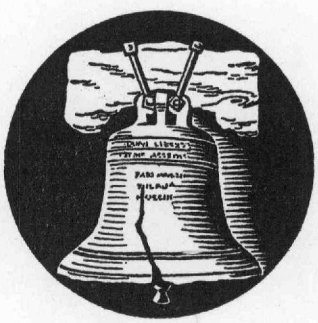
THE

BUSINESS REVIEW

FEDERAL RESERVE BANK OF PHILADELPHIA



RETURN OF THE DEFICIT

For three fiscal years in succession the Treasury had a cash surplus. A cash deficit for fiscal 1950 now seems almost inevitable. Spending is higher, receipts lower. What the resulting deficit means, however, depends on one's point of view. This article gives, in fundamental terms, some of the arguments for and against using the budget as an economic tool.

THE ROLE OF PUBLIC WORKS

The basic role of public works is to render services. Public works alone cannot eliminate the business cycle. Yet, properly timed and coordinated with other policies, they can help. This is easier said than done, for careful advance planning is needed. Problems involved in using public works to iron out fluctuations in business activity are explored here in simplified fashion.

THE MONTH'S STATISTICS

Reports of business activity in July still had a recessionary overcast. Nevertheless, business sentiment seems to be taking on a more optimistic hue. Industrial employment and trade were off but bank lending, coal mining and building expanded.

RETURN OF THE DEFICIT

The deficit is here again. Three fiscal years in a row—1947, 1948, and 1949—produced a combined Treasury cash surplus of $16.6 billion. To those looking 'way back to 1930 for the next closest surplus year, it seemed like old times. But it also seemed almost too good to last. When President Truman's revised estimates come out, they will almost certainly show a cash deficit for fiscal year 1950.

Whether the expected deficit is good or bad, however, depends on one's point of view. Some say the Federal budget must be balanced the same as that of any well-run business or orderly household. Others say it should be used to stabilize business conditions, and so a deficit may even be a good thing—sometimes. The aim of this article is to examine the facts and figures, reconsider the purposes of the budget, and then present some of the points-of-view which are sure to be discussed when the new budget figures are released.

FACTS AND FIGURES

A deficit, of course, simply means that the Government is spending more than it is taking in. This is obvious, and the fact that there are two types of budgets being used today should not be allowed to confuse the issue. One type is an administrative budget which shows transactions of individual agencies of the Government and the relationships among various branches and agencies of the Government. The other is a cash budget which eliminates intra-government transactions but covers all cash payments and receipts—including the trust funds—to and from the public. Because of these differences, the administrative budget showed for fiscal year 1949 a deficit of $1.8 billion and the cash budget showed a surplus of $1 billion. Both were right; they were just measuring different things.

This year, fiscal 1950, both are almost certain to show a deficit. The explanation is apparent in the chart. Government spending is increasing for two main reasons: (1) the war and the unsettled conditions it produced call for larger expenditures for defense, veterans, and foreign aid; (2) the decline in business activity has automatically meant greater expenditures for such things as farm price support and unemployment benefits. At the same time, with a lower national income, the Treasury's cash receipts have been falling off. The result of these trends is a cash deficit—how large will be indicated by the new budget. How long it will last is anybody's guess. A longer-run view reveals that over the stretch from 1789 to now we have had, on the average, a budget deficit in two out of every five years. Seventeen out of the last twenty years, which include a major depression and a world war, have produced deficits and these have totaled about $240 billion.

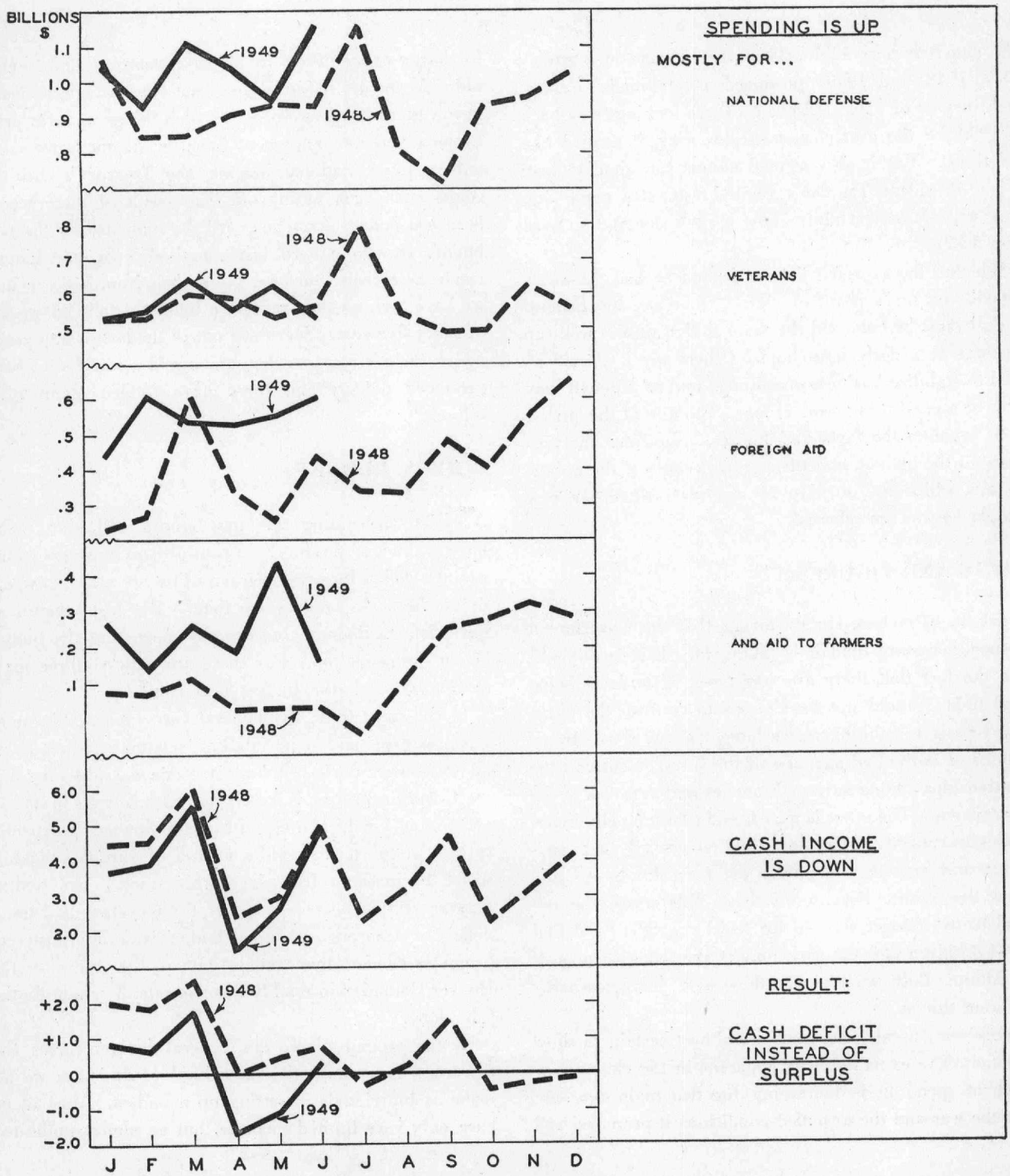
WHY A BUDGET?

A cynic confronting this past record will ask: "Why have a budget anyway? Certainly no business could run at a deficit for seventeen out of twenty years; it would be on the rocks long before that." But just because we have deficits does not *necessarily* mean that the budget is not doing its job. For there are at least three main functions which the budget performs.

In the first place, the Federal Government, like most business firms and some families, sets up a budget as an administrative device. A budget is one way of seeing that the Government spends for the things it intends to and of accounting for the sources of funds to finance its expenditures. In short, it provides a kind of yardstick against which to measure financial performance. The budget may serve this purpose whether the Government runs a deficit or a surplus. A good budget, well administered, promotes efficient management but, as the studies of the Hoover Commission readily demonstrate, it cannot do the job alone.

In the second place, the Federal budget forces the Government to make the same kind of decisions we all make as individuals in setting up a budget. Most of us have only very limited incomes, but an almost unlimited

THE BUDGET SITUATION AT A GLANCE



number of things we should like to buy. A budget always helps us decide what we want to buy most—the order of our preferences. It usually forces us to scale down our outgo to equal our income. But if we find we really must spend more than we earn, a budget suggests that we look around for the best place to borrow.

The Federal budget should do the same thing. It forces economic choices. "Economy" in this sense is not the same thing as "efficiency." *Fortune* magazine, analyzing the budget last January, summed it up: "Economics is the art of alternative uses of resources. If we use our resources for military expenditures, as we must, we cannot use the same resources for vast public works and social services, and we shouldn't try. This choice . . . requires us to cut our federal expenditures with . . . austerity. . . ."

The above statement applies to conditions of full employment. If resources are not all being used, a large group of economists would say that we don't have to cut our outgo down to our income; in fact, we should spend *more* and run a deficit if necessary to help promote full use of resources.

They wouldn't worry about a deficit for its own sake. Concern about balancing the budget, they say, is a carry-over from private finance. It is true that an individual "goes broke" if for very long he spends more than he earns. But Professor Alvin Hansen, perhaps the foremost exponent of this point of view, has said: "For the public economy, expenditures ought to be weighed not in terms of the profit and loss of the state itself, but rather in terms of the effect of such expenditures on the full and efficient functioning of the economy as a whole. Fiscal policy is an important instrument for maximizing the real income of the community and for regulating the distribution of income and wealth. At times it will be sound policy to balance the budget and at times it would be disastrous to do so. Only in the event that one applies the maxims of private finance to the public economy will one be concerned *per se* with the problem of balancing the budget."

This point of view has spread rapidly in our time. It was behind the fiscal operations of the 'thirties, was the basis for the original draft of the full-employment bill, runs through the recently introduced Economic Expansion Act of 1949, and will crop up again in some of the discussions of the revised 1950 budget.

What kind of thinking can it be that produces such a radical departure from orthodox principles of finance? What do these economists have in mind?

THE BUDGET AND BUSINESS

They think of economic activity as a circular flow of funds—money going 'round and 'round. Incomes are spent, become someone else's income, and are spent again. Business pays individuals for their efforts and individuals pay business back for the goods it sells. If we take the sum of business activity over a given period, total incomes equal total expenditures; in fact, they are really the same thing except viewed from opposite sides. Government takes part in the spending and receiving along with consumers and businesses. But it has only been quite recently that the Federal Government has made up a budget to express its cash transactions. For many years the budget was basically an administrative budget. It is essentially the cash budget which economists have in mind when they think of the Government's role in the circular flow of funds.

Compensatory Policy. In this circular flow, all money that is spent—either for consumption goods or for investment in more durable goods—becomes someone's income. But all money received as income is not necessarily spent. Some may be "hoarded." When this happens the level of income declines.

Greatly over-simplified, this is the background for the theory of "compensatory" fiscal policy. When the private economy is spending less than it takes in and incomes tend to decline, it should be the responsibility of Government (so the theory goes) to *compensate* for this unbalance by spending more than it takes in. This will help keep the level of incomes and expenditures stable.

A compensatory budget is a two-way street. The private economy can spend more than its income in any given period both by using money "hoarded" in the past —by activating idle funds—and by creating new money through the credit activities of the banking system. When this happens incomes rise. This is ordinarily quite desirable. But if incomes continue to mount after full employment is reached, growing demand tends to raise prices generally instead of encouraging more production. Result: inflation. So it is the responsibility of the Government in this case to spend less than it takes in, either holding the cash surplus idle or using it to pay off debt held by the Federal Reserve Banks and thus retiring money. The Government can thereby compensate for over-spending by consumers and businesses. In fact, this is exactly what it did during the fiscal years 1947, 1948, and 1949.

Principally because of wars and depressions, and perhaps in some degree the acceptance of the compensatory theory itself, Federal fiscal operations have embraced an ever-widening sphere of activities. A glance at these figures will demonstrate the point:

	In 1929	In 1949
The Federal Government bought this part of the gross national product	1%	9%*
Federal Government taxes took this share of the total national income	4%	17%**
The public debt was this proportion of total outstanding debt	8%	57%†

The implications of these figures extend far beyond the economic into the social and political phases of our life. For the purposes at hand, they suggest how important Government fiscal operations are for business activity.

Pump Priming. The theory thus far described gives a good deal of the background for discussions of the 1950 budget. But it is much more complicated than this, and these complications explain some of the fiscal policies which may be advocated in the future.

Government spending policies, for example, have at times been directed not so much toward *compensating* for ups and downs in private spending as toward *stimulating* private spending. As mentioned before, people can do several things with their income. They can spend it for immediate consumption or they can save it. When they spend for consumption, they contribute to someone else's income. When they save, they reduce the circular flow of funds and reduce the level of income—*unless* they spend for future consumption by *investing* directly in investment goods or by turning their funds over to someone else to invest in new capital goods.

Many economists say, therefore, that a decline in the level of income is caused by individuals and businesses holding their savings as "hoards" rather than investing them, thus reducing the circular flow. On the other hand, they say, a rising level of income indicates that people are "dishoarding" now what they "hoarded" in a previous period and are investing it. Or they are creating new money by borrowing from the banking system and are investing that.

"Pump priming" was conceived in an atmosphere of too much "hoarding" and not enough spending. Businessmen were reluctant to invest because expectations for profit were not good. Some savings were held idle and this tended to reduce incomes. Because incomes were falling and unemployment was rising, consumers were hesitant to spend and there was not enough demand. This made profit expectations bad. Here was a vicious circle which, it was felt, the private economy could not break out of by itself. The policy for Government, then, was to spend more, insofar as possible for useful capital goods. So during the 1930's the Government engaged in huge public works projects—buildings, roads, dams, and the like—to increase investment and to maintain the circular flow.

But pump priming is intended to do more than that. It is supposed to be contagious. Public works, for example, involve spending in basic industries such as construction which, in turn, pay out money for wages and place orders for materials. As this money spreads around, private industry is expected to be stimulated and proceed on its own again. A given expenditure has repercussions like the widening ripples caused by dropping a pebble into a pool of water. The total increase in incomes in the end should be greater than the volume of the initial Government expenditure. Economists have a seventy-five-cent word for this—they call it the "multiplier." Because the multiplier may be greater with certain expenditures than others, it is important in planning public spending to get the maximum results with a given outlay.

Footing the Bill. How effective a spending program may be, however, depends mainly on how it is financed. In making up the budget, the Government must decide what proportion of its outgo is to be met by taxing and what proportion by borrowing. Moreover, it must decide whom it is going to tax and from whom it will borrow.

Fiscal policy can stimulate or depress business only if Government financing changes either the size or the rapidity of the circular flow. The size can be increased by borrowing from the banking system and decreased by paying off debt held by the banking system. The rate of circulation can be speeded up by tapping idle funds of businesses and individuals, and by then paying them out to people who spend rapidly. It can be slowed down by drawing on funds which would have been spent anyway and then either immobilizing them or paying them out to people who spend more slowly.

When the Federal Reserve Banks buy Government securities, they pay for them by increasing the Treasury's deposit account at the Reserve Banks. As the Treasury draws out and spends these funds, the checks are depos-

* First half seasonally adjusted.
** Fiscal year 1949.
† 1947, latest data available.

ited in commercial banks which, in turn, deposit them in their accounts at the Reserve Banks. These accounts are the reserves of the member banks and serve as backing for about six times as much deposits, under present reserve requirements. A purchase of $1 billion of Government securities by the Federal Reserve thus increases bank reserves by a like amount but enables the member banks to expand their own deposits by about $6 billion. Borrowing from the Federal Reserve can have a tremendous leverage power on the volume of deposits or money available for spending.

When the Government borrows $1 billion from commercial banks, however, only $1 billion of new money can be created. To pay for the securities they buy, banks give the Government the right to draw out $1 billion of deposits which never existed before. But this is apt to be more stimulating than borrowing from other institutions or individuals, because except for the Federal Reserve Banks only commercial banks can create money. When other institutions or when individuals lend to the Government, they merely transfer existing funds—they do not create additional funds. Therefore, of the nonbank sources, a more stimulating effect is achieved by borrowing funds which otherwise would remain idle than funds which would be spent anyway. Borrowing from people in high income groups is apt to have a more stimulating effect because they tend to hold larger idle balances than people in the low brackets. If low-income groups redeem their savings bonds and spend the money, they add a further stimulus to business. Conversely, when they buy savings bonds in times of inflation, they are apt to help dampen inflationary forces. The greatest anti-inflationary effect, however, is obtained either by holding the Treasury surplus idle or using it to pay off public debt held by the Federal Reserve Banks, for both actions reduce the volume of bank reserves and spendable money.

It is harder to decide where to tax than where to borrow. Taxes are a burden no matter who pays them, but some are more of a burden than others. The point which many make is that the less depressing taxes should be used during depression and the more depressing taxes during inflation.

Taxes impinge on both consumption and investment. If incomes are declining because savings are being "hoarded" instead of invested, a more progressive income tax is likely to be advocated because most of the saving is done by people in high-income groups. A sales tax probably would not be proposed because it would bear most heavily on low-income groups who could not "hoard" much even if they wanted to. When inflation develops, however, a consumption tax might be urged as a weapon against rising spending and soaring prices. On the other hand, the effect of taxes on business expansion must be borne in mind. Tax rates and other tax provisions can stimulate or discourage efforts to produce more and make more profits. The decision as to which tax to use is thus a difficult one, particularly in avoiding inequities and in striking a middle ground between too heavy an impact on consumption and too great a detraction from the incentive to invest.

Summary. As a crude and over-simplified streamlining of a complicated subject, the following table shows some of the major fiscal policies which one group might advocate, depending on the business situation. Imperfect as it is, this table should, nevertheless, provide some background for one side of the budget story—the side which advocates using the budget as a stabilizing device.

IN DEPRESSION	IN INFLATION
Run a budget deficit	Run a budget surplus
Pay out for: Public works Public services and relief Redemption of savings bonds held by low-income groups	**Take in by:** Less progressive income tax Sales tax Selling savings bonds to low income groups
Take in by: Borrowing from— Federal Reserve Banks Commercial banks High-income groups More progressive income tax	**Pay out for:** Retirement of debt held by Federal Reserve Banks
	Or hold surplus funds idle in Treasury balances

SOME OTHER ASPECTS OF THE STORY

The gospel of using fiscal policy as an economic tool has spread far and wide, but by no means has everybody been converted. The views of the "disbelievers," indeed, are also widespread and perhaps more familiar.

Those who do not agree with the theory have a number of objections. Some believe that the sound canons of private finance apply equally well to public finance. The budget should be balanced year in and year out, and debt should be paid off regardless of business conditions. Almost all view with alarm the rapid growth in the influence of the Federal Government. They deplore the trend toward a "welfare state," of using the budget for social reforms, of growing centralization of Government activity. The rising taxes and debt which inevitably

go with the new activities rest, they feel, like a dead weight on the economy. Heavy taxes become inequitable and destroy incentives to take risks and expand. Deficits year after year have a damaging psychological effect on the public. Government is interfering more and more in narrow segments of the economy when it should, at the very most, confine itself to broad over-all regulation such as quantitative monetary controls. In short, this group sees discretionary fiscal policy as a departure from our traditional economic, political, and social systems.

Some who do agree with the theory see very little new in it. For in the last analysis, they say, the important things influencing the circular flow are the quantity of money and its rapidity of circulation. This is language "old-fashioned" economists understand. Their tools are the well-tried tools of monetary policy.

Others who believe in the theory and its application feel that now is not the time to use fiscal operations for stimulating the economy. They point out that business activity is, after all, still at a high level and if we are unable to balance the budget now, when will we? This opinion, of course, reflects a judgment not only as to the current business situation but also future business conditions. Prompt action is an essential part of the compensatory theory.

Still others agree with the principles of fiscal policy "in theory but not in practice." They approve the ends but not the means. Forecasting economic trends, in the first place, is a hazardous occupation. Until it becomes a more exact science, they feel we had better devise a more automatic compensatory mechanism, such as a tax structure with "built-in" flexibility, than rely on imperfect judgment for timing fiscal operations. Even if we could forecast at all accurately, they say, it is very difficult to put programs into effect soon enough or call them off quickly enough. It simply takes time to get the machinery moving. Moreover, the theory deals only with broad aggregates, while its application must be concerned with specific areas and sectors of the economy. It is no easy matter to channel Government spending into depressed areas. Even if it were, there is great danger of propping up something that should not be propped up, of preventing needed economic changes from taking place.

These same critics feel that numerous administrative difficulties, such as those discussed in more detail in the following article, hinder the application of fiscal policy. They stress the need for close coordination between the Executive and Legislative branches of the Government, such as was attempted in the Legislative Reorganization Act in 1946. Greater coordination among the Federal, state, and local governments is also needed. They point out that the Hoover Commission recommended a "performance budget" to reveal the status of individual programs—something which even experts are now often unable to find out—and other changes in budgetary procedure which are prerequisites for a successful fiscal policy.

Yet, they emphasize, there is a limit to efficiency. It must not be pushed to the point where it disturbs our democratic processes of government. Prompter action by Congress is desirable, but not too much power in the hands of the Executive. They doubt, therefore, that discretionary fiscal policy could be applied efficiently and promptly without giving up something more desirable. And democratic processes being as they are, compensatory policy would probably prove to be a one-way street: deficits in depressions but no surpluses in booms. The result would be a constantly rising public debt.

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Over the long-run, opposition to the theory has become less widespread. Yet, the constructive critics supported by several years' experience have shown that compensatory fiscal policy is not the panacea for all economic ills, nor even the novel doctrine that its proponents often made it out to be. Fiscal policy can hope to work only if it is coordinated with monetary policy—a fact which has often been lost sight of. And to be completely effective, many administrative problems must be solved. Fiscal policy will undoubtedly play a significant part in future efforts to achieve a high and stable level of economic activity—if placed in its proper perspective.

THE ROLE OF PUBLIC WORKS

Government has always undertaken to perform certain essential economic services. As the preceding article pointed out, the idea of what is the proper area for government activity has been expanded and government expenditures have increased. In this article we are concerned with that segment of government spending which falls under the heading of "public works." Some of the technical problems will be reviewed, and their relationship to the budget will be discussed in more detail than in the preceding article. Two points should be emphasized at the outset. First, the primary function of public works is not to give employment; they are needed for the services they render. Second, public works programs alone cannot be expected to solve problems of inflation or deflation. Some of the limitations of such programs will be pointed out.

The theories of compensatory government spending and of pump priming have been described in the previous article. If the government chooses to spend more to compensate for lower private spending it must have something to spend *for*. It could increase operating expenses—hire more people for routine tasks. But that would be wasteful. It could spend more for defense, but presumably such expenditures should be adequate at all times anyway. It could give direct relief payments, but, although there is frequently no alternative, this usually has not been regarded as the most desirable procedure for many reasons. Almost always, discussions of compensatory fiscal policy and "deficit spending" are associated with useful public works expenditures.

COMPENSATORY PUBLIC WORKS SPENDING

The idea of compensatory public spending has usually been associated with public works such as the construction of highways, bridges, public buildings and such utility facilities as have come to be regarded as properly within the government domain. More recently it has been extended to include other public expenditures such as low-cost housing. It could also include, and, in fact, in the days of the WPA, did include certain services. Sewing projects of the 1930's furnished millions of garments to needy persons, art and drama projects provided education and entertainment for millions, and research work provided material for scholars. At the time, many considered these projects "relief" rather than "public works." But the exact line between the two—and it is a rather arbitrary one—seems to be shifting as ideas about government's function are shifting. It would seem that any project, efficiently executed, which provided useful services would have the same status and the same effects as the more familiar highway and building programs. A discussion of how public works can fit into budget policy should not exclude this type of public expenditure.

The idea of compensatory public works spending (as distinguished from many other aspects of fiscal policy) is not at all new. It was well stated in this country in 1921 in the report of the President's Conference on Unemployment, led by Herbert Hoover, then Secretary of Commerce. The Conference recommended that the method of making appropriations for roads, public buildings, and other public works be changed "so that the percentage of the total authorized appropriation to be expended in any one year may be determined by Executive Order, based upon the condition of private industry and employment; in years of normal industry a minimum program, in a year of depression a maximum program of public works resulting from previous accumulations being thus effected."

The principle involved in this recommendation, ignored by legislators at the time it was made, but revived at the onset of the 1930 depression, has wide acceptance among proponents of compensatory finance. It has been incorporated in the Housing Act of 1949, recently passed, and in other pending legislation.

The reasoning behind the Conference proposal and its predecessors is this. Over a long period of years a certain amount of public works must be undertaken. Highways, water works, perhaps research and other projects which have come to be regarded as "public" or government undertakings will be completed. How much public construction will, in fact, be undertaken—how much in the

way of productive resources the public feels it can afford to divert from the activities of the private economy—will depend upon the criteria governing the choice between "public" and "private" production, which the nation adopts. But whether it is a large or a small amount, a good part of it can be done a few years sooner or a few years later without too much difficulty. Urgent community needs must be met when they arise. Vital services cannot be curtailed. But there is a good bit of leeway in the timing of many projects. Since they are not bound by the prospect of monetary profit or loss, government officials can afford to consider other timing factors.

Private investors, however, the argument continues, have little leeway. In fields where demand is steady and predictable, as in certain utilities, long-range plans are executed with some degree of flexibility; but for the most part, private profit opportunities require that the investor "strike while the iron is hot." When poor earnings are in prospect, investment incentives are weak. Consequently, private capital investment has a tendency to fluctuate widely over a period of years. And the same is true of the purchase of housing and, to some extent, of durable goods by individual consumers.

Assuming that other business and government policies will not be completely successful in stopping the ups and downs of private business activity, public works timing should be such that men and materials are freed for work on private undertakings in prosperous times, and absorbed on public projects in periods of slump. The stability of the construction industry, which might be accomplished in this way, and the employment of other available workers on non-construction programs would thus contribute toward economic stability and help to minimize the waste of cyclical unemployment.

THE GREAT DEPRESSION

Compensatory public works spending has many limitations and raises many problems which are not immediately apparent from this description. Public works policy during the depression illustrates some of them. The creation of the RFC in 1932 was the first concrete effort to stimulate public works expenditures, though their importance was recognized earlier by the Administration. In fact, the Federal Employment Stabilization Board had been set up to do some planning in 1931. There followed, in 1933, the Public Works Administration, which provided funds for Federal agencies and state and local governments to undertake construction projects on a private contract basis; the Civil Works Administration and the Federal Emergency Relief Administration which provided work relief by putting workers directly on the Federal pay rolls; and, in 1935, the Works Projects Administration. The final report of the last agency revealed that in the eight years of its life it employed more than 8 million different persons, built 78,000 bridges, 4,100 utility plants, and thousands of schools, airports, and playgrounds. It provided millions of school lunches, put on plays, gave concerts.

Yet, for all the vast administrative machinery that was set up and for all the bridges and schools, the public works programs of the 'thirties did not carry out the compensatory spending idea—not because the Federal Government did not try it, but because its requirements had not been fully appreciated.

The accompanying table gives the record of construction expenditures during the 'thirties. The course of private construction is, of course, quite consistent with the fluctuation of business during that period. What is particularly significant about the table is that total construction showed the same movement. Public construction outlays did not begin to compensate for the decline in private building. Not until 1936, and then with the help of about a billion dollars of work relief each year, did total public construction reach the level of 1930. Two main factors were responsible. First, the ability to "telescope" several years' public works into one, as called for by the compensatory spending idea, presupposed the existence of elabo-

NEW CONSTRUCTION EXPENDITURES IN THE UNITED STATES, 1925-1939

(Millions of dollars)

Year	Total Construction	Private Construction	Total Public Construction*	Federally Financed Construction*	State and Locally Financed Construction*
1925–1929 (average)	10,670	8,400	2,270	199	2,071
1930.....	8,207	5,430	2,777	307	2,469
1931.....	6,225	3,648	2,577	422	2,156
1932.....	3,523	1,729	1,794	460	1,334
1933.....	2,545	1,200	1,345	647	707
1934.....	3,653	1,479	2,174	1,380	794
1935.....	3,758	1,908	1,850	1,234	616
1936.....	5,946	2,730	3,216	2,335	881
1937.....	6,395	3,507	2,888	2,043	845
1938.....	6,350	3,162	3,188	2,085	1,103
1939.....	7,050	3,530	3,520	2,206	1,314

* Includes work relief construction beginning 1933.
Source: U. S. Department of Commerce and National Resources Planning Board.

rate plans—several years' worth of blueprinted projects ready to be "telescoped." In 1929 such plans did not exist, and it took months, in some cases years, to get building projects off the drawingboards. Second, although the Federal Government did manage to expand its outlays steadily, the state and local governments, which had been doing the bulk of public works building, contracted theirs. Their outlays shrank from nearly $2.5 billion in 1930 to $616 million in 1935, after which they increased slowly. Thus, during the crucial early years of recession, the efforts of the Administration in Washington to expand public works were frustrated, and a decline in total Government construction outlays, in fact, contributed to the deepening of the depression.

ADVANCE PLANNING

The advance planning of public works presents many difficult problems. One of the most important of these is the coordination of Federal and local efforts. This involves the formation of planning agencies for states, cities, and towns, and the passage of enabling legislation. Moreover, the authorization of a project and a blueprint for it may not be enough. The acquisition of sites for building is sometimes time-consuming and may have to be done in advance. Contract bidding procedures may have to be overhauled and speeded up. Financing arrangements should be considered in advance. Inadequate tax revenues and inflexible debt limitations forced curtailment of many local projects during the depression and might do so again at the wrong time unless adequate provision is made. Proper timing is essential if public works are to help stabilize the economy. Delays in putting men to work once an accelerated public works program is decided upon may result in a vital loss.

Even a large "shelf" of public works blueprints does not guarantee the best possible timing unless the plans are flexible. Weather—as simple a thing as that—may delay certain types of construction for months. Alternatives should be available. Trouble may develop in stopping projects at the proper time, as well as in starting. Aside from political considerations which make it difficult to cut off a program once started, the engineering requirements of certain projects may be such that a time-consuming process cannot be curtailed without great loss, and the work must therefore go on into a boom period. Projects of short duration should be available when called for in the event of what appears to be a temporary dip in employment and for mixture with longer-term plans. The "shelf" should be flexible, too, with respect to the employment effect of various projects. Some types of public works, for instance reforestation, require more direct "on-site" workers than others, give greater initial stimulus to particular areas. Others require quantities of complex equipment, spread expenditures throughout the nation, and take longer to work through the economy. Both types should be planned for use at different times and places.

There is much more involved in a compensatory public works program than merely turning it on and off like a faucet. It is obvious that the difficulties of planning, administration, and timing suggested here are serious limitations on its effectiveness. Judgments must be made at many stages—as to the business outlook, as to engineering problems, and so on—which, by their nature, have a wide margin of error. For this reason and for others, it is apparent, too, that reliance on public works alone as a business stabilizer is unfounded. The construction industry—which has the largest part of any public works program—cannot be expected to undergo the violent expansions and contractions which would be called for if it alone were to fill the whole gap caused by declining private expenditures during a recession. It might not even be able completely to fill the construction expenditure gap. Workers and equipment are not that mobile; textile workers cannot be put to laying bricks or driving bulldozers; homebuilders cannot erect bridges. Other types of public works projects may be undertaken—public health services, education, and so on; but the useful range of these on a temporary basis is limited. A compensatory public works program can only be a part, albeit an important one, of an over-all fiscal policy for economic stability.

PUBLIC WORKS SINCE THE WAR

The Federal Government's early wartime building, which raised public construction activity to record levels in 1941, 1942, and 1943, cannot properly be considered a public works program. It included extraordinary amounts of construction for the military and large outlays for war-related industrial facilities. From 1940 until the end of the war, annual highway expenditures declined. Educational, hospital, and recreational building was at a low level. Much-needed conservation and development work dropped off after 1942. The Federal Government was a

big employer during the war, but in terms of community facilities provided, only a bare minimum could be done. New construction activity of both the Federal and state and local governments reached $2.5 billion in 1939. In 1945, at current prices, it was about $2.1 billion. These construction figures do not include all public works outlays, but they do represent the largest part of such expenditures and are probably an accurate indicator of trends for this period.

State and local governments began to increase their public works programs sharply in 1946. Highway and utility construction spurted, and school buildings began to go up. As the table shows, public construction outlays doubled between 1945 and 1948, bringing the dollar total to a peacetime record. In the first six months of 1949, public construction activity was estimated to be over 35 per cent ahead of the same period in 1948. All community-facility types of building continued to show large gains. There is no doubt that 1949 will see another dollar outlay record. When making comparisons with earlier years, however, it should be borne in mind that today's building is being done at price levels which are about double those of the late 'twenties, and higher still than those of the depressed 'thirties.

ESTIMATED NEW PUBLIC CONSTRUCTION ACTIVITY IN THE U. S.

(Millions of dollars)

	1940	1942	1945	1948
Public Total	2,652	10,405	2,092	4,212
Federally Financed Total	1,397	9,544	1,558	1,339
State and Locally Financed Total	1,255	861	534	2,873
Residential (nonfarm)	200	545	71	85
Nonresidential structures	556	3,653	652	1,057
Industrial	164	3,437	470	20
Educational	132	116	59	567
Hospital and Institutional	50	32	85	219
Recreational	18	5	9	58
Administrative and General	133	47	15	73
Miscellaneous	59	16	14	120
Military Establishments	385	5,016	690	137
Highways	882	616	386	1,585
Conservation and Development	310	350	130	597
Sewer	67	39	37	269
Water	127	100	60	212
Other Public	125	86	66	270
Miscellaneous Federal	35	50	11	30
Miscellaneous State-Local	90	36	55	240

Source: General Service Administration.

Private building activity rose much more rapidly than public after the war. From a level of $2.7 billion in 1945, it advanced to $14.6 billion in 1948, led by residential construction. Thus far in 1949 it has receded from the peak along with other lines of business activity. But the great increase in public works has not only served to prevent a decline in total construction activity, it has caused a continued increase and has made the construction industry a tower of economic strength in a difficult period of readjustment.

It would seem that this course of events had been planned that way—in accordance with the principles of compensatory public works spending. And to a large extent it had been. Many projects were planned during the war and were held in abeyance until materials and men were available. But, although there was widespread acknowledgment of the necessity for long-range post-war planning and postponement of desirable public works, actual conformance was in part forced by the war. The big question not yet answered is, will we be prepared, on our own initiative, to utilize public works expenditures to the maximum to help deal with serious unemployment, should it arise in the future?

That there is plenty of public construction that needs doing is an undisputed fact. The war interrupted many necessary programs that were under way and left virtually every community with a backlog of community needs for an expanded population. Mr. Jess Larson, Administrator of General Services, has placed the estimate of necessary state and local government construction over the next 15 years at $100 billion. Of this total, highways probably will call for well over half, schools about 10 per cent, sewerage and water systems a little less, and hospitals about 8.5 per cent. The remainder is spread over airports, buildings, public service plants, and recreational facilities. A very rough estimate for Federal construction over the same period, mainly for reclamation, flood control, and river and harbor work, might add something like $20 billion or $30 billion worth of work to the total.

This $120—$130 billion, however, is estimated from a vague listing of necessary and desirable projects. How much is actually planned, and blueprinted? How much is on the shelf? State and local governments have about $2.5 billion of projects ready to go, some prepared with the aid of Federal funds, some in those few states including New Jersey and Pennsylvania which made provision for them with state funds. The Federal Government has blueprints in reserve to the extent of about $2 billion. That comes to about $4.5 billion. Add to it the amount of public housing that can be quickly authorized and the total is still no more than one year's supply of plans at the current rate of public construction—not much to "telescope." The present reserve shelf of community projects does not seem to

be adequate to sustain an effective accelerated public works program should it be desirable. In 1944, the War Mobilization and Reconversion Act authorized the Federal Works Administration to advance funds to state and local governments to meet planning costs. This authorization expired in June 1947 at which time an estimated $2.4 billion worth of construction plans had been approved, and the stock of plans was growing. Since that time, some of the plans have been executed. New plans to replace them are difficult to make because of lack of funds for the purpose. The reestablishment of an advance planning fund has been proposed in Congress.

THE "DISTRESSED AREAS" PROGRAM

In recent weeks, Federal Government agencies have been instructed to give what aid they can through procurement, loans, or construction to certain areas in which unemployment has reached serious proportions. Since both the special channeling of Federal purchases and RFC loans are blocked by legal restrictions, public works may seem to be an attractive remedy. Two points should be noted in this regard. First, public works should not be used merely to provide relief. Unless the particular project is justified by the long-term needs of the community or unless it will strengthen the community's economy, it should not be undertaken. "Pyramid building" will only hide basic problems. Second, the employment effects of most types of public works are diffused. Payments for equipment and materials and even for skilled labor will leave the "distressed area." The cost of putting men to work in particular areas by means of public works may be very high. Subject to these qualifications, compensatory public works spending, primarily designed to cope with a national problem, may also be helpful in individual cities and towns which have developed adequate plans.

A limited number of additional copies of the BUSINESS REVIEW *will be available upon request.*

THE MONTH'S STATISTICS

The latest statistics reveal further business declines in July. Manufacturing production, employment, pay rolls and department store sales were below the levels of both the preceding month and the corresponding month a year ago. The outstanding exceptions were increased activity in construction and coal mining.

The major declines in industrial output occurred in the industries manufacturing durable goods such as rubber and metal products. Producers of nondurables, especially foods and textiles, encountered only fractional declines. Smaller industrial production was accompanied by reduced employment and pay rolls in Pennsylvania's factories—especially among producers of durables. Average weekly earnings were $50.51 in July.

Retail trade, judged by department store sales, dipped considerably and latest reports indicate continued declines in August. In July, sales in economy basements were off to about the same extent as in the main stores; for seven months of this year, however, basement store sales held up better than main store sales.

The lifting of regulation W on June 30 apparently did not have much effect on department store instalment sales which declined further in July. However, consumer instalment loans by commercial banks increased considerably.

Over the past month further reductions have been made in the reserve requirements of member banks. In part the funds released have been used to purchase United States Government securities, particularly those of short term, many of them coming from holdings of the Federal Reserve System. Third District figures show an upturn in loans of banks in leading cities, mostly in accommodation extended to business concerns, which may indicate that the low point early in July marked the bottom of the recent decline in business borrowing.

SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	July 1949 from		7 mos. 1949 from year ago	July 1949 from		7 mos. 1949 from year ago
	mo. ago	year ago		mo. ago	year ago	
OUTPUT						
Manufacturing production	− 3*	−15*	− 9*	− 3	−12	− 6
Construction contracts	+ 9	−27	−15	− 1	0	− 4
Coal mining	+12	−14	−23	−16	−38	−15
EMPLOYMENT & INCOME						
Factory employment	− 2*	−12*	− 7*	− 1	− 9	− 6
Factory wage income	− 3*	−12*	− 4*	.....	.....	.....
TRADE**						
Department store sales	− 3	−10	− 5	− 2	−10	− 6
Department store stocks	− 3	−11	.....	− 3	−10	.....
BANKING (All member banks)						
Deposits	0	0	0	0	− 1	− 1
Loans	− 1	+ 1	+ 6	− 2	0	+ 5
Investments	+ 2	0	− 3	+ 3	0	− 5
U. S. Govt. Securities	+ 2	− 1	− 4	+ 3	0	− 6
Other	+ 3	+ 4	+ 3	+ 4	+ 6	+ 2
PRICES						
Wholesale	.....	.....	.....	− 1	− 9	− 5
Consumers	− 1†	− 3†	0†	− 1	− 3	0
OTHER						
Check payments	− 8	− 7	− 3	−10	− 4	0
Output of electricity	− 2	− 1	− 2	.....	.....	.....

* Pennsylvania. ** Adjusted for seasonal variation. † Philadelphia.

LOCAL CONDITIONS	Factory*				Department Store				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change July 1949 from		Per cent change July 1949 from		Per cent change July 1949 from		Per cent change July 1949 from		Per cent change July 1949 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Allentown	− 3	−13	− 6	−13	.....	.....	.....	.....	− 6	−13
Altoona	−34	−40	−50	−51	.....	.....	.....	.....	− 6	− 9
Harrisburg	− 5	−12	−12	−16	.....	.....	.....	.....	− 9	− 6
Johnstown	− 2	− 7	− 3	− 7	.....	.....	.....	.....	− 6	−11
Lancaster	− 3	−12	− 2	−10	− 8	−11	− 7	−10	−12	−13
Philadelphia	− 2	−11	− 2	− 9	−36	−10	− 8	−10	−10	− 7
Reading	− 2	− 9	− 3	−11	−14	− 4	−11	−11	− 8	− 3
Scranton	− 3	−12	− 3	−14	.....	.....	.....	.....	−11	−11
Trenton	.....	.....	.....	.....	−26	−12	− 6	−11	− 2	+14
Wilkes-Barre	− 3	−12	+ 1	−14	−20	− 7	− 6	−14	−10	−22
Williamsport	+ 7	−11	+11	− 6	.....	.....	.....	.....	− 3	−12
Wilmington	− 2	− 7	0	− 3	.....	.....	.....	.....	+ 1	+ 6
York	0	−15	− 2	−22	−10	−10	− 6	−12	− 5	−21

* Not restricted to corporate limits of cities but covers areas of one or more counties.

MEASURES OF OUTPUT

	Per cent change		
	July 1949 from		7 mos. 1949 from year ago
	month ago	year ago	
MANUFACTURING (Pa.)*	− 3	−15	− 9
Durable goods industries	− 4	−19	−10
Nondurable goods industries	− 1	−11	− 9
Foods	− 1	− 9	− 5
Tobacco	− 7	−12	−12
Textiles	− 1	−20	−19
Apparel	− 6	− 3	− 7
Lumber	− 5	−11	− 8
Furniture and lumber products	− 1	−22	−21
Paper	+14	−10	−13
Printing and publishing	+ 1	− 2	− 2
Chemicals	0	−16	− 5
Petroleum and coal products	− 1	− 3	− 1
Rubber	−27	−37	−21
Leather	− 3	− 3	−10
Stone, clay and glass	− 3	−15	−11
Iron and steel	− 6	−18	− 7
Nonferrous metals	− 4	−16	−14
Machinery (excl. electrical)	0	−27	−15
Electrical machinery	− 4	−17	−10
Transportation equipment (excl. auto)	− 7	− 3	+ 4
Automobiles and equipment	+ 4	−15	−30
Other manufacturing	0	−17	−15
COAL MINING (3rd F. R. Dist.)†	+12	−14	−23
Anthracite	+19	− 7	−24
Bituminous	−27	−51	−16
CRUDE OIL (3rd F. R. Dist.)††	− 7	−18	−11
CONSTRUCTION — CONTRACT AWARDS (3rd F. R. Dist.)**	+ 9	−27	−15
Residential	− 7	−25	−13
Nonresidential	+15	−39	−31
Public works and utilities	+20	− 8	+ 9

* Temporary series—not comparable with former production indexes.
** Source: S. W. Dodge Corporation. Changes computed from 3-month moving averages, centered on 3rd month.
† U. S. Bureau of Mines. ††American Petroleum Inst. Bradford field.

EMPLOYMENT AND INCOME

Pennsylvania Manufacturing Industries* Indexes (1939 avg. =100)	Employment			Payrolls			Average Weekly Earnings		Average Hourly Earnings	
	July 1949 (Index)	Per cent change from		July 1949 (Index)	Per cent change from		July 1949	% chg. from year ago	July 1949	% chg. from year ago
		mo. ago	year ago		mo. ago	year ago				
All manufacturing	112	− 2	−12	251	− 3	−12	$50.51	+ 1	$1.340	+ 5
Durable goods industries	132	− 3	−14	278	− 4	−14	54.84	0	1.466	+ 6
Nondurable goods industries	94	− 2	− 9	220	− 2	− 8	45.10	+ 1	1.185	+ 4
Foods	117	− 2	− 6	250	− 2	− 4	47.64	+ 2	1.152	+ 6
Tobacco	84	− 4	−11	184	− 6	−10	28.99	+ 1	.775	+ 2
Textiles	70	− 1	−17	174	− 1	−19	44.13	− 2	1.191	+ 2
Apparel	86	− 3	− 4	207	− 7	− 7	34.19	− 3	.917	− 4
Lumber	86	+ 4	− 8	195	− 6	− 5	42.12	+ 4	1.087	+ 7
Furniture and lumber products	73	− 1	−21	169	− 1	−23	42.54	− 3	1.016	− 1
Paper	113	+ 4	− 5	253	+14	− 2	48.17	+ 3	1.202	+ 8
Printing and publishing	132	− 1	− 4	286	+ 1	+ 6	61.16	+10	1.648	+11
Chemicals	106	− 1	−14	226	− 1	−14	50.50	0	1.301	+ 6
Petroleum and coal products	145	− 4	− 6	324	− 1	+ 3	68.17	+ 9	1.685	+ 7
Rubber	115	− 7	−21	199	−20	−30	43.09	−12	1.444	+ 4
Leather	84	− 2	− 3	179	− 4	+ 2	36.57	+ 5	1.016	+ 3
Stone, clay and glass	114	− 1	−14	244	− 3	−14	48.80	0	1.264	+ 3
Iron and steel	121	− 4	−12	250	− 6	−13	55.44	− 1	1.535	+ 7
Nonferrous metals	111	− 5	−18	237	− 5	−13	55.59	+ 5	1.410	+ 3
Machinery (excl. electrical)	165	− 2	−21	352	+ 1	−21	53.99	+ 1	1.411	+ 6
Electrical machinery	193	0	−14	391	− 4	−16	56.57	− 2	1.514	+ 1
Transportation equipment (excl. auto)	228	− 7	− 1	452	− 7	+ 3	60.35	+ 4	1.576	+ 7
Automobiles and equipment	121	+ 1	−19	282	+ 7	− 7	64.03	+14	1.553	+ 9
Other manufacturing	112	+ 2	−15	219	+ 2	−12	40.78	+ 3	1.159	+ 5

* Production workers only.

TRADE

Third F. R. District Indexes: 1935-39 Avg. =100 Adjusted for seasonal variation	July 1949 (Index)	Per cent change		
		July 1949 from		7 mos. 1949 from year ago
		month ago	year ago	
SALES				
Department stores	261	− 3	−10	− 5
Women's apparel stores	230	−10	− 7	− 2
Furniture stores	.....	−22*	−14*	− 6*
STOCKS				
Department Stores	224	− 3	−11	.....
Women's apparel stores	190	− 6	−15	.....
Furniture stores	.....	− 5*	−17*	.....

Recent Changes in Department Store Sales in Central Philadelphia	Per cent change from year ago
Week ended August 6	−16
Week ended August 13	−21
Week ended August 20	− 9
Week ended August 27	− 5

* Not adjusted for seasonal variation.

Departmental Sales and Stocks of Independent Department Stores Third F. R. District	Sales		Stocks (end of month)		
	% chg. July 1949 from year ago	% chg. 7 mos. 1949 from year ago	% chg. July 31, 1949 from year ago	Ratio to sales (month's supply) July	
				1949	1948
Total — All departments	−13	− 5	−11	3.6	3.5
Main store total	−13	− 6	−11	4.1	4.0
Piece goods and household textiles	−12	− 5	−16	4.0	4.2
Small wares	−11	− 3	− 6	4.8	4.5
Women's and misses' accessories	−13	− 4	− 6	3.9	3.6
Women's and misses' apparel	−15	− 1	− 5	2.6	2.4
Men's and boys' wear	− 3	− 2	− 8	4.3	4.6
Housefurnishings	−16	−12	−15	4.8	4.7
Other main store	−18	−10	−14	3.8	3.6
Basement store total	−14	− 3	−11	2.1	2.0
Small wares	− 9	− 4	−11	2.2	2.3
Women's and misses' wear	−12	− 1	− 6	1.4	1.3
Men's and boys' wear	−14	− 3	−19	2.3	2.5
Housefurnishings	−25	− 7	−21	3.7	3.5
Nonmerchandise total	− 5	− 2	.....	.....	.....

CONSUMER CREDIT

Sales Credit Third F. R. District	Sales: % chg. July 1949 from year ago	Sales: % chg. 7 mos. 1949 from year ago	Receivables (end of month): % chg. July 1949 from year ago
Department stores			
Cash	−14	− 5	.....
Charge account	−11	− 1	+ 4
Instalment account	−11	− 6	− 4
Furniture stores			
Cash	−14	0	.....
Charge account	− 6	−11	.....
Instalment account	−14	−13	+ 7

Loan Credit Third F. R. District	Loans made: % chg. July 1949 from year ago	Loans made: % chg. 7 mos. 1949 from year ago	Loan balances outstanding (end of month): % chg. July 1949 from year ago
Consumer instalment loans			
Commercial banks	+19	+ 2	+22
Industrial banks and loan companies	− 7	− 7	+ 2
Small loan companies	+ 2	+ 5	+ 8
Credit unions	+11	+13	+23

PRICES

Index: 1935-39 average = 100	July 1949 (Index)	Percent change from: month ago	Percent change from: year ago
Wholesale prices — United States	190	− 1	− 9
Farm products	218	− 2	−15
Foods	204	− 1	−14
Other	179	0	− 4
Consumer prices			
United States	169	− 1	− 3
Philadelphia	168	− 1	− 3
Food	195	− 2	− 7
Clothing	184	− 2	− 5
Fuel	143	0	+ 5
Housefurnishings	192	+ 1	− 3
Other	153	0	+ 3

Weekly Wholesale Prices—U. S. (Index: 1935-39 average = 100)	All commodities	Farm products	Foods	Other
Week ended Aug. 2	189	216	203	179
Week ended Aug. 9	189	216	204	179
Week ended Aug. 16	188	211	204	179
Week ended Aug. 23	188	210	204	179
Week ended Aug. 30	189	213	205	179

Source: U. S. Bureau of Labor Statistics.

BANKING

MONEY SUPPLY AND RELATED ITEMS United States (Billions $)	July 27, 1949	Changes in— four weeks	Changes in— year
Money supply, privately owned	166.7	+1.1	+ .7
Demand deposits, adjusted	83.3	+1.1	0
Time deposits	58.6	+ .2	+1.3
Currency outside banks	24.9	− .1	− .6
Turnover of demand deposits	18.5*	−1.1*	−3.1*
Commercial bank earning assets	114.7	+1.0	0
Loans	40.4	− .8	+ .3
U. S. Government securities	64.5	+1.5	− .8
Other securities	9.8	+ .3	+ .5
Member bank reserves held	17.5	− .5	0
Required reserves (estimated)	16.6	− .8	− .1
Excess reserves (estimated)	.9	+ .3	+ .1

Changes in reserves during 4 weeks ended July 27 reflected the following:

	Effect on reserves
Decline in Reserve Bank holdings of Governments:	−1.0
Net payments by Treasury	+ .1
Return of currency from circulation	+ .1
Increase in loans to member banks	+ .3
Change in reserves	− .5

* Annual rate for the month and per cent changes from month and year ago at leading cities outside N. Y. City.

OTHER BANKING DATA	August 24, 1949	Changes in— four weeks	Changes in— year
Weekly reporting banks — leading cities			
United States (*billions* $):			
Loans —			
Commercial, industrial and agricultural	12.9	0	−1.9
Security	2.0	0	+ .5
Real estate	4.2	+ .1	+ .3
To banks	.2	− .1	− .1
All other	4.1	+ .1	+ .3
Total loans—gross	23.4	+ .1	− .9
Investments	42.1	+1.7	+3.0
Deposits	74.1	+1.4	+ .8
Third Federal Reserve District (*millions* $):			
Loans—			
Commercial, industrial and agricultural	473	+ 16	− 57
Security	33	− 1	+ 1
Real estate	97	+ 3	+ 12
To banks	3	− 5	+ 1
All other	283	+ 2	+ 16
Total loans—gross	889	+ 15	− 27
Investments	1,752	+ 39	+128
Deposits	2,918	+ 45	+ 37
Member bank reserves and related items			
United States (*billions* $):			
Member bank reserves held	16.5	−1.0	−1.2
Reserve Bank holdings of Governments	17.8	− .7	−3.7
Gold stock	24.6	+ .1	+ .9
Money in circulation	27.3	0	− .7
Treasury deposits at Reserve Banks	.5	0	−1.4
Federal Reserve Bank of Phila. (*millions* $):			
Loans and securities	1,221	− 50	−334
Federal Reserve notes	1,604	− 4	− 32
Member bank reserve deposits	764	− 40	− 68
Gold certificate reserves	1,250	+ 23	+139
Reserve ratio	50.8%	+1.3%	+9.5%