rapidly or declined to a smaller extent than from January to June 1949. Member banks added about \$850 million to "other loans to individuals," consisting chiefly of consumer loans, and total loans of this class outstanding on June 30, 1950 were one-fourth larger than a year earlier.

The expansionary trend in real estate and consumer credit was counteracted, in part, by a decline of \$324 million, or nearly 2 per cent, in commercial, industrial, and agricultural loans. However, on June 30, 1950, business loans were \$560 million larger than a year earlier. Total loans of member banks rose \$1.5 billion in the first six months of 1950 and at mid-year were \$3.3 billion

above the level of June 30, 1949. Member banks in the Third Federal Reserve District reported an increase of \$71 million in business loans during the same period.

The aggregate money supply displayed little change from December 31, 1949 to June 30, 1950. Deposits, however, were used more actively than during the first half of 1949. The turnover of demand deposits, seasonally adjusted, was 4 per cent greater in New York City and 2 per cent greater in other leading cities.

Korea brings more inflation

June brought shocking news. The North Korean Communists crossed the 38th parallel, and the United States, although reluctantly, determined to resist Communist aggression. The defense of our freedom involved preparation for war—not that total war was inevitable, but rather because there seemed little hope of preserving both peace and freedom while unarmed.

The problem posed by the Korean War was two-fold. In the first place, the decision to resist aggression also involved the determination to produce less "butter" in order that we might have the requisite guns. How much of a sacrifice of civilian goods would be required was not clear, even at the end of the year, but a substantial diversion of civilian production to defense pointed toward shortages in many items. In the second place, changing our course from a peacetime to a defense economy also posed the problem of growing inflation. Under the circumstances, there was a strong tendency for the supply of civilian goods to be outrun by the income available for the purchase of those goods. This problem was intensified by the fact that the economy was already operating close to capacity, and production lines were finding it increasingly difficult to pour goods into the market at the rate people demanded them. Some symptoms of inflation had appeared even before the enlarged defense program brought added burdens.

People did not wait for an answer to the question how much of a sacrifice in living standards was to be required of them as the

defense effort progressed. With the news that the United States had decided to oppose aggression with armed force, a tidal wave of "caution buying" covered the retail market. Overnight, retail stores experienced an abnormal rise in sales. People bought household appliances, television sets, furniture and bedding, floor coverings, hosiery, shoes, towels, sheets, and even foodstuffs—anything that might become scarce. The department stores did a huge volume of business as sales jumped 21 per cent in one month. Home-furnishings led the list of items most commonly sought. But the caution buying did not last long. In three months it was nearly over and the volume of retail sales, seasonally adjusted, declined steadily until November. Merchants, anticipating a good Christmas season, placed heavy replenishment orders; and then just before Christmas, caution buying surged upward again as the Chinese Communists swept down from Manchuria. December retail sales were 16 per cent larger than the previous Christmas season. The major part of this rise was due to price increases.

The purchase of automobiles, new homes, and other consumers' goods, and business investment in inventory, plant, and equipment added impetus to the boom. Factory sales of automobiles in the domestic market from July through December were almost one-third larger than a year earlier. Housing starts were 20 per cent larger than in the second half of 1949, bringing the total number of housing starts for the year to a record of about 1,400,000. These two basic industries carried many corollary industries to higher levels of prosperity.

The upsurge of consumer spending was accompanied by rising business expenditures for inventory and increased outlays for plant expansion and modernization of equipment. Business inventories, seasonally adjusted, grew about 14 per cent between June and December, but a major part of this increase reflected the rise in prices.

Businessmen not only stepped up their expenditures for inventories, but also their long-run plans for plant expansion and new equipment. Expenditures on new plant and equipment were

increased from \$8 billion in the first half of the year to \$10 billion in the second half, according to the joint estimates of the Department of Commerce and the Securities and Exchange Commission.

Of the segments of the economy demanding goods after June, only the Federal Government failed to increase its demands until the latter part of the year. The preparedness program of the Federal Government remained largely in the planning stage until the closing weeks of the year, and Federal cash expenditures were \$1 billion smaller than in the last half of 1949. With increased tax rates and higher incomes, Government cash receipts actually exceeded expenditures by more than three-quarters of a billion dollars. War had come suddenly, but conversion from a peacetime economy to a defense economy is not accomplished overnight. The supplies needed to equip a military force of 3½ million men are necessarily huge, and obtaining them from the economy requires careful planning. The balance of 1950 was devoted to planning, and only a small trickle of these orders found its way into the economy before the close of the year. The rising demand for goods after the outbreak of the Korean War was primarily civilian in origin.

Industry put its shoulder to the wheel to meet the enlarged demand for goods. The level of production was pushed up another 9 per cent, according to the seasonally adjusted Federal Reserve index of industrial production. Producers of machinery expanded production more than 17 per cent. The majority of industries manufacturing durable items achieved moderate to substantial increases in production. Many manufacturers of nondurable items also expanded production.

But these renewed efforts were insufficient to stem the tide of inflation, and prices climbed faster than ever. Prices of raw materials imported from the Eastern Hemisphere took wings; in the half year, wool tops were up 70 per cent, the price of tin jumped over 90 per cent, and rubber 160 per cent. Industrial metals were in great demand, and the price of lead rose 55 per cent, steel scrap rose more than 25 per cent, accompanied by smaller price increases

for zinc and copper. Price increases occurred in all major classes of commodities. At the close of the year, the all-commodity index of the Bureau of Labor Statistics was up 11 per cent. Foods had gone up 10 per cent, and commodities other than farm and food products had risen 12 per cent. The largest increases occurred in textiles and textile products, chemical products, hides, and household furnishings. In general, raw materials were up 12 per cent and manufactured commodities, 10 per cent from June.

Consumer prices rose steadily but more moderately in the wake of sharply rising wholesale prices. At the end of the year, the index of consumer prices, prepared by the Bureau of Labor Statistics, was up nearly 5 per cent above the June level. Prices of items classified as housefurnishings showed the greatest rise—more than 10 per cent—and retail prices of apparel advanced 6 per cent and food prices rose 5 per cent. Rents inched up steadily about $1\frac{1}{2}$ per cent. At the end of the year, it was clear that the tempo of inflation was quickening, and it was apparent that the battle of the price bulge would be equally as tough as the military struggle.

The swollen spending stream

The spending stream rose higher on its banks as the second half of the year progressed. Record production and employment, and a longer work-week at rising wage rates, produced record levels of personal and business income. The number of persons employed in non-agricultural industries jumped more than $1\frac{1}{2}$ million by December, and unemployment amounted to less than 4 per cent of the total civilian labor force. Accordingly, weekly earnings in many industries rose. Some of this increment was diverted through increased taxation in the last quarter to the defense effort, but disposable personal income rose to a record annual rate of about \$212 billion in the fourth quarter. On the average, people spent 95 cents out of every dollar earned in the last half of the year.

People saved a little less after June; they dipped into their savings more freely to purchase goods. Fewer E Bonds were sold and redemptions during the last half exceeded purchases by more than \$500 million. Withdrawals of savings and loan shares increased. There was a moderate liquidation of security holdings. Time deposits in all banks declined moderately but steadily, and at the year's end were \$570 million smaller than on June 30.

The spending stream was fed by a growing volume of loans. The volume of business loans of all member banks rose nearly \$5 billion, or 28 per cent, during the half year. Following the national trend, but at a slower rate, business loans of member banks in the Third Federal Reserve District rose 21 per cent to a total of \$931 million at the year's end. Partly as the result of the reimposition of Regulation W in the third quarter of the year the rate of growth in the volume of outstanding consumer credit slowed up somewhat. However, there was a net addition of nearly \$2½ billion to the total volume of consumer credit outstanding from June to December, a smaller increase than for the same period a year earlier. Nearly all types of consumer credit grew at a slower rate than in the previous year but charge accounts, reflecting in part the increase in the price of goods at retail, expanded faster than in 1949. Real estate credit climbed higher than ever as the housing boom continued. The volume of non-farm mortgages of \$20,000 or less recorded from July through December reached almost \$9 billion, an increase of 38 per cent over the previous year.

Fed by growing incomes and the greater use of credit, the supply of dollars pouring into the spending stream grew and each dollar was used more often. At the year's end, the aggregate of demand and time deposits and currency outside the banks was more than \$7 billion greater than at the end of June. The turnover of demand deposits in banks in leading cities other than New York rose substantially in the third quarter and declined only slightly in the fourth quarter. It averaged more than 21 times a year—a rate greater than in any comparable period since 1937.

MONETARY POLICY

The job of the Federal Reserve System is to regulate the volume of credit in such a way as to help keep the amount of spending in balance with the available supply of goods at current prices. For this purpose, the System has tools for influencing the over-all supply of credit, mainly by influencing the volume of member bank reserves. The System also has authority to regulate the use of credit for certain purposes. Both types of tools were put to use in 1950.

Economic stability characterized much of the first half of 1950. The recovery which appeared in the fall of 1949 continued, with production increasing and prices moving up only slowly. No sizable defense program had been planned. Accordingly, the easy-money policy pursued in the latter part of 1949 was modified only slightly in the early part of 1950. Some Government securities were sold by the System to satisfy the investment demand for them, and at the end of June the volume of Government securities in System portfolios was about \$550 million smaller than at the outset. This development, together with the loss of nearly \$200 million in gold, more than offset seasonal factors such as the return of money from circulation, and by the middle of the year member bank reserve balances had declined over \$600 million.

With the emergence of strong inflationary tendencies in the second half of the year, the problem was clearly to combat the developing inflation. The first tool employed by the System was "moral suasion." On August 4, the Board of Governors joined with other Federal and state supervisory agencies in requesting voluntary cooperation by banks and other lenders in restricting their lending and investment activities. This appeal was repeated on November 17 in a letter by the Chairman of the Board of Governors to all member banks.

In the latter part of August, the discount rates of all Federal Reserve Banks were raised from $1\frac{1}{2}$ per cent to $1\frac{3}{4}$ per cent; and there was an increase in interest rates on short-term Government

securities. Raising the rediscount rate makes the acquisition of additional reserves by member banks more expensive and tends to discourage an expansion of credit. However, as banks have large quantities of Government securities in their portfolios which they can sell in order to acquire additional reserves, the use of the rediscount rate has become less effective.

Open market operations constitute potentially one of the most effective anti-inflationary weapons in the Federal Reserve tool chest. The sale of Government securities from the portfolio of the Federal Reserve System reduces member bank reserves and shrinks the base upon which new credit can be extended. The use of open market operations, however, has been restricted by the policy of maintaining a stable market for Government securities.

**Factors Influencing the Volume of Member Bank Reserve Balances,
June 30 to December 31, 1950**
(In millions of dollars)

Additions to reserves		
Federal Reserve Bank Credit		
U. S. Government securities	\$2,447	
Loans, discounts, and advances.....	24	
Float, industrial loans, and acceptances.....	1,042	
Total Reserve Bank Credit.....		\$3,513
Decline in Treasury deposits with Federal Reserve.....		282
Other additions		62
		\$3,857
Total additions		
Deductions from reserves		
Net gold exports		1,525
Increase in money in circulation		585
		\$2,110
Total deductions		
Increase in member bank reserve balances		1,747

Banks and other lending agencies were selling substantial amounts of Government securities to obtain funds for loans and other forms of investments. Moreover, the terms on new Treasury issues offered in exchange for maturing securities were not attractive enough and the Federal Reserve added substantial amounts

through its support purchases. At the year's end, the volume of Government securities held by the System was \$2.4 billion larger than at mid-year. The increase in System holdings of Governments was the major factor adding to bank reserves during this period, lesser amounts being supplied by an increase in float and by other sources. These additions more than offset the drain on reserves resulting from the outflow of \$1.5 billion of gold and from the seasonal increase in money in circulation. At the year's end, member bank reserve balances were about \$1.7 billion larger than at the end of June.

To offset this development and as a further step toward arresting the progress of inflation, an increase in the reserve requirements of member banks was announced December 28. By raising the percentage of their deposits which member banks are required to keep on reserve, the amount of funds available for lending or investment is reduced. However, the presence of a large volume of U. S. Government securities in member bank portfolios, which can be converted readily into reserves, also reduces the effectiveness of this instrument.

The Federal Reserve System was also given the responsibility for regulating the use of credit for the purchase of consumer goods and real estate. Authority for these regulations was granted by Congress in the Defense Production Act of September 1950. Regulation W was issued to restrict consumer credit, and Regulation X restricts loans, not insured or guaranteed by the Government, for most types of new construction. Similar restrictions were imposed on Government insured and guaranteed real estate loans. These regulations have a dual objective: to reduce the size of the spending stream, and to divert men and materials from civilian to defense production.

The restriction of credit is but one phase of the battle against inflation, and the activities of the Federal Reserve System tell only part of the story. In the latter half of 1950, the spending stream was swollen not only by a greater use of credit but also by rising incomes and by the greater use of savings. Fiscal policies should

supplement monetary policies in draining off excess purchasing power. If the Government takes in more than it spends, it reduces the money supply and thereby moderates the demand for goods. Tax rates were raised in the last quarter of the year to put fiscal policy into the inflation battle, with the result that the Government's cash receipts have about balanced payments in spite of increased military expenditures. Debt management can also be a very helpful tool in the battle against inflation. Under present conditions, vigorous efforts should be made to place new Government securities, whether for new money or for refunding maturing issues, outside of the banking system. This means that the terms on new issues must be made attractive to non-bank buyers.

PROBLEMS IMPOSED BY DEFENSE

The major problems of a partially mobilized economy began to emerge in 1950. In the latter part of the year, industry was feeling the pressure of a peak level of civilian demand and facing a sharp rise in Government purchases for defense. Backlogs were increasing, shortages were developing, and prices were rising. The defense problem in real terms is to get more goods for defense in the face of the vast demand for civilian goods and services.

The financial problem posed by the defense program is that of checking inflation. The tendency for the volume of spending to exceed the supply of goods and services at current prices stems primarily from two sources. The sharp rise in bank loans and investments has been pouring a large amount of new money into the spending stream at a time when money incomes are already at record levels. The second factor which is of increasing importance is that defense production is adding to money incomes but not to the supply of civilian goods for these incomes to buy. Unless the Government siphons off enough income to pay all of its expenses, Government borrowing will add further to an already excessive supply of purchasing power.

These are the basic problems confronting us in a partially mobilized economy. In this section, we are concerned with how

we can best solve these problems because a vigorous and growing economic system is the very foundation of a strong national defense. Can we rely on the free market mechanism, or is it necessary to supplement it in some ways? These questions lead us into an analysis of how the free market works, whether it can solve the problems facing us in a mobilized economy, and in what ways, if any, it may need to be supplemented.

How the free market works

The free market mechanism runs so smoothly that we often fail to recognize the work it does. In brief, the market mechanism: (1) measures our wants and determines which goods people want most; (2) gets labor, raw material, and plant into the production of these goods and services; (3) regulates the distribution of the income produced among those who participate in its production; (4) rations the limited supply of goods produced among consumers; and (5) protects individuals against the selfish exploitation of others.

Since it is impossible to produce as many goods and services as people *want*, there must be some device for measuring the things we want most. In a totalitarian country, the State determines what people "want"; what is good for them—or at any rate what they shall have. The free market mechanism, however, registers the choices of each consumer. The consumer indicates his preference when he spends his money. If a man buys a white shirt, he casts dollar votes for the production of white instead of colored shirts. If he buys orange juice, he votes for the production of oranges instead of grapefruit. The total amount spent for different goods and services measures their importance to consumers as a whole. The market is a very sensitive barometer of human wants, as any businessman can testify.

The next job is to get labor, materials, and plant into the production of those products and services people want most. In a totalitarian State, this would be done to the extent necessary by force, moving men and plant about like checkers on a checker

board. In a system of free enterprise such as ours, however, people have the right to choose what they do. Manpower and facilities can be shifted from the production of one good to another only by providing incentives for the change. This incentive is provided through the workings of the price-cost-profit mechanism. If consumers want more of a certain product and have the money to pay for it, sales will rise. The increase in demand is quickly transmitted through the markets to the producer. If the increase in demand is sufficient, prices tend to rise and profits increase. A decrease in demand, on the other hand, results in smaller sales, lower prices, and lower profits or losses. Thus, profits act as a governor calling forth more production as they rise and shutting off production as profits decrease or as losses occur.

In addition to acting as an incentive, the market mechanism affects the ability of producers to bid for scarce materials. Producers engaged in the more profitable lines of production can bid labor, materials, and plant away from those engaged in the less profitable lines.

A third job the free market does for us is to distribute the income created in production. In a totalitarian system, income is divided up primarily according to the will of the State. Under our system, however, the wage going to the laborer, the profit going to the businessman, and the amount of interest going to the investor who makes some of his funds available for production, are the result mainly of market forces. It is the value of services rendered as determined in the market that establishes rates of pay which vary widely among laborers, businessmen, and investors. Basically, the principle underlying this method of distributing income is that each participant in production shall be rewarded according to the market value of his contribution. If someone receives less than the value of his contribution, competition for his services tends to raise his income. If he receives more, competition would force a reduction. To be sure, there are many qualifications to the operation of this principle in the real world. With the high degree of specialization which exists today, the work of many individuals and machines goes into a finished product. It is impossible to meas-

ure the exact dollar and cents contribution of each person. Group rather than individual bargaining by workers and employers reduces the competition which is supposed to get for each his rightful reward. Despite the numerous interferences with the free market mechanism, it is still generally true that those making the more valuable contributions as measured by market forces are rewarded with the larger incomes. This principle of gauging one's money income according to the value of his contribution provides the maximum incentive for efficiency and extra effort. It is one of the real advantages of a free enterprise economy.

A fourth task is to ration the limited supply of finished goods among consumers. Under totalitarianism, the State, in fixing prices and wages, makes most of the decisions. In a free enterprise system the price mechanism, which registers the choices of the people, does most of the job. As we have seen, prices such as wages and interest rates—established in the market—largely determine the money income received. In turn, prices established in the market determine the amount of goods and services this money income will buy. Within the limits of their purchasing power, people are free to make their own decisions as to what and how much they will buy. Price is the governor, tending to keep demand and supply in balance. If there is not enough of a product to meet demand at the current price, the price tends to rise. The higher price tends to restore balance by cutting off some purchases and stimulating an increase in production. If too much of a product is put on the market, prices fall, stimulating purchases and discouraging production.

Scarcity is a relative term and not one of absolute amounts. Goods become scarce when the available supply is not sufficient to meet demand. This situation may arise either from limitations on the supply side or an increase in purchasing power. In the last few months, for example, we have had numerous shortages, with production running at all-time peaks, primarily because of a tremendous increase in demand and buying power. Normally, scarcity is reflected in higher prices. If for some reason, prices do not rise enough to restore balance, scarcity manifests itself in shortages or

backlogs—evidence that people would buy more at the current price if they could get the goods.

Finally, the free market helps to protect us against the selfish exploitation of others. Buyers are free to buy or not to buy, and to choose among sellers. Sellers compete against each other for the consumer's dollar. Buyers are inclined to go to the seller who gives the most for the money. Freedom and the competition which it fosters help to prevent the sale of goods and services at exorbitant prices. Competition does not provide complete protection because buyers do not have sufficient information about the quality of the many products they buy, and for numerous other reasons. Nevertheless, competition is still basically a vital force helping to guarantee the consumer a good quality product at a reasonable price.

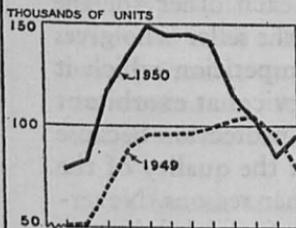
It is obvious that numerous conditions have developed which modify the workings of the free market as outlined above. The dominance of a few large producers and combinations among business firms has modified competition in many industries. The growth of labor organizations and collective bargaining has greatly modified competition among laborers in bargaining over wages. Numerous factors interfere with the free movement of workers, employers, and equipment from one kind of production to another. We have called upon the Government to intervene many times because we are dissatisfied with the cards which a free market deals us. Despite the many modifications which exist, however, we still rely on the free market mechanism normally to perform the basic functions summarized above.

The free market in a mobilized economy

Can we rely on the market to guide us to the objectives of a semi-war economy? The free market can continue to perform most of these functions in a satisfactory manner. But it will be necessary to supplement it in some respects. Market forces alone cannot bring about the necessary increase in defense production, unless

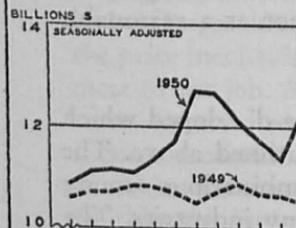
BUSINESS AND FINANCIAL

UNITED



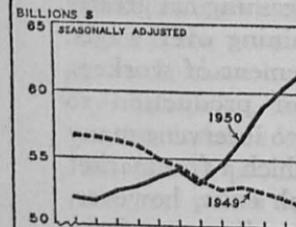
HOUSING STARTS

ATTAINED NEW RECORDS



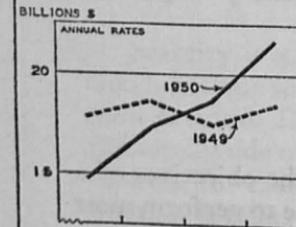
RETAIL SALES

SHOWED THE EFFECT OF "SCARE BUYING"



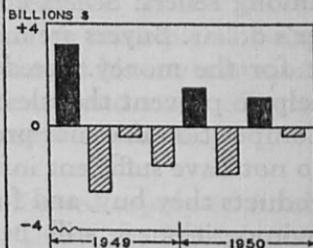
BUSINESS INVENTORIES

EXPANDED AND



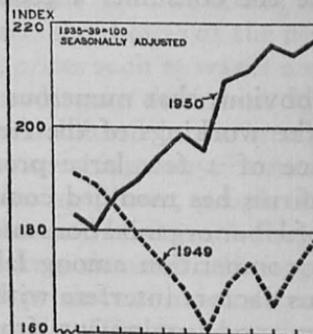
EXPENDITURES FOR NEW PLANT AND EQUIPMENT

INCREASED



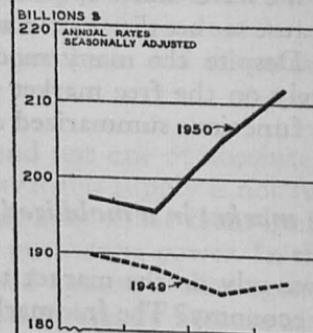
FEDERAL CASH SURPLUS AND DEFICIT

A SMALL NET SURPLUS WITH LAGGING EXPENDITURES



INDUSTRIAL PRODUCTION

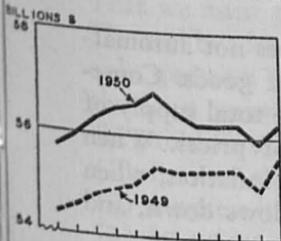
CLIMBED



DISPOSABLE INCOME

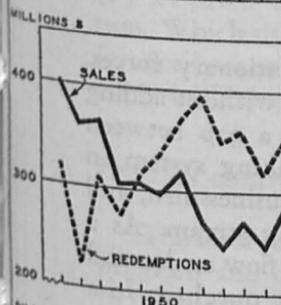
INCREASED SHARPLY

DEVELOPMENTS IN 1950 STATES



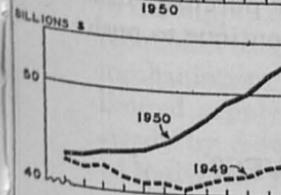
TIME AND SAVINGS DEPOSITS

DECLINED AFTER MID-YEAR



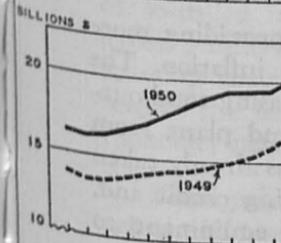
E BOND SALES AND REDEMPTIONS

SALES FELL BEHIND REDEMPTIONS



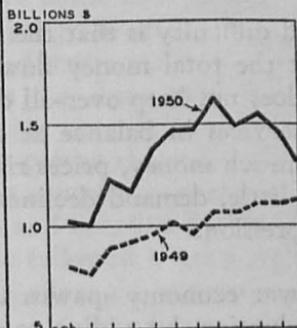
BANK LOANS

ROSE STEADILY



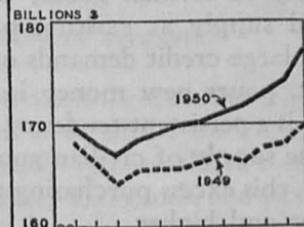
CONSUMER CREDIT

LEVELED OFF



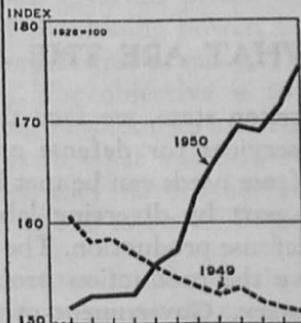
REAL ESTATE LOANS MADE

ROSE AND THEN DROPPED



MONEY SUPPLY

INCREASED AND



WHOLESALE PRICES

SOARED TO A NEW PEAK

the Government siphons off enough income to pay for all of the goods and services it buys. Otherwise the excessive buying power available for civilian goods will exert constant pressure for an increase in their production. It pins down manpower, materials, and plant which should be shifted to defense production.

A second difficulty is that the free market does not automatically adjust the total money flow to the flow of goods. Consequently, it does not keep over-all demand and the total supply of goods and services in balance at a stable level of prices. When there is too much money, prices rise and we have inflation; when there is too little, demand declines, production slows down, and we have depression.

A semi-war economy spawns two strong inflationary forces. Defense production, by adding to money income without adding to the supply of civilian goods, tends to create a gap between demand and supply at existing prices. The banking system in meeting the large credit demands of consumers, businessmen, and government, pours new money into the spending stream. As a result, there is a persistent tendency for the money flow or demand to exceed the supply of civilian goods available for purchase. In a free market, this excess purchasing power would continue to push prices higher and higher.

WHAT ARE THE ALTERNATIVES?

In a garrison state, we face the problem of providing more goods and services for defense and of checking inflation. The enlarged defense needs can be met in part by increasing total output, and in part by diverting labor, materials, and plant from civilian to defense production. The Government has already taken steps to solve the production problem by providing credit and, where necessary, Government-owned plant and equipment to promote defense production. Priorities and allocations are being imposed to channel more of the scarce raw materials into the defense program. Success on the production front will not be too

difficult to achieve, particularly if we can avoid the ravages of inflation.

The most difficult problem facing us in a partially mobilized economy for an unlimited duration is that of checking inflation. That we must give up goods we could have otherwise is obvious. The real burden of the defense program cannot be postponed. The only question is how shall we distribute the sacrifice. Who gets the long straw and who gets the short one? In dealing with the problem of inflation there are three basic courses open to us: (1) remove excess purchasing power through indirect controls; (2) suppress its use with direct controls on prices and wages; and (3) let prices continue to rise and inflation gather more momentum. Which of these courses is followed is not a matter of indifference because the choice will affect the economic well-being of every individual.

Indirect controls—fiscal-monetary measures

The ideal solution of the inflation threat created by the defense program and credit expansion is to adjust the supply of money to the supply of goods. This would remove the source of inflation, reestablish balance between money and goods, and permit the price mechanism to continue to perform its function of rationing the limited supply of civilian goods. Over-all prices would be held steady by reducing the flow of purchasing power, but the prices of individual products would be left free to move. This is the way of so-called indirect controls. The objective is to remove the excess purchasing power, leaving businessmen and consumers free to make their own decisions as to what and how much to buy within the limits of the funds they have available. Fiscal and monetary measures hit directly at the source of inflation.

Fiscal policy is the major weapon for closing the inflation gap which defense production tends to create. It cannot be done by increasing total production because all production creates income, but only a part of the total is available for civilians. The gap can be closed only by siphoning off income—by dipping as much out

of the income stream as out of the goods stream. Since Treasury cash receipts reduce private money incomes, and cash expenditures enlarge them, receipts should at least be sufficient to meet all expenditures. A balanced budget, however, means only that the Government is not adding to the spending stream. Actually, a cash surplus is needed to help offset the enlarged spending coming from idle balances and newly created money.

The first step in getting this cash surplus is for the Government to enforce rigid economies in its own expenditures. Waste, if any, should be pared from the defense budget and non-defense spending should be cut to the bone. Having done this, taxes should be increased enough to provide a surplus which would effectively curb excessive spending. Since consumer spending is the major part of the total, the new taxes should bite into the incomes of all consumers, except the lowest income groups. The tax program should also be designed to distribute the defense burden as equitably as possible.

Management of the Federal debt also has an important influence on the money supply and spending. Federal Reserve purchases of Government securities create bank reserves and commercial bank purchases create new deposit dollars, thus adding to the total supply of purchasing power. New Treasury borrowing and the refinancing of maturing Treasury securities should be carried out in such a way as not to result in a further addition to the money supply. The terms, including maturities and interest rates, offered on new Treasury issues, should be attractive to non-bank buyers as a means of siphoning off current income to help pay for defense.

Restrictions on the creation of new money through bank credit expansion are another major part of this method of checking inflation. We cannot hold down total spending by siphoning off current income as long as new money is being created to replace it. A record amount of borrowing by consumers and businessmen since the outbreak of the war in Korea has been pouring a large stream of new money into an already excessive reservoir of purchasing power. Success in checking inflation requires that we curb

the stream of spending from future income as well as from current income.

The use of fiscal-monetary measures to check inflation has great advantages. Most important, perhaps, is that this method cures inflation. The source is removed. If effectively applied, it would maintain a balance between the flow of money and the flow of civilian goods at stable prices. A second advantage is that it gives the maximum amount of freedom for individual decision which is consistent with achieving our defense goals. Consumers and businessmen are still free to make their own decisions within the limits of the reduced amount of purchasing power available to them. Flexibility is a third advantage of this approach, especially for a prolonged period of rearmament and mobilization. Unless a good measure of flexibility is retained, our economy cannot adjust to changing conditions and it cannot grow, as it must, if we are to have constantly increasing economic strength. A fourth advantage is that much of the work of allocating manpower, materials, and plant; of distributing the income produced; and of rationing the output of finished goods is left to the market mechanism. This method is much less expensive both in money and in manpower than the administration of a maze of regulations by the Federal Government. Finally, by careful planning of new tax legislation, the burden of the defense program can be distributed much more equitably than under inflation.

A weakness of this approach is that it does not directly check the upward pressure exerted by demands for more income on the part of laborers, farmers, businessmen, and other groups. Rising money incomes exert strong pressure for an increase in the money supply and higher prices. Price and wage ceilings clamp a lid on these pressures and in this way help check the rising price-wage spiral.

It should be recognized, however, that effective fiscal-monetary actions remove the condition which makes it easy to pass on higher wages and higher costs in the form of higher prices. With substantially less purchasing power lying around, consumers are both less willing and less able to pay just any price that sellers may ask. The

elimination of excess purchasing power and the resulting stabilization of the cost of living removes one of the strong arguments for high wages. They also strengthen the employer's will to resist demands for wage increases. The major reason the wage-price spiral can continue upward is that there is already enough buying power available, or at least readily obtainable, to sustain it.

Flexible interest rates

Flexible interest rates are an essential part of an effective fiscal-monetary approach to the inflation problem. The paramount question here is what interest rate is best for maintaining economic stability. The increased cost of higher interest rates, both to the Government and to the public generally, would be repaid several-fold, if higher rates were effective in keeping prices from rising.

In considering the anti-inflationary effects of a rise in interest rates, two types of results must be distinguished. The one of paramount importance is that higher rates would make possible an effective limitation of the *supply* of credit. The Federal Reserve System would be free to direct its purchases and sales of Government securities primarily with respect to the supply of reserves which should be made available to commercial banks. With only a limited supply of reserves available to them, commercial banks would be compelled to restrict the amount of credit extended to their borrowers. Within the limits of the funds available to them, however, the banks would be free to decide to whom they would make loans and on what terms.

The only way the prices of Government securities can be kept higher (interest rates lower) than would exist in an unsupported market is for the Federal Reserve, or some other agency, to stand ready to buy whatever quantity holders want to sell and which other buyers are unwilling to take, at the support prices. Purchases made in supporting the Government security market add to bank reserves and pour additional money into the spending stream. When the System purchases Government securities, checks are paid out to the sellers. If the seller is a non-bank holder, the

check will be deposited in a commercial bank, thus increasing deposits. When the commercial bank sends the check to a Federal Reserve Bank for collection, its reserve account will be increased by a corresponding amount. If the seller is a commercial bank, only bank reserves are directly increased, but these reserves provide the basis for about a six-fold expansion of deposits. Thus, Federal Reserve purchases pour out high-powered reserve dollars which serve as the basis for a multiple expansion in bank deposits. More money, unless matched by more goods, merely adds fuel to the fires of inflation.

The Federal Reserve can use its purchases of Government securities either to regulate the supply of bank reserves or to maintain low interest rates (high prices) on Government securities. It cannot do both effectively in a period of strong inflation, especially with a Federal debt of nearly \$260 billion. In periods of inflation, lending agencies sell Government securities and shift to higher-yielding loans and other investments. Some holders sell Government securities and other fixed income obligations to buy stocks and other investments which they expect to increase in value as prices rise. Under these conditions, the Federal Reserve must make substantial purchases if it is to keep the prices of Government securities from falling. Such purchases, however, pour new dollars into the spending stream to compete for the limited supply of civilian goods. On the other hand, if the Federal Reserve limits its purchases so as not to supply more reserves, Government security prices will fall and interest rates rise.

A result of secondary importance of a rise in interest rates, just as in any other price, is the tendency to reduce demand. As explained previously, we normally rely on prices to ration the supply of goods and services. If the supply of any good or service becomes short relative to the demand, a rise in price, which cuts out some would-be buyers, is the free market method of bringing the two back into balance. A rise in interest rates likewise would tend to reduce the demand for credit—how much the reduction would be for any given rise in the interest rate, of course, no one can tell. The important point is that any gain from this result is a

windfall tending to support the major effect which is a reduction in the supply of credit.

The policy of maintaining a stable pattern of interest rates on Government securities was agreed upon at the beginning of World War II. To facilitate financing the war, the Federal Reserve used its open market operations to maintain a pattern of interest rates from $\frac{3}{8}$ of 1 per cent on bills to $2\frac{1}{2}$ per cent on long-term marketable bonds. As a result, a rigid structure of prices for Government securities was maintained throughout the war and early post-war period. Beginning in 1947, the Reserve System shifted toward a policy of more flexible short-term interest rates. In June 1949, the Open Market Committee stated that its purchases and sales of Government securities would be made with "primary regard to the general business and credit situation." The policy of "maintaining orderly conditions in the Government security market" was continued. Recently, still further steps have been taken to gain more freedom in using open market operations to regulate the money supply in the interest of maintaining stable prices and stable levels of production and employment. Ever since 1947, the System has gradually moved toward removing the shackles on its ability to regulate credit, imposed by the support program.

In arriving at a decision as to whether a low level of interest rates on Government securities should be maintained, two points should be given careful consideration. The first is that the primary objective of letting the rates rise is a restriction in the *supply* of credit. The real anti-inflation force is the reduced supply of credit dollars which would be available. Higher interest rates are only a result. If there were no effective anti-inflationary effect, there would be no rise in interest rates. Let us be sure to keep the horse in front of the cart and not vice versa.

The second point to be considered is which do we want to stabilize more—the prices of Government securities or the prices of goods and services? A stable level of prices for goods and services benefits all of us. We avoid the hardships of rising prices and inflation. The bondholder benefits from a stable price level too. The interest he receives and the real value of his bond are not being reduced by depreciation of the dollar in which they are payable.

Direct controls—wage and price ceilings

Two types of direct controls should be distinguished. One type, such as Government priorities and allocations, is designed to channel scarce materials into defense and essential civilian uses. Some controls of this type may be needed in a semi-war economy to supplement the work of the price-cost-profit mechanism. The other type, such as price and wage ceilings, is directed toward holding prices down. These controls represent another approach to the problem of preventing inflation.

Government controls, such as ceilings on prices and wages, and rationing suppress the use of purchasing power. They do not, in themselves, reduce it. Ceilings on a few selected products are not likely to be very effective if inflationary pressures are strong because of the tendency to divert buying power to other products, thus forcing their prices up. Once started, such controls tend to spread until there is a general system of price and wage ceilings.

Price ceilings and rationing are the twins of the direct-control approach. If purchasing power does not exceed the supply of civilian goods available at current prices, there is no need for price ceilings. If, on the other hand, price ceilings are below the prices which would be established in a free market, the inevitable result is some form of rationing. Rationing may take the form of first come, first served, with latecomers not getting any of the scarce goods at all. This form of rationing would not result in an equitable distribution of the sacrifice imposed by the defense program. The alternative is to limit buying through ration coupons such as were issued during World War II. Under this plan, buying goods requires both money and ration coupons. But the amount of ration cards issued rather than the supply of money is the means of holding buying down to the available supply of goods.

As a tool for checking inflation, direct controls have the advantage of cutting in and checking the rising wage-price spiral. By holding down the pressure for larger incomes, one of the important forces tending to bring about a further increase in the money supply and demand is curbed. In the case of indirect con-

trols, the condition which makes possible a continued rise in wages and prices—excess purchasing power—is removed.

The pathway of direct controls is beset with important difficulties, especially in a semi-war economy of prolonged duration. Price and wage ceilings, even if effectively enforced, do not cure inflation. Experience has demonstrated that as purchasing power backs up the pressure tends to break through the ceilings in the form of black markets, poorer quality goods, and the disappearance of low-priced lines from the market; moreover, once controls are removed, pent-up buying power is released and the problem of inflation eventually must be faced. A second disadvantage is that direct controls tend to put the economic machine in a straight-jacket, making it less adaptable to change. This is particularly serious for a prolonged period of mobilization. The incentive for efficiency is impaired because there is less inducement to acquire money as unused buying power accumulates. One's ability to get goods depends on the number of ration points rather than the amount of money he has. In addition, ceilings tend to clamp prices and the use of productive resources into a fixed pattern, keeping new businesses from starting and old ones from growing. A harness of direct controls stifles a growing economy, which is the very foundation of prolonged military strength. A third weakness is that controls shackle freedom of decision, which is one of the basic principles we are trying to protect. We must be careful to maintain those essential freedoms which we are spending billions of dollars to defend. Finally, it is more difficult to enforce direct controls in a partial or semi-war economy than in an all-out war effort. During war, the threat to our national existence and the patriotic fervor which is generated is a strong force for compliance.

Inflation

To the extent that excess purchasing power is not mopped up or its use effectively suppressed, prices will be forced higher and higher. As a result, it will take a larger amount of money to buy

the same quantity of goods and services. This is the road of inflation.

Rising prices and inflation are not a satisfactory means of handling the financial side of the defense problem. In the first place, the cost of defense would rise substantially as Government purchases were made at higher and higher prices. A second disadvantage is that inflation results in an inefficient and wasteful use of economic resources. The incentive for efficiency is undermined because increases in costs can readily be passed on to the consumer in the form of higher prices. A strong demand and high profits tend to keep manpower, materials, and plant pinned down in the production of non-essential goods and services. Third, inflation would result in a very inequitable distribution of the defense burden. Most of the sacrifice would be placed on those with fixed incomes and incomes which rise more slowly than prices. Finally, inflation is likely to get out of hand if prices continue to rise for a prolonged period. A persistent rise tends to undermine confidence in the value of the dollar and eventually eager buying turns into panicky buying and a flight from the currency. A strong, prolonged defense effort cannot be built on the sands of inflation.

CONCLUSIONS

Our basic economic problem is the same in war and in peace—that of making the best use of limited resources to satisfy our wants. However, a semi-war economy does require the allocation of more resources to the production of defense goods. It also poses a serious threat of inflation because defense production adds to money incomes but not to the supply of civilian goods for these incomes to buy.

Normally, the free-market mechanism measures which wants are most important, allocates manpower and materials to the production of the goods people want most, distributes the income produced, rations the limited supply of finished goods, and protects the individual against the selfish exploitation of the few.

In a semi-war economy, there is a need for measures to supplement the workings of the free market and to maintain conditions in which the market can continue to perform its usual functions effectively. The Government should take steps to promote the production of defense goods and to check inflation. Priorities and allocations help channel manpower and materials into defense production. Price and wage ceilings may help temporarily to halt the wage-price spiral, but the only cure for inflation is to mop up excess purchasing power. This requires that the Federal Government, through its fiscal and debt management operations, siphon off enough income to pay all of its expenses. A cash surplus to help check the inflation already under way would be better. It also requires effective action by the Federal Reserve to check the large flow of new money into an already excessive reservoir of purchasing power.

The important problem facing us is not whether we should forego the use of the instrument of government to help achieve the economic task facing us; rather it is that we use government wisely. The people of the United States have not hesitated in the past to modify the workings of the free market, nor should they do so now in those cases where it is the most effective means of achieving our objectives. Departures from the so-called free market are not a new thing. They have been made throughout our history to achieve results the majority of the people considered desirable. Today, the tariff, for example, is an integral part of a system of "free enterprise" to the manufacturer, as are agricultural price supports to the farmer, fair trade laws to the retailer, and Social Security to the laborer.

Actually, our economic system is a combination of free individual enterprise and planned collective action. The use made of government must continue to change, as in the past, if it is to help meet our changing needs. The vital issue confronting us is not whether more or less use is made of government, but whether our economic system measures up to the tasks confronting it in a semi-war economy. Unless it does, we shall lose the fight; and unless we preserve our essential freedoms, we shall lose the things we are fighting for.

RESERVE BANK OPERATIONS

Operations of the Federal Reserve Bank of Philadelphia reflected the general expansion in business activity during 1950, and the steps taken after the outbreak of war in Korea to cope with inflationary developments and lay the groundwork for the coming diversion of men, machines, and materials to the requirements of a greatly expanded defense program.

Growth in the physical volume of work occurred in many departments of the Bank and increases in dollar volume were even more pronounced as industry and trade gained headway and prices advanced. More than 157 million checks, other than Government checks, were handled in 1950, for a total amount of more than \$42 billion. Currency and coin counted reached record volumes, transfers of funds were more numerous and for larger amounts than in 1949, and the volume of securities handled increased considerably, reflecting in part an unusual volume of sales and refinancing by holders of Treasury issues which matured or were called for payment in the latter part of the year.

Advances to member banks, on the other hand, declined further in 1950, and the number of banks accommodated decreased from 126 to 103, since banks continue to adjust their reserve positions chiefly through transactions in Government securities. Interest in loans under the provisions of Section 13b increased, due in part to the growing volume of defense contracts. Twenty loans for a total of \$6.1 million were approved under this Section, half of them in participation with local banks.

Among the steps taken during the year to improve the service rendered to member banks were the extension of door-to-door delivery service for currency and coin, arrangements for the direct shipment of fit 3-C notes from the Pittsburgh branch of the Federal Reserve Bank of Cleveland to banks in the Johnstown-Altoona area of this district, and a reduction from \$500 to \$300 in the large-item limit for special deposits of checks on Saturday.

The number of full-time employes of the Bank continued to approximate 1,000 persons, despite the over-all increase in opera-

tions. This was made possible by continuing efforts to streamline the work, without sacrifice of accuracy or safety, and by the use of new or improved mechanical equipment and procedures to promote efficiency. Employee training, further development of supervision, and provision for succession continued to be major objectives in the field of personnel.

New tasks had to be taken on following the passage of the Defense Production Act of 1950 early in September. Regulation W, dealing with consumer credit, was reinstated and nearly 9,000 lenders and sellers in this district were registered. Regulation V, pertaining to the guarantee of loans to finance contractors and subcontractors engaged in the production of defense supplies, was reactivated. A new Regulation X was promulgated to control the financing of real estate construction not covered by Government insurance or guarantee. The administration of Regulations W and X was merged early in 1951 into a new department—the Department of Selective Credit Regulation. Every effort was made, through interviews, special conferences, and participation in many meetings, to explain the workings of these controls and create a sympathetic understanding of the objectives.

At bank relations field meetings held in the latter part of the year and at the fall meeting of the Federal Reserve Relations Committee, the new regulations received much attention and emphasis was placed on the steps taken by the System to restrain inflationary pressures. In the course of the year, field meetings covered every county of the district, the fifth consecutive year in which this has been done. Representatives of the Bank Relations Department also covered much of the district in their visits to individual banks. A film setting forth the place of the Federal Reserve in the banking system was used widely at meetings and was made available upon request; approximately 20,000 persons saw it. Traveling currency and coin exhibits, loaned to many banks for lobby displays, were much sought after and by the close of the year a lengthy waiting list had accumulated.

Members of the staff of the Department of Research participated actively in field meetings of bankers and in other gatherings. The demand for the monthly *Business Review* was exceptionally

heavy, a reflection of informative articles dealing with industries important to the district and the inclusion of a series of articles dealing with the evolution of the money supply and the development of fiscal and monetary policies. This series was reprinted in a pamphlet under the general title of "The Quest for Stability" and was in such demand as to necessitate further printings. The Department continued to serve the district through periodic releases of statistical material on banking and business and special surveys affording information useful in their operations.

Directors and officers

In the fall, Archie D. Swift was reelected a Class A director by banks in Group 1 for a term of three years beginning January 1, 1951. Warren C. Newton, chosen by banks in Group 2 as a Class B director for a like term, succeeds Walter H. Lippincott, who was not a candidate for reelection.

The Board of Governors of the Federal Reserve System reappointed Warren F. Whittier and C. Canby Balderston—Chairman and Deputy Chairman, respectively, of the Board of Directors—to serve during 1951. Mr. Balderston also was designated a Class C director for an additional term of three years. In the summer of 1950, Philip T. Sharples resigned as a Class C director but the resulting vacancy had not been filled by the close of the year.

The district's representative on the Federal Advisory Council during 1950 was Frederic A. Potts, President of the Philadelphia National Bank. He was reappointed by the Board of Directors of this Bank to serve during 1951.

Changes in the official staff during 1950 included the resignation of Robert R. Williams as Assistant Vice President and Assistant Secretary on February 28; the designation of Richard G. Wilgus as Assistant Secretary on May 1, in addition to his duties as Assistant Vice President; appointment on the same date of Wallace M. Catanach, an Assistant Cashier, to the position of Assistant Vice President; and of Edward A. Aff, Ralph E. Haas, and Henry J. Nelson as Assistant Cashiers. On November 15, George J. Lavin also was made an Assistant Cashier.

Directors
as of April 1, 1951

	Group	Term Expires December 31
CLASS A:		
ARCHIE D. SWIFT Chairman of the Board, Central-Penn National Bank, Philadelphia, Pennsylvania	1	1953
GEORGE W. REILY President, Harrisburg National Bank, Harrisburg, Pennsylvania	2	1951
J. NYCE PATTERSON President, The Watsonstown National Bank, Watsonstown, Pennsylvania	3	1952
CLASS B:		
WILLIAM J. MEINEL President and General Manager, Heintz Manufacturing Company, Philadelphia, Pennsylvania	1	1952
WARREN C. NEWTON President, O. A. Newton and Son Company, Bridgeville, Delaware	2	1953
ALBERT G. FROST Chairman of the Board, The Esterbrook Pen Company, Camden, New Jersey	3	1951
CLASS C:		
WARREN F. WHITTIER, <i>Chairman</i> Agricultural Consultant, Chester Springs, Pennsylvania		1952
C. CANBY BALDERSTON, <i>Deputy Chairman</i> Dean, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia, Pennsylvania		1953
Vacancy		1951

Officers

as of April 1, 1951

ALFRED H. WILLIAMS, *President*

W. J. DAVIS,
First Vice President

RICHARD G. WILGUS,
*Assistant Vice President
and Assistant Secretary*

KARL R. BOPP,
Vice President

WALLACE M. CATANACH,
Assistant Vice President

*L. E. DONALDSON,
Vice President

EDWARD A. AFF,
Assistant Cashier

ROBERT N. HILKERT,
Vice President

RALPH E. HAAS,
Assistant Cashier

ERNEST C. HILL,
Vice President

ROY HETHERINGTON,
Assistant Cashier

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Vice-President and Secretary

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Assistant Cashier

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Vice President and Cashier

HENRY J. NELSON,
Assistant Cashier

JAMES V. VERGARI,
Counsel and Assistant Secretary

NORMAN G. DASH,
General Auditor

* Died April 5, 1951

APPENDIX

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Statement of Condition

Federal Reserve Bank of Philadelphia

(000's omitted in dollar figures)	End of Year		
	1950	1949	1948
RESOURCES			
Gold certificates	\$1,130,280	\$1,208,508	\$1,011,054
Redemption fund—Fed. Res. notes	50,563	48,915	60,212
Total gold certificate reserves	\$1,180,843	\$1,257,423	\$1,071,266
Other cash	19,125	14,489	17,967
Discounts and advances	3,640	7,255	17,495
Industrial loans	2,204	1,885	767
United States Government securities	1,378,198	1,286,381	1,666,658
Total loans and securities	\$1,384,042	\$1,295,521	\$1,684,920
Due from foreign banks	2	3	4
Fed. Res. notes of other Fed. Res. Banks	11,382	10,369	10,935
Uncollected items	268,232	172,456	173,597
Bank premises	2,920	2,986	3,053
All other resources	7,759	6,493	10,279
Total resources	\$2,874,305	\$2,759,740	\$2,972,021
LIABILITIES			
Federal Reserve notes	\$1,665,849	\$1,632,188	\$1,662,531
Deposits:			
Member bank reserve accounts	822,286	788,335	951,233
United States Government	58,227	63,750	104,176
Foreign	71,016	60,848	51,492
Other deposits	5,142	5,131	6,060
Total deposits	\$ 956,671	\$ 918,064	\$1,112,961
Deferred availability items	183,799	143,300	134,950
All other liabilities	239	557	674
Total liabilities	\$2,806,558	\$2,694,109	\$2,911,116
CAPITAL ACCOUNTS			
Capital paid in	\$ 15,675	\$ 15,084	\$ 14,681
Surplus—Section 7	39,710	38,205	36,704
Surplus—Section 13b	4,489	4,489	4,489
Reserves for contingencies	7,873	7,852	5,031
Total liabilities and capital accounts	\$2,874,305	\$2,759,740	\$2,972,021
Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities combined	45.0%	49.3%	38.6%
Commitments to make industrial advances	\$593	\$689	\$46

Earnings and Expenses

Federal Reserve Bank of Philadelphia

(000's omitted)	1950	1949	1948
Earnings from:			
United States Government securities.....	\$18,142	\$21,270	\$21,349
Other sources.....	184	241	343
Total earnings.....	\$18,326	\$21,511	\$21,692
Expenses:			
Operating expenses*.....	4,252	4,159	4,131
Cost of Federal Reserve currency.....	439	458	385
Assessments for expenses of Board of Governors.....	272	260	262
Total net expenses.....	\$ 4,963	\$ 4,877	\$ 4,778
Current net earnings.....	13,363	16,634	16,914
Additions to current net earnings:			
Profit on sales of U. S. Government securities (net).....	2,630	2,272	456
All other.....	1	2	3
Total additions.....	\$ 2,631	\$ 2,274	\$ 459
Deductions from current net earnings.....	—	179	1
Net additions to current net earnings.....	\$ 2,631	\$ 2,095	\$ 458
Transferred to reserves for contingencies.....	23	2,821	2,960
Paid to U. S. Treasury:			
Interest on Federal Reserve notes.....	13,539	13,511	12,184
Net earnings after reserves and payments to U. S. Treasury.....	\$ 2,432	\$ 2,397	\$ 2,228
Dividends paid.....	927	896	874
Transferred to surplus (Section 7).....	\$ 1,505	\$ 1,501	\$ 1,354

*After deducting reimbursements received for certain fiscal agency and other expenses.

Volume of Operations

Federal Reserve Bank of Philadelphia

	1950	1949	1948
Number of pieces (000's omitted)			
Collections:			
Ordinary checks.....	157,300	160,600	147,500
Government checks (paper and card).....	23,300	22,500	20,800
Non-cash items.....	700	700	700
Currency counted.....	277,900	270,300	270,500
Coins counted.....	541,000	431,600	391,800
Discounts and advances to member banks.....	1	1	1
Transfers of funds.....	53	46	44
Fiscal agency activities:			
Marketable securities delivered or redeemed.....	200	148	148
Savings bond transactions (Federal Reserve Bank and agents)			
Issues (including re-issues).....	5,428	5,336	5,151
Redemptions.....	5,964	6,050	6,464
Coupons redeemed (Government and agencies)...	1,106	1,250	1,151
Dollar amounts (000,000's omitted)			
Collections:			
Ordinary checks.....	\$42,416	\$37,186	\$39,221
Government checks (paper and card).....	2,950	2,771	2,890
Non-cash items.....	163	140	169
Currency counted.....	1,708	1,671	1,734
Coins counted.....	52	42	40
Discounts and advances to member banks.....	195	254	623
Transfers of funds.....	21,157	17,706	17,543
Fiscal agency activities:			
Marketable securities delivered or redeemed.....	9,613	7,215	6,730
Savings bond transactions (Federal Reserve Bank and agents)			
Issues (including re-issues).....	522*	483*	533*
Redemptions.....	396*	366*	369*
Coupons redeemed (Government and agencies)...	113	122	120

*Par values.

Member Banks

Third Federal Reserve District

Statement of Condition

(000,000's omitted)	Dec. 30, 1950†	Change during		Percent distribution	
		1950	1949	Dec. 30, 1950	Dec. 31, 1949
Assets					
Loans and discounts.....	\$2,208	+\$ 414	+\$ 52	28.2%	24.6%
U. S. Government securities.....	3,027	- 131	+ 163	38.7	43.2
Other securities.....	752	+ 72	+ 74	9.6	9.3
Cash assets.....	1,740	+ 163	- 68	22.2	21.6
Fixed assets.....	68	...	+ 2	.9	.9
Other assets.....	27	...	+ 1	.4	.4
Total.....	\$7,822	+\$ 518	+\$ 224	100.0%	100.0%
Liabilities and capital accounts					
Deposits:					
Individuals, partnerships, and corporations—					
Demand.....	\$4,228	+\$ 418	+\$ 96	54.0%	52.1%
Time.....	1,835	+ 18	- 26	23.5	24.9
U. S. Government.....	165	- 11	+ 61	2.1	2.4
Bank.....	477	+ 53	+ 43	6.1	5.8
Other.....	399	+ 7	+ 29	5.1	5.4
Total deposits.....	\$7,104	+\$ 485	+\$ 203	90.8%	90.6%
Other liabilities.....	51	+ 8	+ 5	.7	.6
Capital accounts.....	667	+ 25	+ 16	8.5	8.8
Total.....	\$7,822	+\$ 518	+\$ 224	100.0%	100.0%

Earnings, Expenses, and Profits

(Millions of dollars)	1950†	1949	1948	1947
Earnings				
On U. S. Government securities.....	53.6	54.1	54.3	57.8
On other securities.....	16.3	15.0	14.6	14.4
On loans.....	88.0	76.3	68.5	54.4
Other earnings.....	33.8	31.1	29.8	27.1
Total earnings.....	191.7	176.5	167.2	153.7
Current expenses				
Salaries and wages.....	56.5	51.7	49.0	44.4
Interest on deposits.....	16.6	16.4	16.2	15.9
Other expenses.....	46.1	43.6	41.4	38.2
Total current expenses.....	119.2	111.7	106.6	98.5
Net current earnings before income taxes	72.5	64.8	60.6	55.2
Net recoveries and profits on sales (+) or charge-offs (-).....	- 3.8*	- 7.4*	- 9.1*	- 1.3
Taxes on net income.....	20.1	15.5	13.9	16.9
Net profits.....	48.7	41.9	37.6	37.0
Cash dividends declared.....	23.0	21.5	20.3	19.4

†Preliminary.

*Charge-offs include substantial transfers to reserves for bad debt losses on loans.

Employment and Earnings—Pennsylvania Factory Workers

	All Manufacturing		Durable Goods		Nondurable Goods	
	Employment*	Weekly earnings	Employment*	Weekly earnings	Employment*	Weekly earnings
Average:						
1939.....	100	\$22.42	100	\$25.76	100	\$19.16
1940.....	110	24.27	119	28.19	101	19.77
1941.....	134	29.25	158	34.31	111	22.23
1942.....	147	35.45	184	41.57	111	25.58
1943.....	156	41.48	203	47.82	110	30.03
1944.....	153	44.57	198	51.14	108	32.80
1945.....	138	43.29	171	48.89	106	34.47
1946.....	133	42.21	151	45.63	115	37.86
1947.....	143	48.04	166	52.18	120	42.47
1948.....	143	52.84	166	57.59	120	46.42
1949.....	127	52.94	143	57.63	112	47.12
1950.....	131	57.01	150	62.15	114	50.29
1950: January.....	125	54.31	139	59.42	112	48.12
February.....	126	54.85	139	59.70	113	48.98
March.....	125	53.73	139	57.71	112	48.90
April.....	126	54.35	142	59.94	111	47.38
May.....	127	55.71	145	61.12	110	48.77
June.....	129	56.39	147	61.66	111	49.55
July.....	128	56.64	145	61.79	110	50.00
August.....	134	57.47	153	62.24	115	51.27
September.....	138	58.26	158	63.68	118	51.15
October.....	139	59.54	161	64.77	117	52.50
November.....	140	60.55	163	65.91	117	53.21
December.....	140	61.87	165	67.82	116	53.70

*1939 = 100. Revised series

Income and Prices

	Factory Payrolls Pennsylvania			Income from farm marketings N. J., Pa., and Del.*	Consumer prices in Phila. †
	Total	Durable goods	Consumer goods		
Factory Payrolls: 1939 = 100 (1)					
Farm Income—					
Prices: 1935-39 = 100					
Average:					
1939.....	100	100	100	99	99
1940.....	119	131	104	104	99
1941.....	175	210	129	122	104
1942.....	232	297	148	155	115
1943.....	288	377	172	197	123
1944.....	303	394	185	199	124
1945.....	266	324	191	231	127
1946.....	250	267	228	268	138
1947.....	306	336	267	299	158
1948.....	336	372	290	320	171
1949.....	300	320	275	299	169
1950.....	334	362	298	286	170
1950: January.....	303	319	280	235	166
February.....	308	323	288	210	165
March.....	300	312	286	256	166
April.....	306	330	274	276	166
May.....	316	343	281	270	167
June.....	323	352	286	306	170
July.....	322	349	288	365	172
August.....	343	370	308	351	172
September.....	358	391	314	324	174
October.....	369	406	322	286	174
November.....	378	418	325	277	174
December.....	387	434	325	280	178

(1) Revised series. Sources. *U. S. Dpt. of Agriculture. †U. S. Bureau of Labor Statistics.

Department Store Sales

1935-39 = 100 (Adjusted for seasonal variation)	Third District	Phila.	Lan- caster	Reading	Tren- ton	Wilkes- Barre	York
1939.....	104	101	104	103	110	101	107
1940.....	111	108	107	111	120	101	114
1941.....	129	124	129	133	140	118	133
1942.....	143	140	151	152	153	129	157
1943.....	151	147	165	165	177	145	177
1944.....	167	158	178	177	192	174	200
1945.....	184	172	190	185	223	206	220
1946.....	235	214	248	249	294	277	276
1947.....	261	238	276	274	324	304	281
1948.....	284	253	295	296	370	330	311
1949.....	271	241	285	282	375	309	296
1950.....	288	254	308	288	407	318	313
1950: January.....	267	233	282	256	377	281	293
February.....	277	254	288	267	360	294	281
March.....	262	228	311	280	365	271	279
April.....	281	248	292	283	422	317	325
May.....	270	241	307	261	369	323	278
June.....	285	254	301	292	441	315	331
July.....	331	280	336	314	483	409	355
August.....	319	294	322	291	448	340	329
September.....	310	270	313	307	458	331	345
October.....	279	242	295	287	398	301	299
November.....	273	251	284	272	359	302	281
December.....	307	263	342	332	422	335	341

Department Store Inventories

1939.....	96	92	101	106	97	93	108
1940.....	99	92	105	112	101	91	113
1941.....	119	110	120	141	141	113	137
1942.....	167	165	148	190	184	143	177
1943.....	141	138	127	158	162	134	161
1944.....	147	143	132	181	166	144	165
1945.....	150	146	129	191	167	154	159
1946.....	191	184	177	229	205	210	212
1947.....	220	207	218	255	246	249	228
1948.....	252	221	238	297	328	349	269
1949.....	233	205	225	275	314	299	252
1950.....	257	226	245	294	322	328	280
1950: January.....	234	203	227	269	289	291	251
February.....	234	206	248	268	314	296	253
March.....	239	213	241	272	314	294	259
April.....	249	214	244	307	318	313	263
May.....	244	213	248	304	310	306	264
June.....	244	210	233	299	309	323	271
July.....	241	208	230	283	313	321	260
August.....	259	236	237	291	311	333	287
September.....	275	247	241	293	353	351	300
October.....	283	254	260	300	348	361	305
November.....	282	248	260	320	337	370	321
December.....	286	251	265	313	343	373	312