

# The Economic and Business Outlook for 1951

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An expert, I take it, is one who speaks confusingly about a subject he doesn't know anything about, but in such a way as to make the audience feel that it is their fault rather than his. I would like to discuss with you, a little bit, business prospects and economic prospects as I see them, particularly as they have been affected by the invasion of South Korea. Before doing that, I think we should take a very brief, but very long view of this economy.

## Pre-Korea Review

We have had, since prior to the outbreak of the Second World War, an increase in physical output of the general order of magnitude of two-thirds to three-fourths. We have had an increase in prices since that time in the general order of magnitude of two-thirds. As a consequence, our gross national expenditures, the over-all picture, are up to two and a half times what was pre-World War II, and our money supply is about three times what it was then. In short, we have had virtually ten years of prolonged prosperity and inflation.

It is quite true that this inflation, at least temporarily, seemed to be brought to a halt early in 1949, when the index of industrial production fell from about 195 to 161, but we recovered from that in very rapid order. By the middle of

1949 we were again pulling up, and between June of 1949 and June of 1950 the index of industrial production increased about 40 points. Even prior to the outbreak in Korea, we were again having slight revivals of inflation, and it seemed as though the rest of the year would be a good year with moderate inflation, but rather acute in some spots, particularly housing and durable consumer goods.

## Immediate Economic Impact of Korean War

It is at this point that the invasion of South Korea took place, and I think perhaps the best thing to do there is to see what was the immediate economic effect. It was not an increase in governmental expenditures. The government immediately planned to spend a lot more money, but the increase in governmental expenditures has been very slow in moving forward. I think the expenditures for goods and services in the third quarter of this year were less than a billion dollars, at an annual rate, more than in the second quarter.

The immediate impact was in civilian expenditures. You will recall the scare-buying we had on the part of consumers. There was a great increase in expenditures for those things that were scarce during the Second World War, particu-

larly consumer durable goods, automobiles, and housing.

In making these expenditures, consumers and business were not only spending their very large incomes, which were at an unprecedented level, but were cashing in some of their earlier savings, and in addition were going into debt at a rather rapid rate. That is the immediate impact.

#### Economic Magnitudes Confronting Us

Let us look into some of the economic magnitudes that seem to confront us. The basic economic magnitude is that of manpower. In the second quarter of this year, we had a labor force of about 64.8 million people. Of those, three and one-third million were unemployed. A million and a half were in the armed services, and one million seven hundred thousand, roughly, were in defense industries, leaving 58.3 million producing civilian goods and services. Now, if the present estimated expenditures for defense take place as planned, and if we have the increase in the armed forces to 3 million as planned, then what is the nature of our manpower problem? Roughly, we will need an additional million and a half for the armed services and another 3 million to produce defense materials, giving us a requirement of  $4\frac{1}{2}$  million people. Where will they come from?

Our labor force can be expected to increase with some people out of it now coming back into it, to the extent of about 1.7 million. Unemployment might be reduced by a million and a half to one million eight hundred thousand, so we can get from people not now working something like  $3\frac{1}{2}$  of that  $4\frac{1}{2}$  mil-

lion, and that leaves a million to come from those now producing for civilian purposes.

That does not seem an insurmountable economic problem. If we think of it in those real terms, we get a rough idea of the present order of magnitude.

We can move next from the manpower problem to the real resource problem. We have to do this in terms of dollars, but what I am doing here is to express it in terms of dollars of constant purchasing power. Whether that is what we have in store or not, I will come to later.

We will have to take care of roughly 20 billion dollars of additional defense expenditures, which is the annual rate anticipated a year from now. In order to do that, we are going to have to either increase our output or we will have to do without some of the civilian goods we have. As I have indicated, we have some chance of bringing people into the labor force, employing some of the unemployed, using some of our stand-by factories, working longer hours, a little more efficiently perhaps. It is possible that we can get within a billion or 2 billion dollars of this total in these ways alone, and again, the problem in terms of what has to be subtracted from the civilian economy, if we work at our best, does not seem to be of such great magnitude. Why, then, become disturbed about it? Essentially for one reason. If we produce in the order of 17 or 18 billion dollars more of goods, we will be paid for producing those goods and we will not have the additional goods to consume because they are to go into the defense effort. In short, we

will increase incomes by 17 to 18 billion dollars, but we will not increase the things we can buy with those incomes by anything. In fact, we will have some subtraction from the present level. That, essentially, it seems to me, is the nature of our problem.

Unless something is done, we will clearly be faced with an excessive demand over supply of goods and services at existing prices, and that tends to force prices up. There are two ways that have been proposed to deal with the problem. One is the method of direct control.

#### Direct Controls

The method of direct control operates essentially like this: You look at the economy and see the area in which prices have risen most rapidly, and you say, "We have to stop the price rise in this area." You clamp on a price ceiling. It is quickly discovered that, if selling prices are limited, you have to do something about costs. The most important cost item in the economy as a whole is the labor cost. So, price freezes lead to wage freezes.

One feels that solves the problem; but does it? Why is it necessary to put on a price ceiling? Only because not everybody can get all he wants at the existing price, which means that there are some unsatisfied people in the market. What do unsatisfied people in the market do? They say, "Can't we find some substitutes?" That is human ingenuity at work. So they try to get some substitutes. You greatly increase the demand for these substitutes, and your problem shifts from the first area to the

periphery of the area and out into the economy.

So that seems to be the problem. You slap on price ceilings and wage controls, and that shoves the problem one step further. You will recall that in the Second World War we had direct controls pretty well all around.

If not everybody can get all he wants at the existing established price, somebody has to say who is going to get what is available and who is going to have to be denied. If that is the road we choose to follow, I think we should not complain that it requires an enormous bureaucracy, and I use it in its best sense. We need people of extremely high intellectual capacities and integrity and honesty to administer a system to tell what each price shall be and who shall receive the goods and who shall not.

During the World War, we had an elaborate rationing system, which was inevitable under a system of direct controls. We had the red and blue coupons for food stuffs.

There are circumstances where that is an appropriate method for dealing with the problem.

You will recall that in the Second World War our gross national output was in the order of 200 billion dollars a year, 1942-45. The government's take was 100 billion, or about half. So the government take was half the total. Even though we did not know exactly how long it would last, we were quite sure we would win the war and that we would win it within a limited number of years. In short, in the Second World War, we had an enormous effort for a relatively short time, and under those circum-

stances direct controls may be the appropriate way of handling the problem.

Is that the kind of situation that confronts us today? No, so far as one is able to determine. What seems now to confront us is that we may get involved in World War III, but that is not the immediate prospect. We are now confronted with the possibility of five, ten, fifteen, twenty years—some even say a couple of generations—of heavy defense expenditures to defend our way of life. The expenditures will be heavy but not anything like one-half of our total output. The order of magnitude is fifteen or twenty per cent, and does one try to solve the problem of a fifteen or twenty per cent effort for decades in the same way he tries to solve a fifty per cent problem for half a decade? I think not. I think not, for the reason that we had some experience with rent controls, not only during the war but with what happens after the war is over. You will remember that when direct controls were lifted in 1946, we had an immediate and rapid increase in prices, and the reason was perfectly obvious. What we had done via direct controls was to shove the demand from one field to another field to a third field, and finally we had practically the entire area covered. People couldn't spend their money for virtually anything, and so we euphemistically said that they saved a lot in the form of government securities and we had an increase in our money supply. Once controls were removed, these so-called savings began to come in and the demand was still there. All we did by direct controls was to post-

pone facing the real issue of an excessive demand.

Direct controls, in short, do not themselves ever solve the problem. They defer it but they do not solve it. Ultimately one must get to some means by which this excessive demand can be limited or reduced.

#### Other General Methods of Control

That brings us to the other general methods of control, the first of which is that if the government is going to spend 20 billion dollars more per year, it should, first of all, do what it advises its citizens to do and do it in good faith, mainly, reduce expenditures where it is possible to reduce them, and that ought to be a significant amount.

Second, to the extent that expenditures are necessary and must be made, we should pay for those expenditures exactly as we go. I personally am a little impatient with those who say we should pay as much as possible of the costs of defense out of taxes. I think with the magnitude being 20 per cent of our income, we ought to pay every single penny of it as we go along. Otherwise, we will have an increase in government debt and inflation with us forever. We will never solve the problem unless we tackle it there. Even if we tackle this, there is one thing that needs to be done, and all history of monetary systems demonstrate it, the most recent illustration being our experience since the Second World War. That is, we must limit private credit expansion as well.

It seems so long ago now and such a unique sort of case that we may forget that the Federal Government did operate for two years

at a substantial cash surplus. There were only two, but they were substantial. Yet, this substantial cash surplus of the Federal Government did not do much more than tap off a little bit the inflation which continued to develop. Why not? Primarily, for the reason that the private sector of the economy was expanding. Consumers were buying durable goods, buying houses on long-term mortgages, on easy credit, fostered and stimulated by the government, and business went into debt as fast as the government came out. So, the net of that increase in debt replaced the payments by the government, and we went merrily on our way.

#### **Restriction on Private Credit Needed**

In view of this experience, after the Second World War, with private credit, and, as I say, the experience throughout history with credit, in addition to having a balanced budget, we need a restriction in private credit. The Federal Reserve has done something in moving in that direction. It realizes that banks, in order to expand, must have excess reserves or access to reserves. The Fed, therefore, has made the acquisition of reserves more expensive, not because they want to see them more expensive as such. That isn't the objective. The quarrel isn't about one-eighth of one per cent, but it is about whether we will control the volume of reserves and let the market determine what the amount of reserves shall be or not. The Fed has moved by permitting short-term interest rates to rise.

They are also looking at the areas of private credit which have expanded most; namely, real estate credit, and on consumer durable

goods we have had a third incarnation of Regulation W and the appearance of Regulation X.

The point I want to emphasize is that in projecting you can do as good a job of it as I can. I have tried to give you some of the economic magnitudes involved, but where we go in a democracy always depends upon where we, as citizens, insist that our government shall go. In my judgment, the most important single factor, particularly in this crucial period, in determining where our economic system is going, is the matter of public policy. If we think we can solve the problem with direct controls, I think we shall end up in illusion. On the other hand, if we are determined to see to it that we pay as we go and we limit the extension of private credit, we can do this job in real terms. It is of manageable proportions, but your guess as to what Congress will do with respect to expenditures and taxation is as good and, probably in most cases, better than mine, and that is the key to the future.

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### **SUGGESTED READINGS**

**HOW TO ORGANIZE AND OPERATE A SMALL BUSINESS** by Pearce Kelley and Kenneth Lawyer, Prentice-Hall, New York 11, 803 pp., \$6.64, covers retail, wholesale, manufacture and service. Early in 1951 a Work-book and a Teacher's Manual will be issued to go along with this text.

**Peaks and Valleys in WHOLESALE PRICES and BUSINESS FAILURES** by Roy A. Foulke, Dun & Bradstreet, 1950, also includes the ratios for years 1944-48 inclusive.

**STUDY on INVOICE DATINGS and DISCOUNTS** by the Credit Research Foundation, representing the present thinking and practices of some 200 representative companies.



II. IMPACT OF KOREA - JUNE 25, 1950

1. Initial economic impact was on civilian expenditures
2. Increase in planned Government expenditures

III. ORDER OF MAGNITUDES

1. Manpower
2. Real Resources
3. Dollar magnitudes

IV. THE METHOD OF DIRECT CONTROLS

Manpower Projected  
(Millions of persons)

	1950 <u>2nd Quarter</u>	1951 <u>2nd Quarter</u>	Change	
Labor Force . . . . .	64.8	66.5	/ 1.7 )	
Unemployed . . . . .	3.3	1.5	- 1.8 )	3.5
Employed				
Armed Force . . . . .	1.5	3.0	/ 1.5 )	
Defense . . . . .	1.7	4.7	/ 3.0 )	4.5
Civilian . . . . .	58.3	57.3	- 1.0	

Expansion in Output - Projected  
(Annual rates in billions of dollars  
at 3rd quarter 1950 prices)

	1950 <u>3rd Quarter</u>	1951 <u>2nd Quarter</u>	Change
Gross National Product . . .	284.0	301	/ 17
Defense . . . . .	14	32	/ 18
Civilian			
Regular Government . . .	29	29	-
Private . . . . .	241	240	- 1

	Estimated 3rd Quarter 1950	Projected 3rd Quarter 1951	
		Model A*	Model B*
Gross National Product . . . . .	284.0	333.1	318.7
Government purchases of goods and services - total . . . . .	42.5	67.9	65.8
Federal . . . . .	23.5	47.7	46.0
State and Local . . . . .	19.0	20.2	19.8
Gross Private Domestic Investment .	49.0	55.7	51.1
Net Foreign Investment . . . . .	-3.0	-1.5	-2.0
Personal Consumption Expenditures .	195.5	211.0	204.0
Durable Goods . . . . .	31.5	26.0	25.0
Nondurable Goods & Services	164.0	185.0	179.0
Personal Income . . . . .	224.0	259.1	250.2
Disposable Income . . . . .	204.0	232.7	222.2
Personal Savings . . . . .	8.5	21.7	18.2