Group II, Pennsylvania Bankers Association, Bellevue-Stratford, Philadelphia
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ECONOMIC MOODS AND PROSPECTS

Production for defense promises to be the keynote of business for 1952. To produce all the goods and services required by the Government plus all things required or desired by consumers plus all materials and services required by businessmen in their efforts to serve both masters - military and civilian - calls for a huge output. We may throw some light on whether inflationary or deflationary pressures are likely to prevail in 1952 by examining recent and prospective developments in two segments of the spending stream - private and Government.

The first spurt of inflation following Korea was brought on by the upsurge in private spending which arose from the speculative reaction of consumers and businessmen. In efforts to "stock up", consumers and businessmen not only spent most of the current income at their disposal but they borrowed heavily and dipped into their savings.

The defense program, although it did not directly contribute to the inflation of last year, may well become a major source of inflationary pressure in the near future. Every dollar paid out by the Government for tanks, guns, airplanes, food, clothing, and the many other things required for defense, gives someone another dollar to spend. But defense production does not put any more goods in the stores for these dollars to buy. In fact, by diverting raw materials from civilian to defense purposes it reduces the supply of goods which otherwise would be available to civilians. Unless, therefore, the Government siphons back as many dollars as it pays out, it tends to create an inflation gap between buying power and the supply of goods available for purchase.

Whether we have inflation in 1952 will depend on whether effective steps are taken to deal with inflationary pressures should they re-emerge. The only real preventive or cure is to remove the causes. This can be accomplished primarily through adoption of appropriate financial and credit policies. The appropriate fiscal policy is indicated by the fact that the defense program will increase the amount of money people have available to spend unless the Government takes back as many dollars as it pays out. A first step in removing this source of inflation is to hold Governmental expenditures to an absolute minimum. Once expenditures have been reduced to a minimum, the only alternative remaining is for the Treasury to dip enough out of our incomes by taxation and borrowing from nonbank sources to meet all of its expenditures. The appropriate credit policy is to prevent borrowing from generating an excessive amount of spending for the available supply of goods and services.

These monetary and fiscal measures are directed toward removing the major cause of inflation. They differ basically from such measures as regulation of prices and wages which dam up excess demand behind a wall of direct controls.

To the extent that direct controls are effective in damping down prices and wages and therefore the dollar volume of business, they also help curb the demand for credit and reinforce measures to restrict credit expansion. Unless, however, monetary and fiscal measures are effective in preventing the creation of excess purchasing power, direct controls are unlikely to be successful in holding the line on prices and wages, especially in a partially mobilized economy. It does not do much good to clamp the lid on the kettle as long as a hot fire is burning underneath.

Conclusions

Strong counteracting forces which have given us several months of relative stability at high levels of production and employment are likely to continue a few months longer. Rising defense expenditures, a record volume of business capital expenditures, and a steadily rising volume of personal income after taxes have been exerting strong upward pressures. Hesitant consumer buying, liquidation of inventories, cutbacks involved in shifting from civilian to defense production, and credit restrictions have exerted a down pull tending to offset the upward pressures. The result has been a period of relative stability.

The prospects for 1952 are for rising defense expenditures, another very high volume of business capital expenditures, and rising personal income, reflecting both a high level of employment and another round of wage increases. The counteracting forces appear to be weakening. Consumers have the ability to spend and a greater willingness may emerge at any time. Inventory liquidation and shifting from civilian to defense production should be largely completed soon. The large excess of Treasury cash receipts over expenditures in the first quarter will also tend to hold down total spending. After a lull in the early months of the year, however, it appears that inflationary pressures are likely to become stronger than the deflationary forces.

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Digest of Remarks by Karl R. Bopp, Vice President
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