

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
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MEMORANDUM

To: The President
From: The Council of Economic Advisers
Subject: Appraisal of April Economic Developments and Issues of
Current Policy and Action

On April 6, we presented a first quarter review which noted declines in employment, some fall in production, and considerable, though uneven, downward movement of prices. We concluded that there was "a mixture of trends", and "an ambiguity and lack of conclusive evidence in the situation" which suggested that "three possible lines of subsequent development needed to be considered...first, another spurt of inflation...second, a downturn in business activity [with] substantial contraction of investment and production...third, further price adjustment in a manner to facilitate the clearing of markets, with only moderate temporary departure from maximum levels of employment and production."

The month of April has not brought conclusive developments to clarify the economic situation, and we regard it as quite possible that during May, June, or even a longer period the real trend may still be greatly in doubt. The price adjustments which have taken place thus far in 1949 have, on the whole, been favorable but they have been accompanied by some increases in unemployment, decreases in many areas



of production, some increase in business uncertainty, and a failure of the economy thus far to absorb the growing labor force sufficiently to comport with the objective of maximum employment.

In general, we believe that April developments remove still farther the possibility of a new spurt of inflation and that as between the possibility of a healthy readjustment or of the situation getting out of hand on the downside, the dangers of the latter outcome, if nothing is done, call for reconsideration of what the current economic program should be if we are to guard against a serious downturn and are to point the economy toward the restoration and maintenance of maximum employment, production, and purchasing power.

While employment month by month for the first quarter of the year has tended to be above the corresponding months of 1948, this was not true for April 1949. The broad trend since the end of last year has been toward an increase in unemployment due to failure to absorb the growing labor force. It is true that unemployment declined slightly in March and again slightly in April, but the pick-up in employment is less than might be expected for seasonal reasons and the employment situation in manufacturing has definitely softened. While the current level of unemployment, approximately 3 million, is still low, unemployment has become more widespread whether measured by industries or by sections of the country.

Production according to the Federal Reserve Board Index of Industrial Production fell from 189 in February to 184 in March. The data now available suggest that the level in April was around 179. This would be 8 percent below the peak levels of last October and November, a sub-




stantial decrease. Yet most indications are that, measured against anything but the postwar peaks, the general level of production and business activity is continuing strong. Automobile output continued to increase throughout April. Production of electric power continued at high levels, running above 1948. Freight car loadings were above 10 percent higher than last year in the early part of April, but resumed the downward trend from 1948 in the closing weeks. Steel output was scheduled at 97.5 percent of capacity at the end of April, after running above theoretical capacity for the last two months. While retail sales of apparel were generally good during the Easter season, distributors were concerned about the drop in sales of heavy appliances and home furnishings.

Prices of industrial items continued to decline during the month of April and all the major components shared in this trend. Farm prices also declined, while wholesale food prices held steady. A brief accounting of wholesale price trends should note that the declines from respective postwar peaks to the week ending April 26, 1949 have been 8.1 percent for all commodities; 16.7 percent for farm products; 14.7 percent for foods; 3.8 percent for all other than farm and foods; 8.2 percent for textiles; 3 percent for metals and metal products; and 4.2 percent for building materials.

While these price declines have been substantial in varying degree, there has certainly been nothing which might be called a disorderly or perilous deflation of prices. And practically all of the indexes are considerably above the levels maintained at the end of price control and much further above prewar levels.

Consumers' prices have declined less, and according to the March figures for all items were only 2.9 percent below the postwar peak. The decline in food prices from the postwar peak has been 7 percent and in apparel 3.8 percent, but there has been no such trend in the case of rent or fuel. After a steady decline over a five-month period, the consumers' price index rose .3 percent in March.

In summary of economic trends since the end of 1948, we conclude that the inflationary forces then present have waned to the point where inflation is no longer our primary concern, and there is not the need that there was previously for an all-out anti-inflation program. On the other hand, although the employment and production figure is not as good as it was a few months back, we do not believe that there is now need for an all-out anti-deflation program. It is our judgment as economists that a few changes of legislative and administrative program now would contribute toward preventing further declines in employment and production and to creating in so far as possible both economic and psychological conditions favorable to a return toward conditions of maximum employment and production. Some of these suggestions relate primarily to action which should have immediate salutary effect on the business situation, whereas others would immediately set preparations under way which would enable us to deal more effectively with further downturns in employment and production if these should later occur.



PROGRAM RECOMMENDATIONS

Our recommendations at this time are based upon a fairly extensive inventory of legislative and administrative proposals having a direct bearing upon the economic situation. This includes a re-examination of previous proposals and the addition of some new proposals. The legislative proposals, which will be treated first, are mindful of the fact that they may need to be developed and pushed rapidly to secure action before the session ends. These legislative proposals divide into three groups: (1) legislation designed to affect the immediate economic situation; (2) legislation authorizing action which should be commenced now to introduce longer-range stability factors into the economy; (3) legislation needed now to prepare adequately against the possibility of a more serious downswing in employment and production at some later time.

(1) Legislation Designed to Affect the Immediate Economic Situation

Taxation. We feel that, under current conditions, the business climate would be improved if it were found feasible to announce some modification of the January tax program. The feasibility of any such modification depends in part upon the outlook for additions to levels of Government expenditure set in your 1950 Budget. Since tax revenue if national income continues to decline would be below the estimates used at the beginning of the year, the possibility for avoiding a substantial deficit depends upon a more rigorous holding down of expenditures than has been indicated by the action of the Congress thus far.

Because of such deflationary tendencies as have developed, we would recommend that the proposal to advance the date of increase of OASI contributions to July 1949 be withdrawn and that the effective date of health taxes be deferred until payments of health benefits begin. We recommend that the excise tax on transportation be eliminated. This would have a substantial beneficial effect on prices by reducing costs and would improve the condition of the carriers. We recommend also the restoration of the levels of estate and gift taxes.

Selective Controls Over Materials, Prices and Wages. The Administration's reiterated request for selective controls in January was advanced upon the ground that, while inflationary forces were not so ascendant as when the request for such controls was first made, the balance between inflationary and non-inflationary forces was still so precarious that standby measures should promptly be made available. In view of further changes in the economic situation since then, we recommend that the request for such controls no longer be pressed.

Promotion of Production and Supply; Support of Private Investments. The encouragement of the expansion of investment, capacity, and facilities for sustained and balanced maximum production is a continuing responsibility under the Employment Act of 1946. Such study and encouragement would be in line with Title II of the Spence Bill, but we believe that the provision for direct Government construction of plants should be omitted.

International Economic Programs. With a lessening of inflationary pressures it becomes more feasible to consider these programs in terms of the general requirements of national and world policy without the competing

consideration of inflationary impact. In the light of changing conditions action should be considered (a) to speed up the stockpiling of strategic and critical materials from abroad, and (b) to speed up the flow of international capital.

(2) Legislative Action Directed Toward
Longer-Range Economic Stability

There is no sharp or complete distinction between legislation to effect the immediate economic situation and legislation directed toward longer-range stability. Legislation of the latter type, if wisely conceived, will have an immediate effect upon the economic environment by promoting confidence that the obligations under the Employment Act are being taken seriously; and with the enactment of such legislation some of the authority contained thereunder can have immediate utility in the short-run. We are proposing in this area only such legislative action as should be taken now because there should not be further delay in commencement of the introduction of these stabilizing factors in the economic picture.

General credit policy. The Federal Reserve Board's temporary powers over reserve requirements and consumer installment credit should be made permanent. There is no reason for ceasing to place stress upon the importance of enabling the Federal Reserve Board to deal flexibly either with inflationary or deflationary trends on a general or selective basis as the situation may require. Legislation should also be enacted for the regulation of commodity exchanges.

Agricultural Policy. In the agricultural area, we feel that there is a very serious problem of providing a desirable amount of support to farm

income and of allowing abundance to have its maximum favorable effect on cost of living without imposing undue strain on the Federal budget. The sooner legislative determination is made on a permanent farm price support program, the sooner the economy will be released from the factor of continuing uncertainty. We are studying the Brannan Plan with great care in the hope that we can make practical suggestions which will aid him in his effort to develop the most satisfactory long-range farm program.

(3) Legislative Action to Prepare Against the Possibilities of a Serious Downswing in Employment and Production

Finally, we think it not too soon for us to consider legislative and administrative measures which would prepare us for suitable action in the event that a serious downswing in employment and production should develop later in this year or in 1950. We cannot overlook the possibility that the current period of uncertainty may be succeeded by recession of employment and production of more substantial proportions. Even if no actual legislative or administrative steps were consummated at the present time, the mere presentation and frank discussion of such measures should enlarge the area of general confidence and thus accomplish an affirmative purpose in the present - whether or not the plans as developed should need actually to be called into operation in future. Toward this end, the following proposals are made.

(1) Legislation should be prepared and recommended to extend unemployment compensation duration beyond 26 weeks in recession periods or in particular areas, and to provide for automatic increase of Federal contributions to general relief costs with increasing unemployment.

(2) Legislation should be prepared and recommended to support State-local advance planning of public works; to facilitate site acquisition and plan preparation for Federal and Federal-aid programs; to establish a skeleton organization to prepare programs in support of State-local public works on national or area basis as needed. Appropriations for these purposes would be modest in amount.

(4) Administrative Action

In addition to the foregoing legislative proposals, certain actions are recommended for which we believe sufficient administrative authority exists without enabling legislation.

(1) There should be a better organized approach to the spot unemployment problem--using present facilities for business loans, public works and services and defense contracts.

(2) There should be acceleration of the clerical work on veterans' life insurance dividends, to permit disbursal without delay if at a future time it should be deemed necessary in terms of the economic situation.

(3) The Federal Security Agency should be directed to develop or intensify State and local employment security programs.

Respectfully submitted:

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