




BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

June 9, 1949.

Dear Mr. Secretary:

Chairman McCabe thought you might be interested in seeing the attached reprint of an article which appeared in last Sunday's Philadelphia Inquirer.

Sincerely,


Elliott Thurston,
Assistant to the Board.

Enclosure

Honorable John W. Snyder,
Secretary of the Treasury,
Washington, D. C.

Vision Needed to Avoid Recession, McCabe Says

U. S. Return To Old Sales Method Urged

By JOHN M. McCULLOUGH
Inquirer Washington Bureau

WASHINGTON, June 4.—What American business needs more than anything else to ease it out of its present decline is an infusion of good, old-fashioned Yankee merchandising vision and ingenuity in the opinion of Thomas B. McCabe, chairman of the Board of Governors of the Federal Reserve System.

That is not the only factor in the present business decline—or slump, or recession, or readjustment, or whatever you wish to call it—he continued, but it is fundamental.

American business could think or talk itself into a serious business slump almost as easily as an Indian Yogi could stop breathing, although the process would be not nearly so easy as it was just a score of years ago.

INDICES GENERALLY SLIPPED

Just what label is applied to business conditions today—whether readjustment or recession or slump—is not important. The important fact is that business indices generally—industrial production, employment, business and consumer spending, the wholesale price index—have slipped below their levels of a year ago, or nine months ago, by substantial margins.

What's it all about? That is the question which was put to McCabe and his associates, and the answers were gleaned not only from him but from the mass of statements, statistical analyses and reports which generally have been public property since the economic structure began slipping last October. In other words, this article attempts to pull together a variety of information into a picture which makes some sense out of the present uneasy and unclear economic scene.

U. S. ECONOMICALLY SOUND

The very first fact, supported by all information available to the American business community and reiterated by the Federal Reserve System's chairman, is that the United States economically is fundamentally sound, and if that sounds a good bit like the wishful thinking of 1930 and 1931, it is wholly coincidence.

Economically, the United States is sound.

Industrial production has slipped 8 percent since November, 1948, but it still is 79 percent above the pre-war level, which is a very high plateau of business activity indeed.

Unemployment has increased by 1,400,000 since last October, a percentage increase of 87.5 percent but it still is only at 3,000,000 or considerably less than one-third of the total the prophets of disaster predicted for the immediate postwar period.

The banks of the Nation are in a stronger position than they have ever been in the history of the country, and that is a statement of fact and not one man's opinion.

To quote Federal Reserve System's chairman:

"The banks are strong—terrifically strong."

By contrast with 1929, bank portfolios hold relatively little speculative paper. Loans and investments of all member banks of the Federal Reserve System are up 253 percent since 1940; loans, 228 percent; Government securities, 330 percent, establishing extraordinary liquidity; total deposits, 204 percent, and capital accounts, 156 percent.

INFLATION SPIRAL CRACKED

"For months," McCabe pointed out, "the entire business community was practically on its knees praying that the inflationary period would come to an end. Almost no one liked it, outside of a few who get a kick out of a situation such as that, and the people on fixed salaries were really in a log jam. They were being squeezed painfully with no visible way out."

And then the inflationary spiral cracked. Not all at once, but selectively, more sharply in some industries than others. The overall industrial production index began to slip: 3 points, between November and December, 1948; a point in January, 2 in February, 5 in March and another 5 in April.

Some people called it "The Depression," turned up their collars and headed for the hurricane cellars.

CALLED READJUSTMENT

While they fled, economists argued interminably as to whether this was recession depression, readjustment or "disinflation," Dr. Nourse's word. By and large, the view of McCabe and his associates is that it is readjustment, but emphatically that does not mean that is a simple and uncomplicated economic interim in tight with folded hands, awaiting an emergence into greener pastures.

"For nine years, American business has been mainly occupied in appeasing customers," McCabe pointed out. "There wasn't enough to go

around. But merchandising—all of the techniques involved in selling in a competitive, free-enterprise market—made this country great; and you can't revamp sales staffs and rebuilt merchandising organizations overnight. After nine years of absolute and total emphasis upon production—production, production and more production!—American business today and for the past nine months has been faced with the immediate and fundamental job of readjusting its merchandising practices to pre-war levels."

That American business, up to this point, has failed to make that adjustment is revealed, in the opinion of McCabe and his associates, in the curious unbalance of the various price indices. To quote from a current Federal Reserve System analysis:

"As compared with January (1949), 28 basic commodities are down 15 percent, the wholesale all-commodity index 3 percent, and the consumer index about 1 percent."

In other words, between basic commodities and the over-the-counter charge to the customer, there is a huge gap. The spread between the two—the basic commodity price on the one hand, the finished product price which the workaday citizen pays on the other—will be self-adjusting, but unless business by its own initiative lends a hand to close it, somebody is going to get hurt. How badly "somebody" is hurt, in McCabe's judgment, depends to a very large extent upon how swiftly business wakes up to the situation.

NOT GEARED FOR CHANGE

"I am convinced," the Reserve System's chairman said, "that only a small proportion of American business and industry is geared up for the change. I also am convinced that if American business can satisfy the customer—with our tremendous backlog of savings and employment what it is—a very considerable part of our economic problem can be solved, to the extent that purely domestic arrangements can solve it."

For instance, he quoted statistics that today, mid-1949, about 1.8 percent of the total national income is being spent upon advertising in all media, as against 4 percent in 1940, a decrease of 55 percent.

"Much of business has not got into the frame of mind," he declared, "where it accepts the fact that it must streamline its shop or its specialty to pre-war conditions. What this country needs is the sales manager with vision and guts who will tell his board of directors what they've got to do to maintain sales volume in order to keep that business going."

EXPENDITURES DECLINE

Constricting business and consumer purchases to some extent at

least, and obviously in McCabe's view to a considerable extent, are due to this inability or limited ability to make adjustment to a changed economic atmosphere which once again has placed a premium upon market research, product design, quality production to meet acceptable price levels and the other practices of alert and forward-looking merchandising.

The extent of the construction is shown in a Reserve System analysis. Expenditures for personal consumption declined late last year by \$4.5 billions or 2½ percent, a decline partly explainable by satisfaction of the demand back-log, partly by buyer resistance to high prices.

PERSONAL INCOME OFF

"In the first quarter of 1949," the analysis states, "personal income declined by \$3 billion to an annual rate, seasonably adjusted, of \$216.6 billions. Disposable income declined by only \$2 billions, but expenditures for current consumption declined by \$4½ billions.

"The result has been a steady increase both in the aggregate amount of personal savings and in the proportion of disposable income (that is, spendable income) accounted for by savings. In the first quarter of 1949, savings amounted to almost 11 percent of disposable income, the highest figure since late 1945 and an exceptionally high figure in compari-

son with most post-war periods. The sustained increase in this ratio in the past two years probably represents—at least in its more recent stages—a reduction in the willingness of consumers to spend on current consumption at prevailing high prices."

In other words, the money to spend—backed-up purchasing power—exists today to an even greater degree than it did a year ago, but it is not being lured into the market, in McCabe's judgment, by the kind of merchandising methods that can translate potential into actual buying.

ROLE FOR CONGRESS

He agrees that an indication on the part of Congress to move toward economy in National spending would be a reassurance to the business community, just as a relaxation in the 'cold war' would produce an invigorating change in the entire national business psychology.

"The American people are uneasy, there's no question about that," he said. "The whole world's uneasy. We're fighting a 'cold war.' We are spending one half of our Federal budget, in round numbers, on military expenditures and ECA—\$15,000,000,000 and about \$5,250,000,000, respectively. Appropriations to veterans add another \$7,000,000,000. Whether or not it is possible to cut them is one question; the other is whether, at the same time we are

spending this huge amount each year, we can embark upon a full-scale expansion of our domestic social welfare program.

CITIZENS CONFUSED

"I am not arguing one side or the other. All that I am saying is that the average citizen, studying these tremendous expenditures and proposed expenditures, is confused and uneasy. He wonders where it is all coming from, and his reaction is to retrench in his personal fiscal policy.

"What this average citizen needs is some positive expression of the relationship of these tremendous matters, exterior to the domestic economy, in terms of his own economic future. Like it or not, the 'cold war' is a fact, not a figment of someone's imagination. Over a period of several decades, the American people have indicated that they want their government to support a broad policy of social welfare and security, and that too is a fact.

"If these two vast programs—the one largely military and international, the other non-military and domestic—are to be fitted into an economy in which the average citizen can repose confidence, positive and not negative approaches must be devised. Mere negative opposition will not serve."