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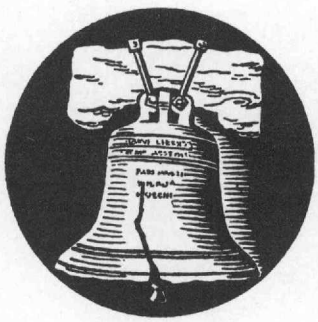
THE BUSINESS REVIEW

FEDERAL RESERVE BANK OF PHILADELPHIA



THE NEW FEDERAL BUDGET

The budget sent to Congress by the President set a peacetime record—outgo $85 billion, income $71 billion, deficit $14 billion. What are all of these billions to be spent for? Where is the money coming from? How will such a large outflow and inflow of funds influence business? Why is a deficit inflationary? What is the difference between the administrative budget and the cash budget? This article deals with these and other questions about the new budget.

CURRENT TRENDS

Business trends in the Third District were mixed during December. Construction contract awards rose and department store sales declined. Preliminary figures indicate department store sales in January were considerably below a year ago. Bank loans also declined.

THE NEW FEDERAL BUDGET

The President's budget message to Congress estimated that in the year beginning July 1 the Federal Government will:

Spend $85.4 billion, $51.2 billion for military services.
Receive $71 billion in taxes and other revenue.
Have an operating deficit of $14.4 billion.

This is a record peacetime budget—in terms of expenditures, receipts, and the deficit. The amount the Government plans to spend would have been sufficient to pay for more than 40 per cent of the goods and services purchased by consumers last year. It would take a printing press, turning out 3,800 sheets of one dollar bills a day, over 7,000 years to print $85 billion.

The financial operations of the Federal Government are of real concern to all of us. We benefit from the services rendered and we pay taxes so that the Government can provide them. The taxes paid are the price tag for the services received.

A budget — whether for an individual, business firm, or the Government — is a dollar-and-cents picture of the activities planned for the coming year. In the narrower sense, the Federal budget shows the estimated cost of the great variety of services the Government proposes to render and the amount of personal and business income it expects to take to pay for them. In the broader sense, the budget indicates forces which will have an important influence on financial and economic developments. The inflow and outflow of funds generated by an $85 billion budget permeates the entire economy, influencing the total demand for goods and services, the amount and kinds of goods produced, and the prices at which these goods are exchanged. This article attempts to analyze the budget, not only in the narrower sense but also in terms of its broader economic implications.

In a democracy, a Government budget has a dual function — for the Executive branch it is a tool of management, and for Congress it is a means of control over Governmental activities. The Congress, in passing appropriation and revenue bills, fixes the scope of Government activities and establishes the framework within which these activities must operate. The Executive department, which is responsible for administering the activities called for in the budget, largely determines how efficiently they are carried out.

Just a word here about how the budget is prepared. Under the present procedure, the President has the responsibility for preparing an over-all budget, including expenditures recommended for all of the various Government agencies, and estimates of the revenue to be derived from taxes and other sources. The budget is prepared for a fiscal year beginning July 1 and ending June 30, rather than for a calendar year. To avoid unnecessary repetition, a year, as used in this article, refers to fiscal years unless otherwise noted. The Bureau of the Budget, which is directly responsible to the President, has the job of preparing the budget. The initial steps in its preparation are usually taken about one year in advance when the Bureau of the Budget sends requests to the various departments and agencies of the Government to submit estimates of the amount of funds they will need in the coming year. These requests usually go out in June for the year beginning twelve months later. Once these estimates are received, usually around September, the Budget Bureau begins an intensive analysis of the departmental requests to see whether they are justified and in accordance with existing legislation. The departmental and agency estimates are then combined into a national budget which the Bureau submits to the President. The budget is then reviewed by the President and his staff, and provides the basis for his recommendations to the Congress in January. Once the President's budget message is received by the Congress, it is referred to the appropriate committees for study and recommendations. Appropriation bills and revenue bills, if any, are then prepared, hearings are conducted, and finally the bills are debated on the floor before passage. In the last few years, appropriation bills for billions of dollars have been passed in the log-jam at the end of the session, a procedure which is not conducive to careful and thorough consideration by the Congress. Not until these bills have been passed by the Congress and approved by the President (or passed over his veto) does the new budget become the legally adopted financial program of our Federal Government.

The process of preparing the budget consumes the

greater part of a year, and in the course of its development the budget is viewed and reviewed by department heads, the Bureau of the Budget, the President, committees of Congress, and the Congress as a whole. Final responsibility for both the expenditure and the revenue sides of the budget rests primarily with the President and the Congress.

ANALYSIS OF THE BUDGET

The activities of the Federal Government are so vast that the budget is necessarily a comprehensive and complicated document. In analyzing the budget, three types of information should be distinguished: new authority to spend; estimated expenditures and receipts on a budget or bookkeeping basis; and estimated cash to be received from and paid out to the public. As a basis for comparison, the new estimates for 1953 are presented along with those for 1952, and actual expenditures and receipts for 1951.

New Authorizations

The Government spending process involves three stages: authorization, incurrence of an obligation, and actual payment or expenditures. The Constitution requires that all expenditures of Federal funds be authorized by the Congress. The authorizations usually specify the purposes for which payments are to be made, the amounts to be spent, and the persons or agencies authorized to make the expenditures. In the 1953 budget, new authorizations recommended total $84 billion, about $9 billion less than the $93 billion requested in the budget for 1952.

Budget authorizations differ both as to type and timing. The two major types are appropriations and contract authorizations. Most authorizations grant authority both to incur obligations and to spend money in liquidating them. These are called appropriations, the type which accounts for nearly all of the total new obligational authority requested for 1953. Sometimes, however, the Congress grants certain agencies authority to incur obligations but not to spend money. In such cases, the Congress must later appropriate funds to liquidate the obligations incurred under these prior contract authorizations. Appropriations recommended in the 1953 budget to liquidate prior contract authorizations exceed $3 billion. Authorizations differ also as to the period of time covered. Current authorizations are valid for only one or a limited number of years, while permanent authorizations grant authority to spend money year after year without further action by Congress. Most current authorizations permit obligations to be incurred only during the fiscal year, but they are valid for the payment of such obligations for another two years. Of the $84 billion of new obligational authority recommended, $77 billion is for current and $7 billion for permanent authorizations.

New authority to incur obligations influences spending, but is not an accurate indication of what actual expenditures will be. Once authority is granted, the second stage in the process is that of planning, product designing, and awarding contracts. There is frequently a considerable time lag between authorizations and the placing of contracts, and between contract awards and actual delivery of the end product, especially for heavy, complex defense equipment such as airplanes and tanks. This is reflected in the new budget, which shows that nearly one-half of total expenditures in 1953 will be from authorizations made in previous years, and about one-half of the new authorizations will not be spent until after 1953. In a period of rearmament, when purchases of heavy goods are substantial, expenditures from new authorizations are frequently spread over two or three years. Consequently, actual expenditures are likely to continue to rise for some time after new authorizations have begun to decline.

The lag of actual expenditures behind new authorizations means that only a part of the budget is subject to Congressional pruning. Frequently, programs are authorized which require only small sums in the first year but increasing amounts as the program gets under way. New authorizations which carry over until later years get Congress "hemmed in," leaving less leeway for cutting current expenditures. Since about one-half of the expenditures for 1953 will be under prior authorizations, only the remainder can be trimmed by Congress without repudiating in part its former actions.

The Administrative Budget

The so-called administrative budget shows expenses to be incurred during the fiscal year, including accrued interest on Savings Bonds, and income received from taxation and other sources. It is the administrative budget that shows whether the financial operations of the Federal Government will result in a surplus or a deficit.

Expenditures

Expenditures represent the last stage in the spending process. The estimated cost of running the Government in 1953 is $85 billion—about the actual cost in 1951—and nearly ten times that of 1940 just before World War II. War is expensive in terms of money, human life, and misery. National defense is the major determinant of Federal expenditures. In the analysis that follows, expenditures are grouped into three major classifications: current defense, past defense, and non-defense.

BUDGET EXPENDITURES
(In billions of dollars)

Expenditure	*Actual 1951*	*Estimated 1952*	*1953*
Current defense			
Military services	20.4	39.8	51.1
International security	4.7	7.2	10.8
Atomic Energy	0.9	1.7	1.8
Other*	0.2	0.7	1.1
Total	26.2	49.4	64.8
Past defense			
Veterans	5.3	5.2	4.2
Interest on debt	5.7	5.9	6.2
Total	11.0	11.1	10.4
Non-defense			
Social security, welfare, and health	2.4	2.7	2.6
Housing and community development	0.5	0.9	0.7
Education and general research	0.1	0.2	0.6
Agriculture and agricultural resources	0.1	1.4	1.5
Natural resources	1.2	1.4	1.5
Transportation and communication	1.7	2.1	1.6
Finance, commerce, and industry	**	0.1	**
Labor	0.2	0.2	0.2
General government	1.2	1.4	1.5
Total	7.4	10.4	10.2
Total expenditures	44.6	70.9	85.4

* Civil defense, promotion of defense production, and economic stabilization costs such as price, wage, and rent controls.
** Less than $50 million.

As used in this article, current defense expenditures include the cost of direct military services and such defense-related activities as atomic energy, international security, which in reality is an integral part of the defense program, promotion of defense production, price, wage, and rent controls, and civil defense. Interest on the Federal debt, and veterans' services and benefits represent primarily the carry-over of past defense efforts — the aftermath of war. The cost of national defense — current and past — is about $75 billion, or 88 per cent, of total expenditures budgeted for 1953 as compared to $61 billion in 1952.

Current defense. Current defense activities will cost $64.8 billion in 1953, an increase of $15.4 billion over 1952. This increase reflects the progress expected in building up our national defense, primarily in the form of an increase in military equipment, a larger number in the armed forces, and an increase in foreign military aid.

By far the largest item on the expenditure side of the budget is the cost of military services. Military expenditures in turn are primarily for men, munitions, and maintenance. Present plans call for 3.7 million in the armed forces by the end of 1953, a small increase over 1952, and more than double the number in the armed forces just prior to the outbreak in Korea. The cost of this enlarged military personnel in 1953 — pay, clothing, food, other subsistence, and transportation — will be $11 billion, only moderately above the current fiscal year but substantially larger than in 1951. This represents an average expenditure of about $3,000 per person in uniform. Included in this budget estimate for 1953 is a recommendation that military pay and allowances be increased comparable to the increases granted civilian employees of the Federal Government last year.

Equipping the armed forces with modern weapons is even more expensive than paying their salaries and supplying them with food, clothing, and other forms of subsistence. Actual expenditures for aircraft, tanks, ships, vehicles, ammunition, electronic equipment, guided missiles, and other weapons are estimated at $20 billion in 1953, as compared to $13 billion in 1952 and actual expenditures of $4.3 billion in 1951. Aircraft will take more than one-half of the total, in part because of heavier planes and the more complicated electronic equipment used.

The increase in equipment expenditures reflects both the higher cost of the more complex modern weapons and higher prices. For example, the cost of equipping an armored division is $293 million, as compared to $40 million in World War II. The B-36 bomber, which is the backbone of the present bomber fleet, costs $3.5 million, as compared to $680,000 for the B-29, which was the heavy bomber of World War II. The Defense Department estimated that about 20 per cent of the cost of military supplies and equipment in 1951 reflected the rise in prices following Korea.

The budget estimate includes not only the cost of supplying the present armed forces with weapons, but also

the building up of reserves of equipment in the event of all-out war. At present, however, the announced policy is to have a continuing flow of production and the ability to achieve rapid expansion in case of all-out war, rather than the accumulation of large inventories of military equipment which would become obsolete.

An increase in military equipment adds to operation and maintenance costs. It is estimated that the purchase of fuels, lubricants, spare parts, supplies, and the cost of storage, repairs, maintenance and handling of armament and ammunition, et cetera, will total $12 billion in 1953 or double the amount actually spent for these purposes in 1951. Wages and salaries of civilian employees account for a substantial portion of this total. The number of civilian employees in the Department of Defense performing military functions is expected to exceed 1.3 million in 1953, with about three-fifths of them being engaged in industrial work at arsenals, shipyards, ordnance depots, repair shops, and other military installations. Military construction, stockpiling of strategic materials, and research and development will also take more funds than in 1952.

Military and economic assistance to free countries is a part of the program of strengthening our national defenses against foreign aggression. The bulk of the $11 billion requested for international security and foreign relations in 1953 is earmarked for building up military defenses. It is estimated that delivery of military equipment and other types of military assistance to foreign countries under the mutual security program will total about $8 billion in 1953, up from $4 billion in 1952. The major part of this increase is accounted for by a substantial rise in the delivery of weapons to foreign countries, which is expected to result from an expansion in defense production. The purpose of this part of the foreign aid program is to provide planes, tanks, guns, raw materials and other supplies needed in rearmament which the European countries cannot obtain from their own resources. Assistance to non-European countries will consist largely of economic aid and technical assistance rather than military supplies and equipment.

Another cost which is largely for current defense purposes is the $1.8 billion budgeted for atomic energy development in 1953, approximately the same as for 1952. The funds recommended for the Atomic Energy Commission include increased expenditures for uranium ores, the production of fissionable materials, and the production and development of atomic weapons. The promotion of defense production and the cost of price, wage, rent, and other direct controls for maintaining economic stability are estimated at $800 million — only a small increase over 1952.

Past defense. The cost of veterans' services and benefits and interest on the Federal debt represents the aftermath of previous wars. Consequently, they are a part of the cost of national defense. Veterans' services and benefits are expected to decline about 20 per cent from the 1952 level, reflecting mainly a decrease in the cost of the education and training program. The bulk of the expenditures for veterans' benefits is the $2 billion expected to be required for compensation and pension payments to 3,179,000 individuals and families. This includes $1.5 billion in compensation payments to service-disabled veterans and families of veterans who died from service-connected causes. The remainder is in the form of pension payments for non-service connected disabilities.

Interest on the Federal debt is expected to total over $6 billion, a small increase over the 1952 estimate, reflecting an increase in outstanding debt and higher interest rates.

Non-defense spending. The cost of non-defense activities, as here classified, is $10.2 billion — a slight reduction from 1952 but about 38 per cent higher than actual expenditures in 1951 and more than double the post-war low of $4.7 billion in 1946. Major non-defense expenditures, which have registered a 100 per cent or more increase since 1946, are those for social security, welfare, and health, agriculture and agricultural resources, natural resources and transportation and communication.

Social security and welfare services have expanded steadily in the past five years, a period of generally unparalleled peacetime prosperity. Nearly one-half of the cost of social security, welfare, and health services is for public assistance, mostly to the aged and needy. This expense, which has trebled since 1946, is leveling off as more of the older people become eligible for old-age insurance payments. Until the last year or so, more people were receiving public assistance than old-age insurance. At present, however, about 3.2 million people are receiving old-age insurance payments as compared to 2.7 million receiving public assistance. Other important costs in this general category are aid to special

groups, such as rehabilitating the disabled, providing low-cost lunches for school children, and health, welfare, and educational services for about 400,000 Indians; promoting public health; and crime control and correction.

The cost of Governmental activities in the field of agriculture and agricultural resources fluctuates rather widely, principally because of the price and income stabilization program. The cost of supporting the prices of farm products and stabilizing farm income is estimated at more than $500 million in 1953, somewhat higher than in the current fiscal year but much less than actual expenditures in 1949 and 1950, when agricultural prices were relatively weak. Other important expenses in the field of agriculture are for the financing of farm ownership and operation, rural electrification and rural telephones, and conservation and development of agricultural land and water resources. Natural resource conservation and development expenditures other than agriculture have also risen substantially in the postwar period, although the estimate for 1953 is only slightly higher than for 1952. The major costs in this classification are flood control, reclamation and electric power projects. Other expenditures which although small have shown substantial increases since 1946, are the conservation and development of fish and wild life, the recreational use of natural resources, and general resource surveys. The postal deficit — a subsidy mainly to the users of second and third class mail — which is estimated at $814 million for 1952, is expected to be reduced to $444 million in 1953.

Federal aid. Federal aid, which is another classification and is not shown separately above, is increasing. Aid to state and local governments and the cost of services primarily for the benefit of particular economic groups total $17 billion for 1953, a $5 billion increase over actual expenditures in 1951. Federal aid granted to states and local governments, estimated at $3 billion for 1953, is approximately double that of 1946. The major activities financed by this aid are social security and welfare services, highway construction, hospital and school construction, unemployment compensation, and recently civil defense. The cost of other types of Federal aid in 1953 are international security $10.3 billion and veterans' services and benefits $3.8 billion, already mentioned, agriculture $497 million, business $920 million, labor $213 million, and general aid $1.4 billion.

Receipts

Net receipts in 1953 are expected to total $71 billion, an increase of more than $8 billion over the current fiscal year. The major part of the increase estimated for 1953 is from taxes on corporations, individuals, and excise taxes. Corporate taxes are expected to provide about 60 per cent of the additional receipts, reflecting higher rates under the Revenue Act of 1951, which were effective for only a part of 1952 tax receipts; accelerated quarterly payments under the Mills Plan; and a moderate rise in corporate income. Individuals are expected to contribute about one-third of the additional income in 1953, reflecting the higher rates imposed in 1951, and higher levels of salaries and wages. The remainder of the increase will come from excise taxes which are expected to yield more both because of some increase in rates in 1951, and a higher dollar volume of business.

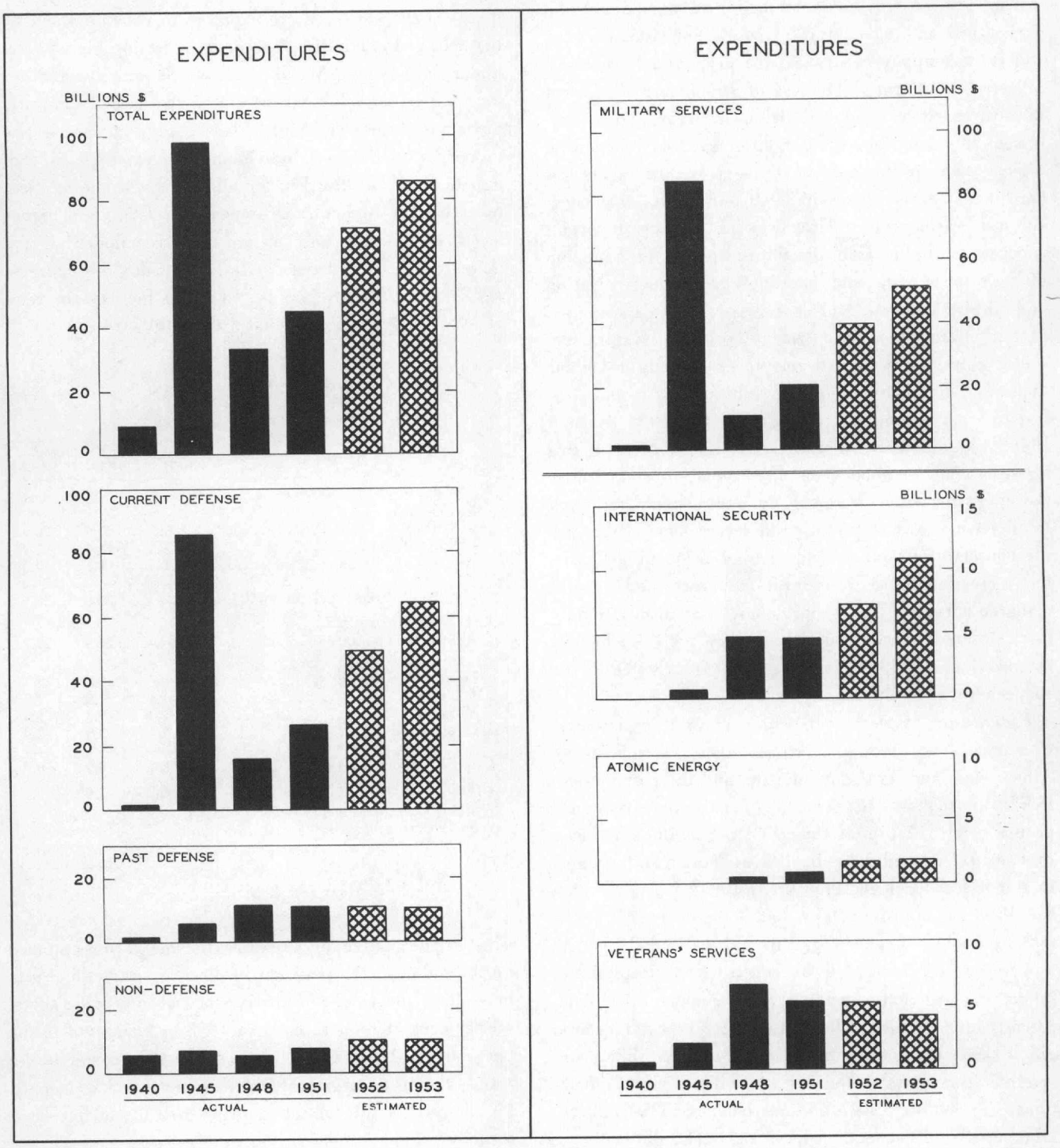
BUDGET RECEIPTS
(In billions of dollars)

Source	*Actual 1951*	*Estimated 1952*	*Estimated 1953*
Direct taxes on individuals			
Income tax			
Withheld	13.5	17.9	20.4
Not withheld	9.9	11.4	11.9
Estate and gift taxes	0.7	0.7	0.8
Total direct taxes on individuals	24.1	30.0	33.1
Corporate income and excess profits taxes	14.4	22.9	27.8
Excise taxes			
Liquor	2.5	2.6	2.7
Tobacco	1.4	1.6	1.7
Manufacturers'	2.4	2.3	2.4
Other excises	2.4	2.5	2.9
Total excise taxes	8.7	9.0	9.7
Other receipts	6.2	7.0	7.2
Deduct: appropriations to Federal old-age and survivors' insurance trust fund and refunds of receipts	—5.3	—6.2	—6.7
Total receipts	48.1	62.7	71.1

The largest source of Treasury income is direct taxes on individuals—the personal income tax, estate, and gift taxes. This source of revenue is expected to provide about 46 per cent of total receipts in 1953 as compared to 50 per cent in 1951. Corporate income and excess profit taxes—the next largest source—are expected to supply 39 per cent, a substantial increase over the 30 per cent actually provided in 1951. Excise taxes are also expected

BUDGET EXPENDITURES*

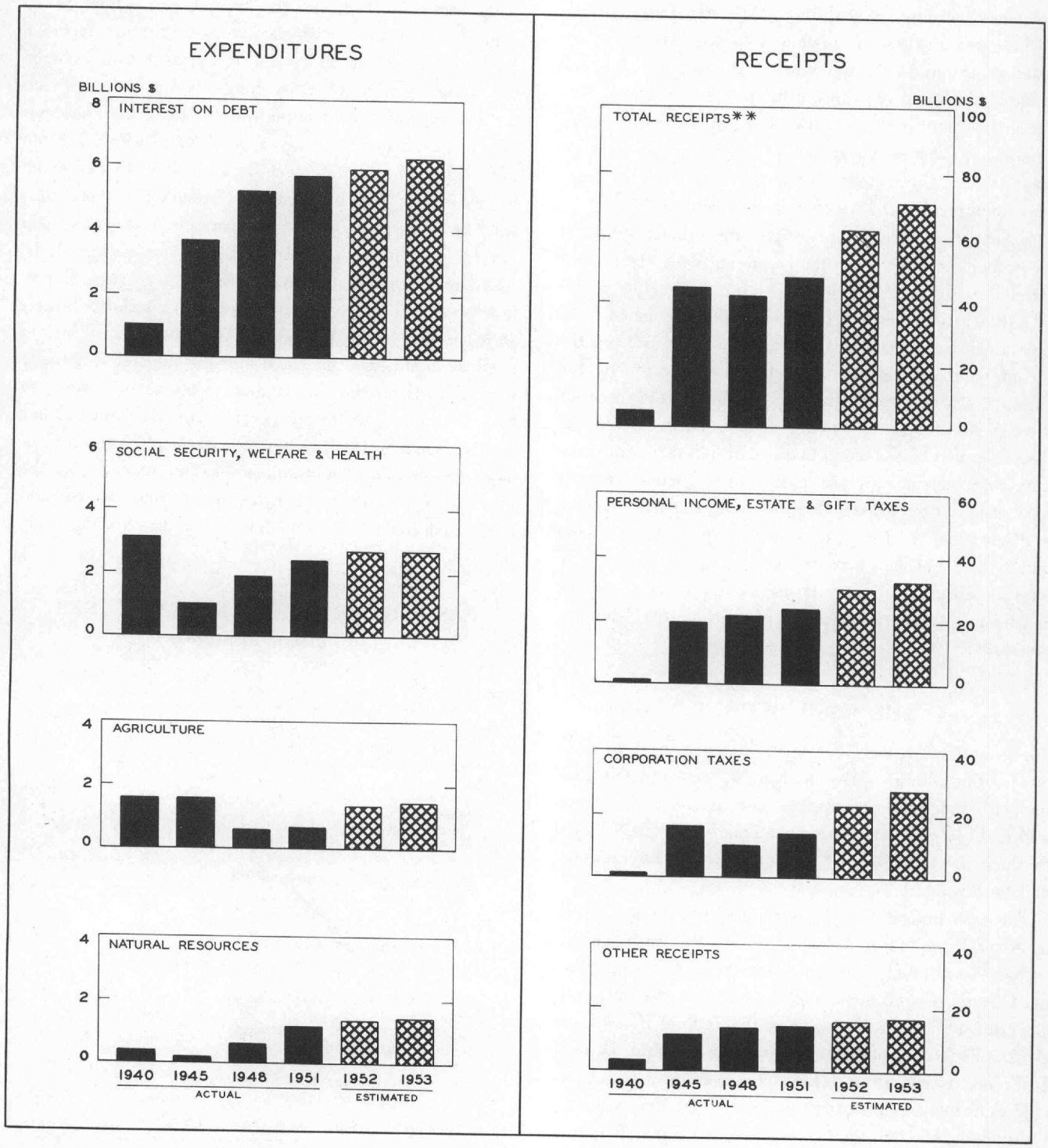
Selected fiscal years



*** Total expenditures were at a peak in fiscal 1945; the post-war low was 1948.**

AND RECEIPTS

1940 - 1953.



** Net of appropriation to Federal old-age trust fund, and refund of tax receipts.

to contribute a smaller proportion of the total in 1953, 13.6 per cent as compared to 18.1 per cent in 1951. Receipts from excise taxes are derived largely from liquor taxes, $2.7 billion; the manufacturers' excise tax, $2.4 billion; tobacco taxes, $1.7 billion; and other miscellaneous excises $2.9 billion. Miscellaneous receipts include many rivulets flowing into the Treasury, for example seigniorage on coinage, fees for permits and licenses, fines and penalties, gifts, interest on loans, dividends and earnings from Government-sponsored enterprises, rents and royalties, sale of products, fees for services, sale of Government property, repayment of loans and investments, and recoveries and refunds.

Estimates of Treasury receipts are usually made in December for the fiscal year beginning over six months later. It is difficult to estimate accurately receipts so far in advance both because changes in the volume of business affect tax revenue, especially that derived from the income and excise taxes which provide most of the receipts, and because new tax legislation may change the base and the rates of taxation. Estimating tax receipts therefore involves a combination of political and economic forecasting. In the past decade, actual receipts have usually been greater than the budget estimates. Such a discrepancy is likely to occur in periods of rising income and business activity because of the tendency to base the estimates on approximately the levels of income and business activity prevailing at the time the estimates are made.

THE CASH BUDGET

For several years, the Government has prepared, in addition to the administrative budget, a "consolidated cash budget" sometimes referred to also as the cash income and cash outgo of the Treasury. This budget is designed to show the total flow of money between the Treasury and the public.

The cash budget and the administrative budget differ in several important respects. First, the cash budget includes some financial transactions of the trust funds managed by the Government and net expenditures of quasi-Government corporations such as the Federal Home Loan Banks, Federal Land Banks, and the Federal Deposit Insurance Corporation. These transactions are not included in the administrative budget. Trust fund transactions are substantial, total receipts being estimated at $8.8 billion, and expenditures at $5 billion in 1953. Second, transactions between Government agencies, and between the Government and the trust funds are excluded from the cash budget but are included in the administrative budget. For example, the payment of interest on Government securities held by the trust funds which is an expenditure in the administrative budget is not included in the cash budget because it is a transaction between the Treasury and the trust funds rather than between the Treasury and the general public. Third, there are certain non-cash items, mostly expenditures, which are not included in the cash budget because they do not result in any flow of cash between the Treasury and the public. Interest on Savings Bonds, for example, although it will not be paid in cash until the bonds are redeemed, is, in a bookkeeping sense, an expense as it accrues. Hence, it is shown as an expense in the administrative budget as it accrues, but it does not show up in the cash budget until the bonds are redeemed and the interest is actually paid. Sometimes the Government meets an obligation by the issue of securities, e.g., the Armed Forces Leave bonds issued in 1947, and which are still being cashed. This transaction would appear as an expense in the administrative budget when the bonds were issued, and in the cash budget when the bonds are turned in for cash.

CASH RECEIPTS AND EXPENDITURES
(In billions of dollars)

	Actual 1951	*Estimated* 1952	1953
Receipts			
Budget receipts	48.1	62.7	71.0
Trust fund receipts	7.8	8.8	8.8
Total	55.9	71.5	79.8
Less—			
Intragovernmental transactions, non-cash receipts, etc.	2.5	2.9	3.0
Total cash receipts from the public	53.4	68.6	76.8
Expenditures			
Budget expenditures	44.6	70.9	85.4
Trust fund expenditures	3.7	5.2	5.1
Total	48.3	76.1	90.5
Less—			
Intragovernmental transactions, non-cash expenditures, etc.	2.5	3.5	3.3
Total cash payments to the public	45.8	72.6	87.2
Cash surplus or deficit	+7.6	—4.0	—10.4

These and other minor differences are reflected in the administrative and cash budgets for 1953. Receipts in the administrative budget are estimated at $71 billion and cash receipts at $76.8 billion. Total Treasury and trust funds receipts minus intragovernmental transactions and non-cash receipts, which are minor, give the total cash inflow from the public. Cash receipts are substantially larger than budget receipts, primarily because of the receipts of the trust accounts. Cash payments to the public are nearly $2 billion larger than budget expenditures, primarily because of the addition of cash disbursements of the trust funds which are only partially offset by non-cash expenditures in the administrative budget. The cash deficit is about $4 billion less than the budget deficit, chiefly because cash receipts of the trust funds exceed expenditures by about $3.7 billion.

The cash budget is more useful for certain purposes than the administrative budget. It is a more accurate indication of the economic impact of Federal financial transactions. The cash budget shows whether the Government, on balance, is siphoning funds away from or pouring funds out to the public, thus reducing or enlarging their spending power. Likewise, excluding changes in the cash balance, it shows whether the Government will need to borrow from the public or whether it will be able to repay some of the public-held debt. However, cash borrowing from the public or repayment of debt held by the public do not accurately reflect changes in the public debt outstanding. The debt increases, for example, as interest accrues on Savings Bonds and when special Treasury obligations are issued to the trust funds. In periods of cash deficits, therefore, borrowing from the public will tend to be less than the increase in the total debt because, in effect, the Treasury is borrowing from Savings Bond holders and the trust funds. Thus, even when the cash budget is in balance, the Government is operating at a deficit in the sense that it is using surplus cash receipts of the trust funds and is not accumulating funds to offset the interest payments accruing on outstanding Savings Bonds.

ECONOMIC IMPLICATIONS OF THE BUDGET

An $85 billion budget exerts a tremendous influence on economic activity. One of the important implications of the budget is that the Government is going to take a larger bite out of our total output of goods and services. Unless total production can be increased sufficiently to meet the larger Government demand, which is not likely, fewer goods will be left for civilian use. The real burden of the defense effort is the amount of goods and services we are deprived of and which otherwise would be available for civilian consumption. The burden of the defense program, in this most significant sense, can neither be postponed nor transferred to future generations.

The budget does not show what portion of the expenditures will be used to purchase goods and services. To get such an estimate, expenditures such as social welfare payments, interest on the Federal debt, and direct loans of the Government and Government-owned corporations which only transfer funds from one group to another, must be deducted. In 1950 and 1951, Government purchases of goods and services were about $16 billion less than total budget expenditures.

Federal purchases of goods and services, which took 8 per cent of total national output in calendar year 1950, are rising rapidly. Government purchases rose from an annual rate of $32 billion in the first quarter of calendar 1951 to $47 billion in the third quarter. For the year as a whole, about 13 per cent of our total output went to the Government. Although no one can tell what total output of goods and services will be in fiscal 1953, present indications are that only about one-sixth will be purchased by the Government—still far below the 41 per cent taken by the Government in the peak year of World War II.

Government purchases also affect the pattern of demand for goods and services. Funds which otherwise would have been spent by taxpayers are channeled into the purchase of the types of goods the Government needs. As indicated previously, defense purchases are concentrated largely in military hardware such as airplanes, tanks, guns, and electronic equipment. Rearmament shifts the pattern of demand toward the metals and metal product industries. For the second quarter of this calendar year, about 30 per cent of the steel output, 50 per cent of the aluminum, and 30 per cent of the copper are allocated for defense purposes. Growing defense requirements for these materials mean reduced supplies available for civilian production. The shortage will be relieved when additional capacity, now planned and under construction, is completed.

A second important implication of the budget is that Government operations may be increasing total spending

power at a time when our economic machine is already operating under forced draft. More money and more spending when the physical output of civilian goods cannot be increased to match it, tend to push prices up and generate inflation.

Taxation acts like a great suction pump siphoning funds into the Treasury from all over the economy, and expenditures serve as outlets pouring funds out to those who receive Government checks for goods and services. If the Government siphons in more funds than it pays out —i.e., if it has a cash surplus—the amount of funds left at the disposal of the public is reduced. The final effect on spending power depends on how the surplus is used. On the other hand, if the Government pays out more than it takes in, not only is the reservoir emptied—the deficit must be financed by borrowing. Here again the effect of a deficit on the amount of funds at the disposal of the public depends on where the borrowed money comes from. Despite some necessary qualifications, however, it is fair to say that when cash receipts siphon more funds into the Treasury than expenditures pour out, the amount left at the disposal of consumers and businessmen is reduced; when cash expenditures exceed receipts, the amount people have available to spend is increased. Thus, a cash surplus tends to curb spending and a cash deficit tends to stimulate it.

If there is a $10 billion cash deficit in the fiscal year beginning next July the tendency will be to stimulate total spending. How much inflationary pressure will be exerted by the deficit will depend largely on how it is financed. If borrowing results in net purchases by the Federal Reserve System, bank reserves and bank deposits are increased. If the Treasury borrows from commercial banks, new deposits are created and total buying power is increased. If borrowing is from non-bank sources, deposits are shifted from the purchasers of Government securities to the Treasury, leaving total buying power unchanged. Thus the amount of money people have available to spend will be increased unless the gap between expenditures and receipts is bridged entirely with funds drawn from non-bank sources. If borrowing is resorted to, the interest rates and the types of securities offered should be sufficiently attractive so that the necessary funds can be obtained from non-bank investors.

The defense program is inherently inflationary because defense production adds to incomes but not to the supply of civilian goods. This source of inflationary pressure can be removed only by siphoning off enough income to meet the Government's expenditures; in other words, by eliminating the cash deficit or raising the funds from non-bank sources.

There are only two ways of approaching this problem. The first step is to see that Government expenditures are kept at a minimum consistent with the necessary strengthening of our national defense. In view of the large volume of defense spending, it is especially desirable that non-defense expenditures be examined critically. The substantial rise in non-defense spending in the post-war period indicates that some of these activities could be curtailed, or at least deferred during the defense emergency. However, since non-defense expenditures are only about $10 billion, drastic cuts here, although a significant contribution, would not be sufficient to balance a budget with an estimated $14 billion deficit. It is equally important, therefore, that high standards of efficiency and economy be enforced in military and defense-related activities in order that the cost of building up our military strength can be held to a minimum. Once total expenditures have been determined, however, a balanced budget can be achieved only by increasing tax receipts enough to eliminate the deficit. Tax receipts can be increased by closing loopholes in present tax laws and, if necessary, the imposition of new taxes. It certainly is not sound public finance to resort to borrowing to help finance the current defense program, with a Federal debt of $260 billion, and with production, employment, and income at record levels.

One of the problems involved in raising tax rates is a weakened incentive to produce. Higher taxes, by reducing the net income of laborers and businessmen, diminishes the incentive to work harder and to produce more. However, with a larger proportion of output going for defense, it is inevitable that a smaller proportion will remain for civilian use. Unless a corresponding amount of income is taken to pay for defense, excessive spending pushes prices up and inflation, rather than taxation, reduces the amount of goods our incomes will buy. The diminished incentive stems primarily from the larger amount of goods required for defense and not from the higher taxes which is one way of paying for them. In this sense, a diminished incentive cannot be avoided by using some form of financing other than taxation.

CONCLUSIONS

The budget is the financial plan of the Federal Government. The volume of funds flowing in and out of the Treasury is so large that Treasury operations are a major force shaping the course of business and financial developments. Consequently, budget policies should be directed toward helping achieve our economic goals of supplying more goods for defense and of maintaining stability at high levels of production and employment.

Economy and efficiency in all Governmental activities are essential. Such a policy would enable us to re-arm and build up our national defense at a minimum cost both in terms of Government expenditures and the drain on manpower and materials. It would make possible the maximum of both guns and butter.

A "pay-as-we-go" budget policy is also essential if we are to remove the threat of further inflation involved in deficit spending. The deficit should be eliminated by reducing the expenditure side of the budget as much as possible and then increasing taxes enough to meet the remainder. Borrowing would enlarge the debt when income and ability to pay are at peak levels, and would tend to generate more inflation unless the funds came entirely from non-bank sources. Preventing inflation at home is an integral part of an effective program for maintaining our economic strength and resisting aggression from abroad.

A democracy thrives when the people are well informed and actively interested in its affairs. The activities of the Federal Government outlined in the budget, once it is finally adopted, will be *our* program. Consequently, it behooves every one of us to study carefully where our money is going and what we are getting in return.

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CURRENT TRENDS

Indicators of business activity in the Third Federal Reserve District showed mixed changes during December.

Department store sales, on a seasonally adjusted basis, fell during the month and were below those of a year earlier. Preliminary figures indicate that January's volume will be considerably beneath that of last year when a buying wave, precipitated by the entry of the Chinese Reds into the Korean war, was still much in evidence.

Construction contract awards showed a sharp gain for the month, the first since July, but failed to equal the level of a year ago. The increase was mainly in the public works and utilities category but non-residential building also shared in the advance. The value of construction awards for the year topped that of 1950 by 7 per cent, due in large part to the boom in the industrial field.

In Pennsylvania manufacturing plants, the principal areas of strength continued to be found in the hard goods group. Total production and employment were under year-earlier levels as increased activity in defense and supporting industries failed to take up the slack resulting from curtailments made by soft goods firms.

Business loans of reporting member banks in the Third Federal Reserve District declined considerably in the four weeks ended January 23. Repayments, chiefly by sales finance companies and public utilities, were only partly offset by further borrowing by metals and metal products manufacturers. Business loans also declined at weekly reporting banks in the United States.

The Nation's private money supply increased by about $3 billion in December as bank loans and investments rose substantially. From June 30, 1951 to the end of December, deposits and currency held by business and individuals increased by about $11 billion, compared with $7 billion in the same six months in 1950. The large increase in the second half of 1951 reflected an increase in Government security holdings, an inflow of gold and an increase in loans. In the latter part of 1950, a larger loan expansion was partly offset by a reduction in Government securities and an outflow of gold.

SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	December 1951 from		12 mos. 1951 from year ago	December 1951 from		12 mos. 1951 from year ago
	mo. ago	year ago		mo. ago	year ago	
OUTPUT						
Manufacturing production	+ 2*	− 1*	+ 8*	− 1	0	+10
Construction contracts	+15	− 9	+ 7	− 8	−10	+ 8
Coal mining	−14	+ 4	− 5	−11	− 4	+ 4
EMPLOYMENT AND INCOME						
Factory employment	0*	− 2*	+ 6*	0	− 1	+ 6
Factory wage income	+ 2*	+ 4*	+18*	.....	.....	.....
TRADE**						
Department store sales	− 4	− 4	+ 3	− 3	− 1	+ 4
Department store stocks	+ 4	0	.....	+ 2	− 2	.....
BANKING (All member banks)						
Deposits	+ 1	+ 1	+ 3	+ 2	+ 5	+ 6
Loans	+ 2	+12	+20	+ 2	+11	+20
Investments	− 1	− 6	− 8	+ 1	0	− 6
U.S. Govt. securities	− 2	− 9	−11	+ 1	− 2	− 9
Other	+ 1	+ 5	+ 4	+ 2	+ 6	+12
PRICES						
Wholesale	.....	.....	.....	0	+ 1	+12
Consumers	0†	+ 7†	+ 9†	0	+ 7	+ 9
OTHER						
Check payments	+ 8	+ 3	+11	+10	+ 4	+12
Output of electricity	− 1	+ 1	+ 6	.....	.....	.....

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

LOCAL CONDITIONS	Factory*				Department Store				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change Dec. 1951 from		Per cent change Dec. 1951 from		Per cent change Dec. 1951 from		Per cent change Dec. 1951 from		Per cent change Dec. 1951 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Allentown	0	0	0	+ 8	.....	.....	.....	.....	+ 2	− 2
Altoona	−2	−15	0	−22	.....	.....	.....	.....	− 1	− 1
Harrisburg	−1	+ 2	−1	+12	.....	.....	.....	.....	+ 1	+20
Johnstown	−1	+ 3	+2	+11	.....	.....	.....	.....	+ 2	+ 6
Lancaster	−1	− 3	+3	− 2	+27	−7	−24	0	− 6	− 6
Philadelphia	+2	− 1	+3	+ 4	+18	−5	−20	0	+ 8	+ 3
Reading	0	− 5	0	− 9	+49	−1	−24	+ 2	+ 5	+ 1
Scranton	−1	− 6	+3	0	.....	.....	.....	.....	+ 1	+ 5
Trenton	.....	.....	.....	.....	+40	−1	−21	+10	0	+10
Wilkes-Barre	+1	+ 1	+4	+ 5	+41	−3	−18	−11	+ 4	+10
Williamsport	−1	+ 1	+2	+ 3	.....	.....	.....	.....	+ 3	+ 5
Wilmington	+1	− 1	+3	+ 3	.....	.....	.....	.....	+33	− 3
York	+1	− 6	+3	− 2	+56	+3	−26	0	+ 3	−22

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

MEASURES OF OUTPUT

	Per cent change		
	Dec. 1951 from		12 mos. 1951 from year ago
	month ago	year ago	
MANUFACTURING (Pa.)	+ 1	− 1	+ 8
Durable goods industries	+ 1	+ 4	+15
Nondurable goods industries	+ 1	− 8	− 2
Foods	− 1	− 3	0
Tobacco	+ 2	+ 1	+ 2
Textiles	+ 3	− 22	−13
Apparel	+ 6	− 9	− 4
Lumber	+ 2	− 10	− 4
Furniture	+ 3	− 17	−15
Paper	+ 1	− 14	+ 1
Printing and publishing	0	0	+ 1
Chemicals	− 1	+ 3	+11
Petroleum and coal products	− 1	+ 1	+ 2
Rubber	− 2	0	+16
Leather	+ 3	− 13	− 6
Stone, clay and glass	− 1	− 6	+ 9
Primary metal industries	+ 2	+ 8	+16
Fabricated metal products	+ 1	− 4	+17
Machinery (except electrical)	+ 1	+ 3	+19
Electrical machinery	+ 3	+ 5	+14
Transportation equipment	+ 2	+ 22	+27
Instruments and related products	− 1	+ 2	+23
Misc. manufacturing industries	− 3	− 17	+ 9
COAL MINING (3rd F. R. Dist.)*	− 14	+ 4	− 5
Anthracite	− 15	+ 5	− 6
Bituminous	− 8	− 9	+ 5
CRUDE OIL (3rd F. R. Dist.)**	+ 2	− 6	− 3
CONSTRUCTION—CONTRACT AWARDS (3rd F. R. Dist.)†	+ 15	− 9	+ 7
Residential	− 13	− 29	− 2
Nonresidential	+ 2	− 24	+36
Public works and utilities	+131	+102	−19

*U.S. Bureau of Mines.
**American Petroleum Inst. Bradford field.
†Source: F. W. Dodge Corporation. Changes computed from 3-month moving averages, centered on 3rd month.

EMPLOYMENT AND INCOME

Pennsylvania Manufacturing Industries* Indexes (1939 avg.=100)	Employment			Payrolls			Average Weekly Earnings		Average Hourly Earnings	
	Dec. 1951 (Index)	Per cent change from mo. ago	Per cent change from year ago	Dec. 1951 (Index)	Per cent change from mo. ago	Per cent change from year ago	Dec. 1951	% chg. from year ago	Dec. 1951	% chg. from year ago
All manufacturing	137	0	− 2	402	+2	+ 4	$66.66	+ 8	$1.62	+6
Durable goods industries	168	0	+ 2	474	+2	+ 9	72.49	+ 7	1.75	+7
Nondurable goods industries	107	+1	− 8	307	+2	− 5	55.15	+ 3	1.42	+4
Foods	127	−1	− 1	313	0	+ 3	55.13	+ 4	1.34	+5
Tobacco	90	0	0	255	+2	+ 7	37.15	+ 7	.95	+6
Textiles	70	+1	−19	208	+3	−20	53.43	− 1	1.39	+2
Apparel	126	+4	− 7	362	+6	− 6	40.78	+ 1	1.16	+3
Lumber	154	0	− 9	404	+2	− 6	45.93	+ 3	1.12	+5
Furniture and lumber products	124	+4	−17	377	+4	−12	56.08	+ 6	1.29	+6
Paper	137	−1	− 9	415	+2	− 7	65.64	+ 2	1.54	+8
Printing and publishing	118	−1	− 2	320	+1	+ 4	76.60	+ 6	1.94	+7
Chemicals	145	−1	0	410	0	+ 4	67.09	+ 4	1.61	+4
Petroleum and coal products	155	−2	+ 1	426	0	+ 6	82.97	+ 6	2.05	+6
Rubber	245	0	+ 1	758	−1	+ 4	76.91	+ 3	1.87	+7
Leather	83	+1	−10	222	+3	−10	45.82	0	1.19	+3
Stone, clay and glass	137	−1	− 4	383	0	− 1	64.16	+ 3	1.64	+5
Primary metal industries	144	0	+ 6	413	+3	+14	80.22	+ 8	1.94	+5
Fabricated metal products	174	0	− 3	489	+1	0	66.73	+ 3	1.62	+5
Machinery (except electrical)	243	+1	+ 4	708	+2	+10	73.95	+ 6	1.72	+8
Electrical machinery	275	+1	+ 3	670	+4	+13	68.14	+10	1.65	+9
Transportation equipment	177	+1	+22	483	+2	+28	77.43	+ 5	1.90	+4
Instruments and related products	183	−1	+ 2	542	+1	+ 9	67.80	+ 6	1.64	+6
Misc. manufacturing industries	128	−5	−17	344	−3	−15	55.10	+ 2	1.30	+2

*Production workers only.

TRADE

Third F. R. District Indexes: 1947–49 Avg.=100 Adjusted for seasonal variation	Dec. 1951 (Index)	Per cent change Dec. 1951 from month ago	Per cent change Dec. 1951 from year ago	12 mos. 1951 from year ago
SALES				
Department stores	105	− 4	−4	+3
Women's apparel stores†	92	− 3	−9	+1
Furniture stores	.....	+26*	−1*	+5*
STOCKS				
Department stores	119p	+ 4	0	.....
Women's apparel stores†	112	+ 6	+2	.....
Furniture stores	.....	− 7*	−6*	.....

Recent Changes in Department Store Sales in Central Philadelphia	Per cent change from year ago
Week ended January 12	−11
Week ended January 19	−11
Week ended January 26	−18
Week ended Feburary 2	+ 5

*Not adjusted for seasonal variation. p—preliminary.
†Philadelphia.

Departmental Sales and Stocks of Independent Department Stores Third F. R. District	Sales		Stocks (end of month)		
	% chg. Dec. 1951 from year ago	% chg. 12 mos. 1951 from year ago	% chg. Dec. 1951 from year ago	Ratio to sales (months' supply) December 1951	1950
Total—All departments	− 6	+1	− 2	1.6	1.5
Main store total	− 6	0	− 2	1.7	1.6
Piece goods and household textiles	−10	+1	−12	3.2	3.3
Small wares	− 4	−1	− 2	1.4	1.3
Women's and misses' accessories	− 4	+2	− 3	1.3	1.3
Women's and misses' apparel	− 7	+4	+ 1	1.5	1.4
Men's and boys' wear	− 4	+3	+10	1.4	1.2
Housefurnishings	−11	−3	− 3	3.2	2.9
Other main store	− 3	+1	− 5	0.6	0.6
Basement store total	− 4	+2	− 6	1.1	1.1
Domestics and blankets	− 8	+1	−17	2.2	2.4
Small wares	−13	−7	−23	0.6	0.7
Women's and misses' wear	− 3	+2	− 6	0.8	0.8
Men's and boys' wear	− 1	+5	− 8	0.8	0.9
Housefurnishings	− 7	−1	+ 3	2.0	1.9
Shoes	− 3	+3	+ 7	1.7	1.5
Nonmerchandise total	0	+2	.....	.....	.....

CONSUMER CREDIT

Sale Credit Third F. R. District	Sales: % chg. Dec. 1951 from year ago	Sales: % chg. 12 mos. 1951 from year ago	Receivables (end of month): % chg. Dec. 1951 from year ago
Department stores			
Cash	− 4	+ 2	.....
Charge account	− 5	+ 4	+6
Instalment account	− 3	− 7	−8
Furniture stores			
Cash	+10	+ 7	.....
Charge account	− 8	+11	.....
Instalment account	+22	+12	0

Loan Credit Third F. R. District	Loans made: % chg. Dec. 1951 from year ago	Loans made: % chg. 12 mos. 1951 from year ago	Loan balances outstanding (end of month): % chg. Dec. 1951 from year ago
Consumer instalment loans			
Commercial banks	+52	+ 2	− 6
Industrial banks and loan companies	+37	+ 8	+ 7
Small loan companies	+20	+16	+12
Credit unions	− 4	+ 7	+ 4

PRICES

Index: 1935–39 average = 100	Dec. 1951 (Index)	Per cent change from: month ago	Per cent change from: year ago
Wholesale prices—United States	221	0	−1
Farm products	255	−1	+3
Foods	237	−1	+5
Other	206	0	0
Consumer prices			
United States	190	0	+7
Philadelphia	190	0	+7
Food	229	+1	+9
Clothing	204	0	+5
Rent	.....	.....	.....
Fuel	154	0	+3
Housefurnishings	221	0	+1
Other	172	0	+7

Weekly Wholesale Prices—U.S. (Index: 1935–39 average = 100)	All commodities	Farm products	Foods	Other
Week ended January 8	220	255	239	204
Week ended January 15	219	253	237	203
Week ended January 22	218	249	235	203
Week ended January 29	219	251	235	204
Week ended February 5	218	249	235	203

Source: U.S. Bureau of Labor Statistics.

BANKING

MONEY SUPPLY AND RELATED ITEMS United States (Billions $)	Dec. 26 1951	Changes in— four weeks	Changes in— year
Money supply, privately owned	185.7	+2.9	+8.8
Demand deposits, adjusted	98.1	+1.8	+5.8
Time deposits	61.2	+ .6	+2.0
Currency outside banks	26.3	+ .5	+ .9
Turnover of demand deposits	20.7*	−2.4*	−1.9*
Commercial bank earning assets	133.4	+1.5	+6.7
Loans	58.3	+1.0	+6.0
U.S. Government securities	61.9	+ .3	− .1
Other securities	13.2	+ .2	+ .8
Member bank reserves held	20.2	+ .6	+3.0
Required reserves (estimated)	19.6	+ .4	+3.1
Excess reserves (estimated)	.6	+ .2	− .1

Changes in reserves during 4 weeks ended December 26, reflected the following:

	Effect on reserves
Increase in Reserve Bank holdings of Governments	+.3
Increase in Reserve Bank loans	+.3
Other Reserve Bank credit	+.3
Net payments by the Treasury	+.3
Gold and foreign transactions	+.2
Increase of money in circulation	−.7
Other transactions	−.1
Change in reserves	+.6

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

OTHER BANKING DATA	Jan. 23 1952	Changes in— four weeks	Changes in— year
Weekly reporting banks—leading cities			
United States (*billions* $):			
Loans—			
Commercial, industrial and agricultural	21.3	− .3	+ 3.3
Security	1.6	− .5	− .7
Real estate	5.7	0	+ .4
To banks	.5	− .1	+ .1
All other	6.0	0	+ .1
Total loans—gross	35.1	− .9	+ 3.2
Investments	39.0	− .4	+ .1
Deposits	84.6	− .3	+ 4.8
Third Federal Reserve District (*millions* $):			
Loans—			
Commercial, industrial and agricultural	795	− 43	+131
Security	41	− 5	− 3
Real estate	134	+ 1	− 10
To banks	24	+ 13	+ 8
All other	397	− 1	+ 21
Total loans—gross	1,391	− 35	+147
Investments	1,537	− 2	− 77
Deposits	3,286	− 16	+ 87
Member bank reserves and related items			
United States (*billions* $):			
Member bank reserves held	20.7	+ .5	+ 2.4
Reserve Bank holdings of Governments	23.0	− .5	+ 2.4
Gold stock	22.9	+ .3	+ .4
Money in circulation	28.3	−1.1	+ 1.3
Treasury deposits at Reserve Banks	0	− .3	− .2
Federal Reserve Bank of Phila. (*millions* $):			
Loans and securities	1,420	− 76	+120
Federal Reserve notes	1,725	− 58	+ 97
Member bank reserve deposits	929	+ 5	+ 68
Gold certificate reserves	1,248	+ 12	+ 5
Reserve ratio (%)	46.3%	+1.5%	− 2.3%