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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Extension of the Defense Production Act

This is the third and last of three articles on various aspects of the proposed extension of the Defense Production Act. In this article we explain further the economic significance of a rearmament program.

Rearmament Prosperity, A Delusion

The American public has been told that prosperity is virtually assured during the next few years by the rearmament program. *U. S. News & World Report* states, for example, "To the economy as a whole, it [rearmament] promises an early revival of the boom. Once that boom gets going again, it should have the strength to carry on for a long time." We believe that such statements may give a misleading impression regarding the economic significance of the rearmament program in two ways: first, by overemphasizing the importance of the defense program in the over-all economy; second, and perhaps of greater significance, by leading the public to expect prosperity in the usual sense, which implies a high and probably increasing standard of living for nearly everyone.

Importance of Rearmament to Business Activity

Defense spending during the fiscal year ending June 30, 1952, has been estimated at approximately $46,000,000,000. The sum includes expenditures for airplanes, ships, tanks, guns, construction, pay and keep of troops, operating costs, foreign military aid, and other military items. Total payments for defense purposes thus will represent nearly 15 percent of the "gross national product."[1]

Apparently those who are so sure that rearmament will create a prolonged boom argue as follows: In the first place, huge quantities of materials will be required, and transportation agencies as well as raw-materials producers and manufacturers will benefit; second, the money paid for defense goods and services will be spent by the recipients for other goods.

These two arguments will be answered briefly in turn. First, the prices of tanks and other military goods presumably include the cost of the raw materials used plus the transportation charges plus other costs of the manufacturers. Therefore, the $46,000,000,000 presumably will account for only that specific dollar amount of demand for products and services initially.

Second, any stimulus to business activity attributable to the subsequent spending by those who receive the $46,000,000,000 will be offset by taxes unless the Government pays for the rearmament program by inflating. In the absence of inflation, no purchasing media will come to market that are not balanced by an equivalent amount of goods.[2]

A rearmament program financed on a pay-as-we-go basis will force a reduction in the demand for civilian consumers' goods. Under such circumstances, production at boom levels in the civilian sector of the economy could not continue even if ample supplies of raw materials were available.

In several recent articles we have discussed the possibility of a recession as a result of the liquidation of excessive inventories and the continued effects of credit restrictions.[3] We suggested that "in view of the steadily increasing volume of military production, any substantial decrease in total production will be of short duration. However, we do not believe that rearmament production *guarantees* an "early revival of the *boom*." Although we believe that a contraction of business activity during the next several months may be avoided, the probability

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[1]To the extent that defense goods cost more per unit of raw materials involved, the shortages of raw materials brought about by these expenditures may be somewhat less than might be expected from the dollar figures. Such a situation could develop as a result of amortizing new plant and equipment and other overhead costs over a relatively small number of units. Furthermore, the costs of some military weapons, such as tanks, probably will not be reduced so much by mass-production economies as have the costs of their peacetime counterpart, the automobile.

[2]In the absence of inflationary financing, the rearmament program will proceed somewhat as follows: An industry with a Government contract for armament may borrow from the bank on the completion of part of its production and pay out the newly created purchasing media in order to meet its expenses (wages, rents, raw materials, etc.). The Government then will tax all who receive incomes in order to obtain funds to pay the manufacturer. Therefore, the Government thus takes, from those who otherwise would buy in the markets, funds equal in value to the armament produced. The industry will use the funds received by the Government to repay its loan at the bank. In summary, no goods will have come to market, and no increase in the total purchasing media will have occurred: consequently, there would not be an increased supply of purchasing media making possible increased demand for other goods. The Nation simply will have decided to devote its land, labor, and capital to producing goods that are not to be used by the general consumer.

[3]*Research Reports*, June 11, 1951, p. 95; *Research Reports*, June 4, 1951, pp. 89-90; *Research Reports*, April 2, 1951, pp. 53-54; *Investment Bulletin*, June 4, 1951, pp. 37-39.

of a short but severe recession (we have guessed 3 to 4 chances in 10) seems to be far from negligible.

Rearmament and Real Wealth

Some confusion apparently has resulted from assertions that the rearmament program should be paid for *now* rather than at some future time. However, rearmament *must* be at the expense of alternative uses of land, labor, and capital *during the period of rearmament.* Furthermore, a high level of activity (that is, relatively *complete* utilization of the available land, labor, and capital) does not necessarily imply the most *effective* utilization of those resources.

Monetary policies cannot prevent "real" wealth from being used now. A tank, an airplane, or any other implement of war can be made only by using land, labor, and physical capital, not by using dollar bills or demand deposits, not by using taxes or Government bonds. Regardless of how rearmament is financed, the materials that will be used for defense production, the physical depreciation of plant and equipment involved, and the human effort expended must be provided now rather than at some future time.

In any society, production is a result of the applications of labor and physical capital to land; consequently, in the sense of foregoing alternative uses, a society must simultaneously "pay" for its output. However, a Government can determine which *specific* individuals will relinquish their *claims* to current production and whether some will forfeit their claims permanently or only for the time being until the burden can be placed on others.

Money taxes require taxpayers (individuals or groups) to relinquish *permanently* a portion of their claims on currently produced wealth. The taxpayer gives his claim on the product of land, labor, and physical capital to the Government; and what he gives up is used to meet the claims of those from whom the Government has taken the armament or other materials.

The effects of inflation when it is used as a means of "paying" for rearmament are as follows: The injection of inflationary purchasing media makes possible increased demand with resulting higher prices. As prices increase, those persons whose incomes do not increase proportionately find that, in spite of the same application of effort on their part, the share of current production represented by their money claims on wealth has decreased. In other words, the sacrifice of real wealth is made primarily by those persons having relatively fixed money incomes.

Government borrowing from agencies other than the commercial banks, borrowing that therefore is not inflationary, has different consequences. Those who buy savings bonds, for example, relinquish their claims on currently produced wealth but receive in exchange a claim on wealth to be produced some time in the future. The purchaser of a savings bond gives up his claim on wealth temporarily. He is promised a share of the wealth produced at some future time, and the monetary policies then in effect will determine which specific individuals will relinquish their claims on wealth in order that his deferred claim may be honored.

Satisfaction of Human Wants

Full employment, industry functioning at the theoretical capacity of its plant and equipment, and full utilization of land do not necessarily represent the most effective use of land, labor, and physical capital. An absurd exaggeration may make this point clear. If *all* available land, labor, and physical capital were employed in rearmament production, activity as measured by employment, industrial production, commercial and industrial building, and other economic time series might be at an all-time high. The so-called "prosperity" would be unparalleled. However, there would be no consumers' goods, no food, no houses, no clothing, etc. Of course, such a situation is impossible. Nevertheless, the example may serve to emphasize that maintenance of a high level of activity because of rearmament denies the use of land, labor, and physical capital for other purposes. The greater the level of activity resulting from rearmament, the less the production that can be available for satisfying other wants.

We do not, of course, imply that rearmament is undesirable because it involves a diversion of production from the satisfaction of consumer desires. Adequate armament may well be part of the price of survival, but no one should labor under the delusion that rearmament can be purchased at a bargain counter labeled "boom prosperity."

Conclusion

Rearmament "prosperity" is a delusion in two ways. First, the rearmament program is not so great that a short but serious recession cannot occur; second, the suggestion of economic well-being that many people seem to associate with a high level of business activity based on rearmament is not "prosperity" in the usual sense of that word. This fact the American people are in the process of discovering.

SUPPLY

Industrial Production

Steel-ingot production, scheduled at 103.2 percent of capacity for the week ended June 16, 1951, was unchanged from that in the preceding week and was 7 percent more than production in the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1950*	*1951*
Percent of Capacity†	97	18	76	27	101	103p
Weekly Cap. (Million Tons)	1.38	1.52	1.51	1.54	1.91	2.00
Production (Million Tons)	1.34	.27	1.15	.42	1.93	2.06

Automobile and truck production in the United States and Canada during the week ended June 9, 1951, was estimated at 155,323 vehicles, compared with a revised total of 121,476 vehicles during the previous week.

	1929	*1932*	*1937*	*1938*	*1950*	*1951*
Vehicles (000 omitted)†	126	53	119	40	201	155p

Electric-power production in the week ended June 9, 1951, increased to 6,733,662,000 kilowatt-hours from 6,444,741,000 kilowatt-hours in the previous week.

	1929	*1932*	*1937*	*1938*	*1950*	*1951*
Billion Kilowatt-Hours†	1.70	1.44	2.21	1.99	5.92	6.73

Lumber production in the week ended June 2, 1951, increased. *The New York Times* seasonally adjusted index was 19 points above that for the preceding week and was 5 points above that for the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1950*	*1951*
The New York Times Index†	120*	39*	96*	81*	129*	134*

†Latest weekly data; corresponding weeks of earlier years p=preliminary; *holiday

New Consumer Goods Per Capita

The April index of new consumer goods produced per capita, unadjusted for long-term trend, decreased nearly 2 percent to the February level. The April figure was nearly 6 percent below the all-time peak reached last September but was 6 percent above the figure for April last year.

The index adjusted for long-term trend decreased nearly 2 percent in April and was 7 percent below the all-time high reached last August and September. The April adjusted index was nearly 7 percent *below* the 1941 peak, compared with the unadjusted index, which was 34 percent *above* the 1941 peak.

Our index of new consumer goods per capita is a 3-month moving average (plotted at the last month) based on the production of several consumer commodities. The various components are weighted in accordance with total consumer expenditures for each of the items.

The 3-percent decrease in the over-all index during April was attributable primarily to decreases in the following components: automobile production, 15 percent; residential construction, 5 percent; furniture production, 4 percent; and textile output, 2 percent. On the other hand, food production and cigarette production increased slightly.

A recent NPA order, which restricts passenger-car production in the third quarter to 1,200,000 units, presumably will cause a substantial decrease in the automobile component of the new-consumer-goods index. The NPA limit is 14 percent less than estimated passenger-car production during the second quarter of 1951, 29 percent below that of the first quarter of 1951, and 37 percent below that of the third quarter of 1950. The 1,200,000 limit may be modified somewhat if more or less steel is used per car than was used in January 1950.

Residential construction through May 1951 (the April index is a 3-month moving average that includes May) has decreased 24 percent from the all-time high reached last July. For the first time since June 1949, the index for April was below that of the corresponding month a year earlier. Recent data on housing starts reveal that a greater-than-seasonal increase occurred during May from the unusually low April figure. However, the May total of 97,000 was 6 percent below the figure that would reflect the usual seasonal increase from March to May and 24 percent below that reflecting the usual seasonal increase from February to May.

Textile production, which decreased 3 percent in March and 2 percent in April, has remained at relatively high levels. According to the *Journal of Commerce*, the slowdown apparently has been attributable largely to the indecision resulting from the failure of the OPS to issue a price order applicable to the industry. Some increase in activity is expected to begin in July, when large Government orders are expected.

The May index of new consumer goods produced per capita probably will decrease further. If retailers attempt to reduce inventories to the levels that prevailed in 1948 and 1949 just prior to the usual accumulation of goods for fall business, substantial cut-backs in the production of consumer goods probably will occur. In any event, because automobile output will be curtailed and residential construction presumably will decrease further, a further decline in our index is almost assured during the next several months.

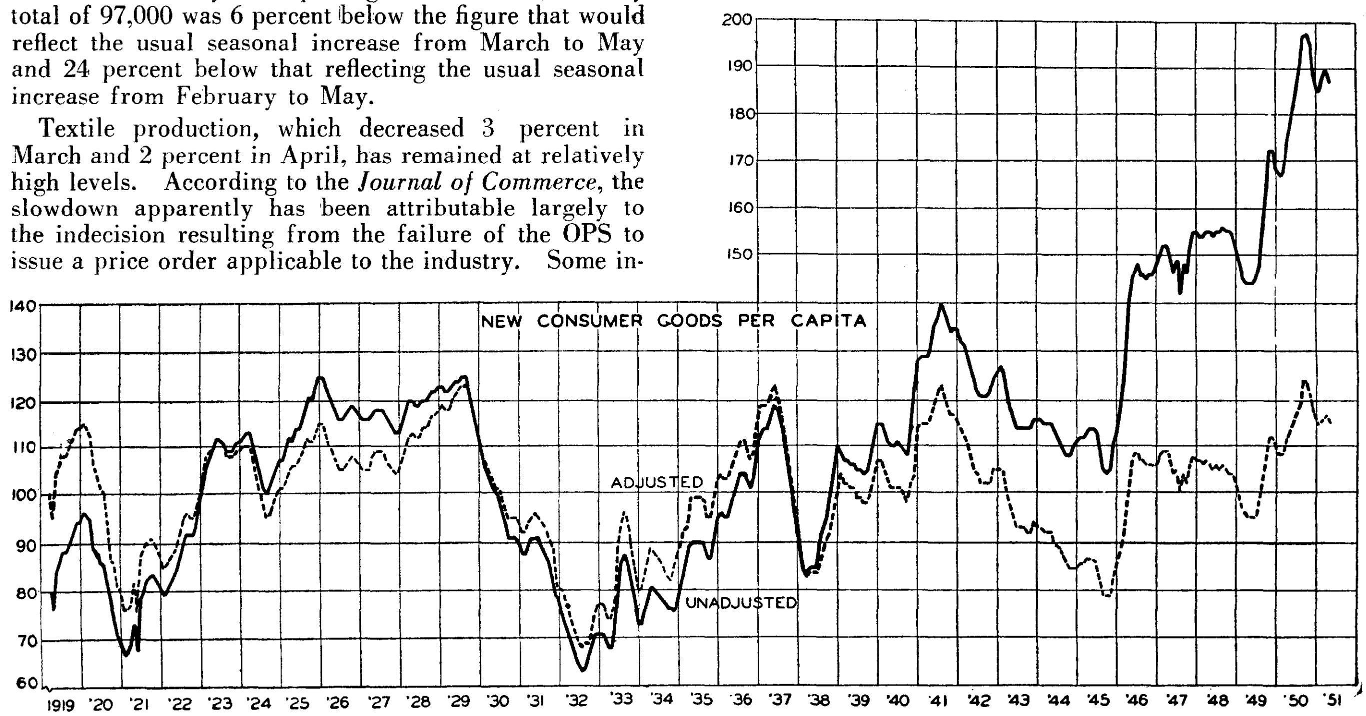
Manufacturers' Orders, Sales, and Inventories

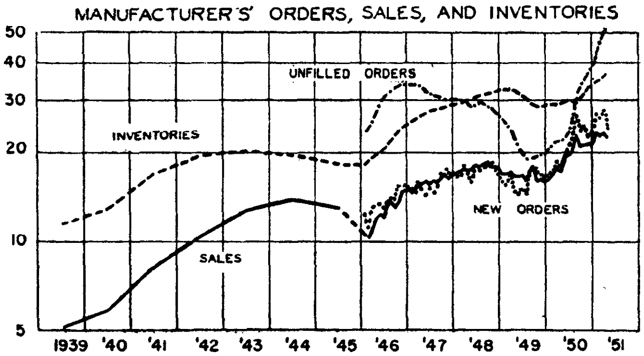
The dollar value of manufacturers' new orders during April (compiled by the Department of Commerce) was 17 percent less than the all-time high reached in March but was 38 percent more than that for April 1950. Orders for nondurable goods decreased less than did orders for durable goods; and, in the latter category, orders for producers' durable goods decreased less than did orders for consumers' durable goods.

The dollar value of new orders reported for March was an all-time high that exceeded the highs reached in August 1950 and January 1951 by $1,300,000,000 and $900,000,000 respectively. However, the record physical volume of goods represented by manufacturers' new orders probably was reached in August 1950, when prices were much lower than they were last January or March.

The recent increase in retail sales as a result of the fair-trade "price war" may stimulate orders for certain consumers' goods. However, inventories at wholesale and retail levels are still unusually large. Consequently, new orders for consumers' goods probably will decrease further in the near future. On the other hand, additional defense orders may prevent a large decrease in the orders reported by manufacturers.

The seasonally adjusted dollar value of manufacturers' sales decreased 4 percent during April, was nearly





3 percent less than the monthly average for the first quarter of 1951, but was 30 percent more than that during April 1950. According to estimates made by the Department of Commerce, perhaps two-thirds of the sales gain from March 1950 through March 1951 has been attributable to higher prices; therefore, the physical volume of March sales may have been only 10 percent greater than that of March 1950.

Because the dollar value of new orders has exceeded the sales total in nearly every month since September 1949, manufacturers' unfilled orders have increased steadily and by the end of April 1951 had reached an all-time high of $53,200,000,000, nearly 3 times the figure for August 1949, when the postwar low was reached. Of the $30,100,000,000 gain, approximately $25,600,000,000, 85 percent, represented unfilled orders for durable goods, no doubt largely defense items.

The seasonally adjusted dollar value of manufacturers' inventories increased nearly 4 percent during April to a level 28 percent above that at the end of April last year. In view of the price increases during the year, the gain in the physical volume of inventories may have been less than 10 percent. According to the Department of Commerce, " * * * the durable-goods industries have swung into production of heavy equipment and defense items where the production period is long." Therefore, if military production expands in the next several months to the extent indicated by mobilization officials, inventories of goods in process may increase further. Inventories of raw materials, on the other hand, following a sharp increase during the second half of 1950, increased little during the first quarter of 1951. The level of manufacturers' finished-goods inventories did not change materially during 1950 nor during the first quarter of 1951.

In the nondurable-goods industries, military orders have been relatively unimportant. Furthermore, retailers apparently have reduced their orders for nondurable goods substantially in recent months. Consequently, manufacturers' inventories of nondurable goods have reached unprecedented levels.

DEMAND

Retail Sales

Total retail sales (seasonally adjusted dollar values) decreased nearly 3 percent during April to a level 8 percent below the all-time high reached in January 1951 but 8 percent above the volume of April 1950.

The seasonally adjusted indexes of durable- and nondurable-goods sales have fluctuated widely during the last 12 months. However, sales of durable goods have fluctuated to a greater extent than have sales of nondurable goods. From the peak of scare buying reached in August 1950, sales of durable goods decreased 22 percent but by January 1951 had increased 23 percent again to the August level. Since January this index has decreased nearly 17 percent. Although the durable-goods index was substantially below the August 1950 level (by 15 percent) in April, sales of nondurable goods exceeded those of August 1950.

Because much of the increased buying of consumers' durable goods during recent months represented anticipation of future needs and involved commitments to pay that will extend several months into the future, a marked decrease in sales of consumers' durable goods in the next few months would not be surprising. Decreased demand may have a greater influence than the shortages that have been predicted for several months but have not yet materialized.

Department-Store Sales

Department-store sales for the week ended June 9, 1951, were 14 percent more than sales in the previous week and were 3 percent more than sales in the corresponding week last year.

PRICES

Commodities at Wholesale

	1950	*1951*	
(August 1939=100)	*June 14*	*June 7*	*June 14*
Spot-Market Prices (28 basic raw materials)	265	356	352
Commodity Futures Prices (Dow-Jones Daily Index)	319	399	396

BOOK REVIEW

The New Image of the Common Man by Carl J. Friedrich
Beacon Press, Incorporated, Boston ($3.75)

Those who despair of the Republic because they fear the greed of special interests and the indifference of men in the mass may find new courage and new hope in this volume. We believe that the author has good reason for his confidence in the common humanity of men and in the capacity of men to govern themselves.

The following comments are especially apropos today: "There is no wisdom in sentimental optimism. The coming of freedom is the reward of protracted effort. The prospects are anything but rosy. The United States States will find herself in a world full of totalitarian forces. Like little Switzerland she will have to face up to these forces. The prophets of gloom proclaim that this will mean the end of democracy and freedom in the United States. They do not know that the Swiss have grown to be the stoutest democrats with guns in hand. They do not realize that the Swiss have ever been mindful of the importance of each man's having a share in the defense of freedom. They do not realize that such a conception of military service can be a positive contribution to the education for citizenship.

Universal military training and the necessity of devoting a large part of the Nation's productive effort to rearmament do not necessarily imply a degredation of the citizens to the level of robots. On the contrary, the fact that citizenship in the United States will, for some years at least, involve great responsibilities as well as great privileges may, if the opportunity is wisely used, strengthen and make more capable the citizens of our Republic.