TWO POSTWAR RECESSIONS

SAM ROSEN *

The Post-World War II period has experienced two recessions, notable both for their similarities and differences. While the emphasis here will be upon the 1949 downturn, wherever possible its counterpart of 1953-54 will be examined comparatively.

The index of industrial production, seasonally adjusted, fell steadily from a postwar high of 105 in October, 1948 (also achieved during the prior July), to a nadir of 94 in July, 1949. For this eight-month period, the index dropped over 10%. The index of industrial production, which had risen to 137 in July, 1953, fell to 123 by March, 1954, and as late as September, 1954, was still at about 124. This represented a maximum decline of 10%, but one which lasted fourteen months.

That the two recessions were not entirely unheralded can be ascertained by reference to business and economic journals of the respective preceding periods.¹ In the case of the 1949 downturn, however, neither the Administration nor the Council of Economic Advisers responded quickly to the danger signals.² A comparable situation also prevailed in the more recent decline, although perhaps not as overtly.³

The total drop of gross national product (GNP) in 1949 was slightly less than one billion dollars. However, this reversed an upward movement beginning in 1947 which had added an average of $24 billion per year in current prices and about $2.5 billion per

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¹ See, for example, Business Week, August 21, 1948, p. 116; The Economist, April 3, 1948, p. 545; Economic Reports of the President (New York, 1949), Part II, p. 272; Business Week, January 3, 1953, p. 27; The Economist, April 11, 1953, p. 89.

² Economic Reports, 1949 Edition, Part II, p. 121, p. xv, p. xxiv, pp. 38-39, p. 43, p. 74. The minority members of the Joint Congressional Committee on the Economic Report were quick to call the turn on the President and the Council, albeit in April, 1949, when the evidence was inescapable (Joint Economic Report, Minority Views, 1949, p. 2 and 8). In late January, however, Slichter had argued against a tax increase on the ground that deflation had become the key problem. See his article in the New York Times Magazine, January 23, 1949.


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year in 1939 prices to GNP. Viewed in this light, together with the aforementioned changes in the production index, it is apparent that the economy was not merely leveling off but was at grips with a possible dangerous downswing. At midyear the Council of Economic Advisers observed: "The most serious fact confronting us is that the decline, which has reached serious proportions in some sectors of the economy, has not yet been reversed." Later, with the advantage of hindsight, the President of the United States could state: "Our success thus far in reversing the forces of recession cannot hide the high price we paid for economic instability. The downturn brought anxiety and suffering to millions who became unemployed, and to their families. It brought failure to many businesses. It reduced the opportunities for the creation of new enterprises. It hurt the free nations whose continuing revival depends upon trade with us. It caused our total output for 1949 to be some 10 to 13 billion dollars lower than it would have been if maximum production and employment had been maintained."

In the 1953-1954 decline gross product fell from an all-time high of roughly $870 billion in the second quarter of 1953 to about $356 billion in the first half of 1954, an over-all drop of some four per cent. Again this ran counter to a steady upward climb, whether expressed in current or constant prices, which had begun in the first quarter of 1950.

Nonagricultural employment decreased 1.9 million from December, 1948, to February, 1949, while the labor force decreased only 1 million. But a seasonal decline in agricultural employment raised the total of unemployed to 3.2 million in this period. A later seasonal increase in agricultural employment was still insufficient to counterbalance the growth of the labor force and a continued drop in nonagricultural employment. In April employment was still somewhat below the same month of the previous year. By July, 1949, the official number without gainful work reached 4.1 million or 6.4% of the total civilian labor force. Some critics alleged that these figures understated the true picture of unemployment.

Unemployment in October, 1953, was only 1.16 million, the lowest recorded at any time since World War II. But in both November

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and December it rose above normal seasonal changes. Moreover, the rise in unemployment was not as great as the fall in employment, indicating that the labor force had sharply declined. In January, 1954, unemployment jumped to 3.1 million, or 4.9% of the civilian work force. By March the figure was 3.7 million or 5.8% of the civilian work force. Thereafter, a decline set in (with a moderate upward movement in June), settling at a reported 3.1 million in September. Once more criticism of the official statistics for purported understatement has been voiced.

As in most recessionary developments, one of the first signs of the downturn was exhibited by agricultural prices. Beginning in mid-August, 1948, this decline persisted with slight interruptions until December 15, 1949. The parity ratio, which was at 110 for 1948, dipped to 95 by December 15, 1949, only two points above the monthly average for 1941. Wholesale food prices responded rather rapidly and followed the downward course of farm prices. By September, 1949, the consumers' price index began to reflect the slower reaction of retail food prices to the farm price dip in spite of a continued upward movement of other consumer goods prices. On balance, however, consumer prices dropped only moderately during the recession. Fuel and scrap metal prices also were shaky.

While the farm situation contributed to the downturn in 1949, it was not as significant as the diminished activity in private investment, especially inventories. Grain and other farm prices had broken sharply as early as January-February of 1948. But the agricultural break was reflected neither in a decline of production or employment nor in any significant downturn of either wholesale or consumer prices. Shortly afterwards, in fact, agricultural prices renewed their rise. And both wholesale and consumer prices displayed a narrower range of variation in 1948 than in the years immediately preceding, leading to the suggestion that the relative

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7 See the extended discussion by the Council of Economic Advisers in Economic Report of the President, January, 1954, pp. 149-158.
8 This was the first month for which improved Census Bureau samples were used and consequently cannot be compared with prior data.
10 Even so farmers along with unskilled workers were the most severely affected by the reversal in economic activity. The income of farm proprietors (along with non-farm proprietors' and rental income) diminished the most of all the components of personal income.
price stability of that year along with technical full employment confuted those who viewed stability and substantial unemployment as concomitants.\textsuperscript{11}

The explanation of the fall in prices lies in increasing quantities of goods in the United States and elsewhere. Those prices which had risen the fastest fell the most (farm prices). Moreover, a resistance to high prices by consumers set in.\textsuperscript{12} However, the relationship between the weakening of prices and disinvestment in inventories will be examined subsequently.

The Decline in Private Investment. The outstanding economic event of 1949 was the reduction of business investment. While gross national product fell by less than one billion dollars, gross private domestic investment was reduced $9.2 billion or 22%. Private investment was 16.5\% of gross product in 1948, but only 12.9\% in 1949. The other major component which declined as a percentage of gross product was foreign investment, and this merely by five-tenths of one per cent.

Table 1 indicates the changes in domestic investment by quarters for 1948 and 1949. In the last quarter of 1948 investment reached a record annual rate of about $46 billion. During the second quarter of 1949 it had declined to $32.6 billion or a drop of almost 29\%. It remained at about this comparatively low level for the rest of the year. As Table 1 shows, most but not all of the decline was attributable to a sharp switch from net accumulation to net liquidation of inventories. Plant and equipment expenditures declined by about $2 billion or nearly 8\% from the second half of 1948 to the first half of 1949. Business men indicated plans for lower outlays in the second half\textsuperscript{13} compared with the corresponding period in the preceding year, and Table 1 bears out their expectations.

Between 1948 and 1949 manufacturing expenditures for plant and equipment declined about 22\%. Manufacturing, representing 40\% of all non-farm plant and equipment outlays, was responsible for over 90\% of the decrease in the total dollar amount of outlays for new plant and equipment.\textsuperscript{14} Transportation other than railroads

\textsuperscript{11} Alvin H. Hansen, A Guide to Keynes (New York, 1933), pp. 229-230. From the beginning of 1952 through September, 1954, both wholesale and consumer prices were exceptionally stable. Farm prices reached new peaks in 1951 and declined steadily thereafter. If anything, price changes played a lesser role in the recession of 1953-54 than in 1949, especially since the farm situation deteriorated even earlier.


\textsuperscript{13} Midyear Economic Report, 1949, p. 75.

\textsuperscript{14} Economic Report of the President, 1950, p. 48.
<table>
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Source: Department of Commerce, Office of Business Economics.
Detail may not add to totals because of rounding.
declined about 30%; mining dropped about 10%; and commercial and miscellaneous industries fell about 13%. Only railroads and public utilities increased investment spending in 1949. It was maintained, however, that: “The decline in non-farm investment in plant and equipment during 1949 does not appear to have been accelerated by the downturn in the first half of 1949, but represents an orderly tapering off of programs along lines that had been planned by the end of 1948.”

Gross product dropped about $14 billion from the second quarter of 1953 to the third quarter of 1954. Gross private domestic investment was reduced $10.6 billion or approximately 19%. Unlike the earlier recession, government purchases of goods and services also declined, in this instance by $11 billion. But the government component did not turn down markedly until the start of 1954, at which time investment had begun to level out. The change in investment in 1953-54, moreover, was not from a record rate (reached in the fourth quarter of 1950), although by the last quarter of 1953 the level was the lowest since early 1950.

**Inventory Liquidation.** The building of inventories began after V-J Day and, with the exception of a slight break in mid-1947, progressed unabatedly until 1949. In the latter year a net liquidation of $2.5 billion occurred as against a net accumulation of $5.0 billion in 1948, or an overall net change of $7.5 billion. About 82% of the total 22% decline in investment was attributable to inventory changes.

Table 1 shows the movement of net changes in inventories throughout 1949. Liquidation reached a peak in the fourth quarter but was pronounced over the entire year. So abrupt was the change in inventory movement that the net absorption of gross business saving through domestic business investment fell from about $14 billion in 1948 to $3.3 billion in 1949. Liquidation of non-farm inventories occurred primarily in manufacturers’ stock. Retailers and wholesalers decreased their inventories in the first half, while in the second half retail reductions were slower and wholesalers more than restored their stocks. “At the end of the year, trade inventories combined were only slightly lower in physical volume (although much lower in book value) than at the close of 1948.”

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15 Ibid., p. 49.
Farm inventories changed from a rise of $1.3 billion in 1948 to a decline of $0.9 billion in 1949. This reflected an increased physical volume of crop marketings together with slightly smaller crop production. "It should be noted that increased price-support acquisitions by the Federal Government, which are included in farm marketings, were responsible for part of the difference in farm inventory movements. . . ." 18

The book value of manufacturing and trade inventories combined dropped from $55.6 billion at the end of 1948 to $52.1 billion at the end of 1949. Sales, on the other hand, fell proportionately more, so that the ratio of inventories to sales was actually higher in 1949 than in 1948. For 1949 as a whole the book value of manufacturers' inventories declined about $3 billion or roughly 9%; wholesalers' inventories declined about $105 million or roughly 1%; and retail inventories declined about $517 million or roughly 3%.

Changes in manufacturers' inventories in 1949 affected durable goods most. They fell about $2 billion in book value compared with an approximate $1 billion drop in non-durables. In both cases the decline was almost entirely in stock of materials and goods in process. Stocks of finished goods were remarkably steady for the year as a whole. The decline in durable inventories partly reflected a tightness in the steel supply, accentuated by a work stoppage in steel during the fourth quarter, but also the fact that durable stocks were somewhat out of line with sales in the early part of the year and required readjustment downward. 19 For manufacturing and trade taken together, the drop in the book value of inventories was due both to the fall in prices which affected replacement of stock and to actual physical liquidation. Still inventory-sales ratios, with the exception of those in wholesale trade, were well below prewar levels. 20

By mid-1949 it became apparent that: "As regards investment in expansion of inventories it is quite clear that the pace set in the first three postwar years was abnormally fast." 21 For these three years stocks were accumulated as rapidly as goods became available due to confidence in the existing market demand, as well as to the prospect of expansion, even in the face of advancing prices. But by

18 Ibid.
20 Ibid.
the end of 1948 inventories had been rebuilt to a figure approximately in line with postwar sales. First a slack appeared in the demand for specific luxury goods and then for successive items of consumers and producers goods. "With production increasing more than consumption, inventories were built up steadily. As consumers failed to absorb promptly the growing flow of goods, swelling inventories induced business to cut down its orders and to stop and . . . to reverse inventory accumulation." Instead of part of current production being used to stockpile inventories, part of current demand was met by depletion, reflecting cautious business buying policies as a result of price and sales uncertainties. The decline of prices in the first half of 1949 caused the replacement costs of inventories to fall. Business, which largely figures the value of its stocks on the criterion of cost or market price (whichever is less), marked down its inventories to the lower prices, resulting in falling book profits. Any advantages of lower prices on purchased materials and parts had to await the working off of accumulated stocks. It was observed that "... there was an important difference between the situation at the beginning and end of 1949. At the start of the year, continued accumulation at a substantial rate would have been needed to avoid the deflationary effect of a decline in inventory investment. At the close, maintenance of the size of stocks would imply no reduction in investment and hence would have no retarding influence on total output." The net liquidation of inventories from the fourth quarter of 1953 to the third quarter of 1954 averaged $4.3 billion in contrast to a net accumulation of $5.4 billion in the second quarter of 1953. At least 90% of the total 19% decline in investment was due to inventory changes, even more than in 1949. Liquidation of non-farm inventories in 1954 was offset to some extent by farm accumulation, as Table 1 reveals.

The book value of manufacturing and trade inventories fell from a record $82 billion at the end of September, 1953, to $77.7 billion (or 5%) one year later. Sales, which had reached a peak in July, 1953, fell proportionately less—the ratio of inventories to sales consequently falling by the end of September, 1954, as compared with a year earlier. In this period the book value of manufacturers'
inventories declined about $3.5 billion or about 7%; wholesalers' inventories declined about $303 million or 3%; and retail inventories declined about $514 million or 2%. Liquidation of manufacturers' inventories was concentrated mainly in durable goods which fell about $2.9 billion in book value. This was true in 1949 as well, although not as markedly.

It has been shown that a significant part of inventory reduction in 1949 was the result of lower replacement costs. This factor, however, was not at work in 1953-54 when prices were unusually stable. Also the inventory-sales ratio was down somewhat in the middle two quarters of 1953-54, whereas it did not decline until after the 1949 recession.

It has been suggested that the downturn in 1949 was largely an inventory recession. Just as in 1921-1922, investment in inventories was overextended and gave way to vast liquidation.\textsuperscript{25} That the inventory decline did not degenerate into a general depression of the 1929 variety was due to some off-setting factors which also prevailed in 1921-1922 as well as to other new elements to be examined later. Any characterization of the 1953-54 situation as simply an inventory one, however, ignores the important depressant effect of reduced government spending.

Other Investment Components. A major source of strength in the 1921-1922 recession was spending for construction which was well-maintained. A similar situation existed in 1949. Non-farm producers' plant outlays declined from $6.7 billion in 1948 to $6.4 billion in 1949. The slight reversal in the construction of factories and commercial facilities was not entirely unforseen since activity here had gone forward as soon as the War ended and had proceeded rapidly ever since. Residential non-farm construction of $8.6 billion in 1948 was virtually matched by outlays of $8.3 billion in 1949, although the fall from the second half to the first half was relatively large. Private housing starts, in fact, reached a phenomenal height in 1949—984,000 in contrast to the previous peak of 937,000 achieved in 1925.\textsuperscript{26} As Table 1 shows, residential non-farm building in the fourth quarter of 1949 reached a then record annual rate of $9.6 billion. Of all the private investment components, it was the

\textsuperscript{25} For a comparison of the post-World War I and II inventory booms see Alvin H. Hansen, \textit{Business Cycles and National Income} (New York, 1951), pp. 508-508.

\textsuperscript{26} \textit{Joint Economic Report}, January 1950, p. 49. Other non-farm private construction rose in 1949, but it is insignificant in its impact upon the economy.
only one which increased substantially by the end of 1949. Farm construction outlays declined slightly, but farm equipment spending rose by somewhat more than the decline in the former. Taken together these farm investment outlays moderately exceeded those for 1948.

The total volume of new (seasonally adjusted) construction—public and private—was $22.8 billion in 1949 contrasted with $21.7 billion in 1948, or a rise of 5%. The very minor dollar decrease in private construction was more than offset by a 33% rise in public construction. The latter development was doubtless due to the necessary removal of restraints which had been placed upon the building of schools, hospitals, highways, and the like since 1940. Briefly: "The strength in construction acted to minimize the general decline in the first half of 1948 and was one of the main forces of revival evident in the second half."\(^{27}\)

Non-farm producers’ plant spending, unlike 1949, rose moderately from the second quarter of 1953 to the third quarter of 1954 (culminating in an all-time peak of $10.7 billion in the first quarter of 1954). Most of the rise was attributable to greater outlays for stores, office buildings, and general commercial facilities. Residential non-farm construction, down slightly for three successive quarters from the second quarter rate of 1953, far eclipsed this rate by the third quarter of 1954, soaring to $14 billion or a rise of almost 15%! A small decline in outlays for farm equipment and construction (mainly due to the latter) was roughly offset by a rise in "other private construction" (basically of the institutional variety).

Combined public and private construction expenditures in 1953 slightly exceeded $35 billion, while in 1954 the estimated volume approached $37 billion. Public construction outlays were about the same in both years, so that most (if not all) of the increased stemmed from the private sector. The reverse was true in 1949.

Non-farm producers’ equipment fell about $1.4 billion from 1948 to 1949. In dollar terms this represented the greatest decline of any of the investment components excepting the incomparably larger change in inventories. Apparently postwar equipment expenditures, which were above normal and had made up most of the postwar backlog, could no longer depend on anything except

"currently accruing demand." ²⁸ The Machinery and Allied Products Institute urged the creation of a new normal by the equipment producers through stimulation of a faster turnover of the capital equipment in the United States: "... the basic approach to the enlargement of demand is through the rationalization of equipment policy by American industry. The Institute has been at pains to point out repeatedly that the possibilities of such rationalization are enormous. ... It is our conviction that the administration of equipment policy is presently the most backward area of management, in this country as elsewhere, and that the general adoption of good policy would redound to the benefit not only of producers of equipment, but of the Nation as a whole. It is here, fundamentally, that a new normal must be sought." ²⁹

What transpired in 1949 now appears to have been tacit recognition of the end of an investment "bulge," especially as regards inventories and, to a lesser degree, equipment.³⁰ For various reasons, not the least of which was the great increase in marriages

²⁸ A recent analysis ("Capital Equipment Boom and Backlog," Capital Goods Review, Machinery and Allied Products Institute, Chicago, February 15, 1950, reprinted in Joint Economic Report, June 1950, pp. 84-89) of all producers' equipment—industrial, agricultural, public utility, commercial and miscellaneous—has shown that in the 30-year span before the Great Depression, equipment outlays (in 1929 prices) moved upward, although with much irregularity, at an average rate of slightly less than three percent annually. In an effort to extrapolate this rate of growth to the post-war period as a rough measure of normal, it was found that expenditures in 1948 were about 50% above the trend figure. (Another comparable study, which used different data and a different trend calculation, arrived at a 1948 figure of around 35% over normal. See Survey of Current Business, June, 1949, p. 8. But the two variant figures can be considered the upper and lower limits of a fairly accurate range, so that equipment outlays were one-third to one-half above normal.) In January, 1950, total equipment spending was about 15 to 20% below the 1948 average, but still 10 to 20% above the trend line. In other words, there was a strong presumption that total postwar equipment outlays had been substantially above normal, and that while the stock of equipment then in use was near normal, it was still somewhat below it, i.e., the postwar pent-up demand for equipment was mainly, but not completely, over. Historically, equipment prices have lagged behind the rise in hourly wage rates, but the lag has been greater than ever in the postwar period. The average hourly wage rate in industry (including nonwage factors such as pensions, insurance, paid holidays, and vacations) was 150% above 1939 ten years later in contrast with an average rise in equipment prices of about 65%. Therefore, labor-saving via re mechanization was at a premium and had aided in establishing what may evolve as a new normal for equipment expenditures.

²⁹ Joint Economic Report, op. cit., p. 89.

³⁰ For an interesting discussion of the concept of "investment bulges" as they relate to the postwar period, see Hansen, Economic Policy, pp. 252-254.
and population growth in the 'Forties, the housing "bulge" did not terminate at that time. If it had, the recession probably would have been immeasurably more severe.

Spending for non-farm producers' equipment was at an annual rate of $22.2 billion in the second quarter of 1953 and rose a bit in the third quarter. Thereafter it declined steadily to an estimated $19.4 billion in the third quarter of 1954, or a fall of about 12%. Of the various investment components, only the inventory change exceeded the fall in equipment expenditures (a condition paralleling that of 1949). This drop in spending for equipment seems in part to have been the result of the large increase in capacity in many industries in the preceding few years and the completion of substantial defense-inspired investment plans. It was noted that: "Reductions have been largest among the smaller manufacturing firms, whose after-tax incomes have not held up so well as those of the large companies."

Future Investment Plans. Foremost among the reasons accounting for the slowing down of fixed capital investment in 1949 was the change in emphasis from expansion of facilities to cost-cutting projects. During reconversion the investment pattern took the form of closing the gap created by the low capital outlays of the depressed 'Thirties and the war years of the 'Forties. Innovations remained in the background. But by 1948 it was observed by the Council of Economic Advisers that: "In many fields, including all nondurable goods lines, the expansion of capacity to catch up with postwar markets . . . has now been accomplished; further investment will take largely the form of cost-cutting improvements and new products." A McGraw-Hill survey of industry's needs for new plant and equipment (1949-1953) emphasized that planned capital expenditures would be more for modernization, cost-cutting, and efficiency and less for expansion of capacity. In 1948 manufacturing capital outlays were composed 50% for expansion and 50% for replacement and modernization, but planned outlays for 1949-1953 were divided 75% for replacement and modernization and only 25% for expansion.

Not only the kind but also the volume of future capital investment requires examination. The previously mentioned survey by

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the McGraw-Hill Company was published late in 1948. It was the most ambitious poll of businessmen’s intentions then available, covering actual plant and equipment outlays in 1948 and contemplated outlays for the succeeding five years. All industries covered expected capital expenditures to fall 5% in 1949 which is, if anything, an understatement of what actually occurred. The anticipated drop of about 12% for manufacturing was more than matched by the facts. No attempt will be made to compare investment plans beyond 1949 with currently available data since the focus here is upon the expected capital expenditures over a five-year interval rather than changes in plans due to unforeseen factors (such as the Korean War).

The McGraw-Hill survey disclosed an expected decline in plant and equipment outlays of about 40% from 1948-1953 for all the industries polled. Manufacturing anticipated a 41% fall over the same period. Aside from manufacturing, planned mining expenditures for new plant and equipment were 33% lower for 1953 than for 1948; those for electric utilities, 13% lower; those for gas utilities, 55% lower; and those for railroads, 34% lower. Electric utilities expected to spend more in both 1949 and 1950 than in 1948 but less thereafter. Railroads planned greater outlays in 1949 than in 1948 but less thereafter.

The general outlook for capital investment at the time the survey was conducted, then, was for a steadily decreasing annual rate of expenditures. The repercussions of such a decline in the absence of countervailing forces, especially in view of the importance of capital outlays to the economy since V-J Day, were not lost on the public policy-makers. It was observed in 1949 that previously scheduled projects were being completed in most cases, but that a hesitancy had arisen with reference to new investment commitments due to uncertainties about markets, prices, and costs. Few immediately favorable investment prospects existed, although these included a special backlog of deferred replacements arising from the very high percentage of over-age motor vehicles, tractors, locomotives, railroad cars, and oil refining equipment in service.

Since about one-third of all industrial workers in the United States are engaged in producing plant and equipment, the initial

impact of reduced activity in these industries would be severe aside from possible multiplier effects. The Council of Economic Advisers took cognizance of a private study which showed that large manufacturing concerns expanded capacity on the average about 6% per year from 1948-1948, considerably faster than the long-run growth trend of industrial output. Still it felt obliged to assert that: "If expenditures for plant and equipment should decline below current levels, the decline would not reflect a general excess of productive facilities in relation to the needs of a maximum employment and production economy. For such an economy, present capacity in general is now no more than adequate and in some industries is distinctly inadequate. Continued long-run economic growth will call for further expansion of productive capacity, though quite possibly not at as rapid a pace as in the first postwar years."  

At the beginning of 1949 capital investment appeared too large to the Council of Economic Advisers. Thus, "... the proportion of resources currently being devoted to productive facilities as a whole is somewhat higher than the level that will be required on a sustained basis over the next few years to meet maximum production objectives in a self-sustaining and steadily growing economy."  

In any event, the reaction of the Administration and the Council to the decline of private investment in 1949 and to the anticipated future reduction was to urge immediate counterbalancing proposals. In addition the salutary impact of the foreign aid and defense programs upon investment was recognized. In sum, future investment plans as envisaged in 1949 were changing qualitatively with the emphasis turning to cost-cutting projects. Quantitatively, the outlook was for a progressively lessened rate of expenditures for new plant and equipment. In spite of various government proposals to smooth the way for private investment as well as the stimulating effects of large government outlays, many sectors of business exhibited a reluctance to replace old facilities and buy new ones at a rate commensurate with an expanding economy.
The McGraw-Hill survey for 1954 estimated a decline of about 5% in fixed capital expenditures. Actual outlays fell from $28.4 billion in 1953 to about $26.7 billion in 1954, or approximately 6%. The same survey indicated a further decline in 1955 of 5%. Moreover, the S. E. C.-Office of Business Economics survey in November, 1954, supported this projection of a downward drift in fixed investment.

The Decline in Requirements for Corporate Funds. Table 2 indicates the sources and uses of non-financial corporate funds from 1946-1949. Since comparable figures are not yet available for 1953-1954, no attempt will be made to relate business financing in the two recessions. But many striking facts emerge from the data concerning corporate requirements for funds over the course of the aforementioned period. First, total uses of these funds in 1949 decreased about $12 billion, or 43%, compared with 1948. "Even if one attaches no derivative or multiplier effects to such a reduction in capital outlays, this would have been sufficient by itself, in the absence of countervailing factors, to throw 2,600,000 men out of work." The overwhelming part of this reduction took place in inventories, although plant and equipment expenditures fell off moderately as did the relatively unimportant item tabbed "other current assets." Liquidation of inventories along—mainly in manufacturing—made for a net decline of around $8 billion from 1948 to 1949 in the overall demand for new capital. The expansion of inventories in 1948 required $4.2 billion of new financing, but the 1949 reversal, which was a negative use (i.e., a source) of funds, made $3.6 billion available for other uses. Requirements for financing customers also decreased substantially. This item, which had necessitated a use of $4.1 billion in 1948 (well below the 1947 figure but considerable nonetheless), dropped to a $600 million increase in customer credit in 1949.

Table 2 shows, furthermore, that liquid assets were scarcely

42 Though comparatively few in number, these corporations are responsible for approximately two-thirds of all private domestic investment. See Joint Economic Report, 1950, pp. 45-48.
43 Ibid., p. 46.
### TABLE 2.
**Sources and Uses of Corporate Funds, 1946-49** *
(billions of dollars)

<table>
<thead>
<tr>
<th>Items</th>
<th>1946</th>
<th>1947</th>
<th>1948</th>
<th>1949</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uses</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>12.7</td>
<td>17.1</td>
<td>19.1</td>
<td>16.3</td>
</tr>
<tr>
<td>Inventories (change in book value)</td>
<td>11.2</td>
<td>7.1</td>
<td>4.2</td>
<td>3.6</td>
</tr>
<tr>
<td>Customer receivables</td>
<td>4.8</td>
<td>7.4</td>
<td>4.1</td>
<td>.6</td>
</tr>
<tr>
<td>Cash and U. S. Government securities</td>
<td>-4.7</td>
<td>1.2</td>
<td>1.0</td>
<td>3.2</td>
</tr>
<tr>
<td>Other current assets</td>
<td>-.7</td>
<td>-.1</td>
<td><strong>-</strong></td>
<td>-.2</td>
</tr>
<tr>
<td>Total Uses</td>
<td>23.3</td>
<td>32.7</td>
<td>28.4</td>
<td>16.3</td>
</tr>
<tr>
<td>Sources</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retained profits and depletion</td>
<td>7.6</td>
<td>11.6</td>
<td>12.8</td>
<td>8.0</td>
</tr>
<tr>
<td>Depreciation</td>
<td>4.3</td>
<td>5.2</td>
<td>6.2</td>
<td>7.2</td>
</tr>
<tr>
<td>Total Internal Sources</td>
<td>11.9</td>
<td>16.8</td>
<td>19.0</td>
<td>15.2</td>
</tr>
<tr>
<td>External:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in trade debt</td>
<td>4.0</td>
<td>4.4</td>
<td>1.2</td>
<td>- .2</td>
</tr>
<tr>
<td>Change in Federal income tax liability</td>
<td>-1.6</td>
<td>2.3</td>
<td>.8</td>
<td>-2.3</td>
</tr>
<tr>
<td>Other current liabilities</td>
<td>2.1</td>
<td>1.0</td>
<td>.3</td>
<td>.5</td>
</tr>
<tr>
<td>Change in bank loans</td>
<td>3.6</td>
<td>2.6</td>
<td>1.2</td>
<td>-1.8</td>
</tr>
<tr>
<td>Change in mortgages</td>
<td>.7</td>
<td>.6</td>
<td>.7</td>
<td>.7</td>
</tr>
<tr>
<td>Net new issues</td>
<td>2.3</td>
<td>4.4</td>
<td>5.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Stocks</td>
<td>1.3</td>
<td>1.3</td>
<td>1.2</td>
<td>1.6</td>
</tr>
<tr>
<td>Bonds</td>
<td>1.0</td>
<td>3.1</td>
<td>4.7</td>
<td>3.3</td>
</tr>
<tr>
<td>Total External Sources</td>
<td>11.1</td>
<td>15.3</td>
<td>10.1</td>
<td>1.8</td>
</tr>
<tr>
<td>Total Sources</td>
<td>23.0</td>
<td>32.1</td>
<td>29.1</td>
<td>17.0</td>
</tr>
<tr>
<td>Discrepancy (Uses less Sources)</td>
<td>.3</td>
<td>.5</td>
<td>-.7</td>
<td>-.7</td>
</tr>
</tbody>
</table>


* Excludes banks and insurance companies.
** Less than 50 million dollars.
utilized to finance capital requirements after 1946. "Cash and deposits owned by corporations increased substantially in both 1946 and 1947, but sales or redemptions of United States Government securities were much greater in 1946 and approximately equal to the cash increase in 1947." 45 The decline in capital requirements was accompanied by a decrease of corporate debt to other businesses and to banks. Trade debt was down $200 million and bank loans fell $1.8 billion in 1949. During the first three postwar years, however, trade debt (payables) rose by $9.6 billion and bank loans by $7.4 billion. Mortgage debt of corporations showed no tendency in 1949 to change from its previous general level.

The volume of funds secured by corporations through the sale of securities reached a peak in 1948, but remained high in 1949. Whereas more than half of the net new issues were of the equity kind in 1946, in the following two years—with total net new issues increasing greatly—bond sales accounted for all of the change. In 1948 the proportion of equity issues was approximately 20% of total issues. This composition was altered in 1949 when stocks made up about 30% of the total. But debt funds played a minor role in the postwar period compared with previous years. In 1949 it was observed that: "The decline in long-term interest rates has been the result of sharply reduced corporate requirements for debt funds. New issues in the first quarter fell short of those in 1948 by 30 per cent. This development is linked with frequent reports of the completion of postwar capital expansion programmes, or the restrictive effect of high costs for equipment and construction and political uncertainties arising from the election." 46

Table 2 indicates that the switch from increasing inventories and increasing customer credit in 1948 to inventory liquidation and reduction of customer credit in 1949 permitted corporate enterprise to improve its liquidity position. Internal sources alone were nearly sufficient to take care of the requirements for capital investment in 1949, but were only 67% of such requirements in 1948. Total external sources, which reached $10 billion in 1948, were almost negligible in 1949 mainly owing to large reductions in trade debt, bank debt, and Federal income tax liability.

Internal sources of funds were absolutely less in 1949 than in 1948,

45 Materials, p. 73; also Joint Economic Report, op. cit.
46 I.e., the campaign of 1948 in which Truman won reelection. The Economist, April 9, 1949, p. 654.
but much greater relative to external sources in 1949 than in any of the other postwar years. Depreciation funds rose $1 billion while retained profits and depletion declined $4.8 billion. Corporate profits before taxes fell about 20%—from $33.8 billion in 1948 to $27.1 billion in 1949, mainly reflecting the usual corporate practice of charging inventories to cost of sales in terms of previous-period prices rather than current replacement prices. “In 1948, when prices were rising the replacement cost of inventories used in production exceeded the reported ‘book’ cost; and the opposite was true in 1949, when the course of prices was downward.”

Of course, funds available for investment and dividend payments depend on profits after taxes. In the national income accounts, the corporate profits and inventory valuation adjustment figure for 1949 is $29.2 billion compared with $31.7 billion for 1948. The decline in this measure of earnings—about 8%—was much less than unadjusted profits before tax for reasons already detailed. “The sharp difference between the two profit series helps to explain one striking aspect of corporate financial policy in 1949—the steady flow of dividend disbursements in the face of the apparent substantial decline in total profits.”

Not only were corporate profits, including the valuation adjustment, well maintained on a before-tax basis, but also they hardly changed on an after-tax basis. Thus, using this criterion, profits after taxes amounted to $18.4 billion in 1949 as against $18.7 billion in 1948. These figures are derived from Table 3 following:

### TABLE 3.

**Corporate Profits and Inventory Valuation Adjustment, 1948 and 1949**

<table>
<thead>
<tr>
<th></th>
<th>1948</th>
<th>1949</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate profits before tax</td>
<td>33.8</td>
<td>27.1</td>
</tr>
<tr>
<td>Inventory valuation adjustment</td>
<td>-2.1</td>
<td>2.1</td>
</tr>
<tr>
<td>Adjusted total</td>
<td>31.7</td>
<td>29.2</td>
</tr>
<tr>
<td>Tax liability</td>
<td>13.0</td>
<td>10.8</td>
</tr>
<tr>
<td>Adjusted after tax</td>
<td>18.7</td>
<td>18.4</td>
</tr>
</tbody>
</table>

Ibid.
The decline in tax liability (federal and state corporate income and excess profits taxes) by $2.2 billion was due to the striking fall in book profits upon which they are based. Thus, when lessened dollar requirements for inventory replacement and for income taxes are considered, corporate profits available for distribution and reinvestment were almost as high in 1949 as in the preceding year. "In addition to these, other factors—such as diminished investment needs in many industries and the unusually low proportion of dividend distribution throughout the war and in the postwar periods, when capital outlays by business for expansion created extraordinary demands for investment funds—undoubtedly contributed to the maintenance of dividend disbursements in 1949." 50

Corporate dividend payments were $7.5 billion in 1949 contrasted with $7.2 billion in 1948, substantially less in the other postwar years and $5.8 billion in 1929. Nevertheless, non-financial corporations increased their net working capital by $3.8 billion. Holdings of cash and U. S. Government securities rose by $3.2 billion while current liabilities declined by $3.7 billion. Thus, the liquidity ratio of cash and Government securities to current liabilities increased to 71% in contrast with 62% in 1948 and only 45% in the years before the war.51 Despite the recession, or perhaps because of it, corporate business closed out 1949 more liquid than ever.

Other Reasons for the 1949 Decline. The commanding role of inventories (and to a lesser extent of other domestic investment components) in explaining the pattern of events that transpired in 1949 has been emphasized by most writers. Additional reasons which have been suggested include the decline in foreign investment, monetary restriction, and underconsumption.

Net foreign investment fell precipitously in 1948 and virtually vanished as a figure in the national income accounts of 1949. In the first half of the latter year, payments under the European Recovery Program reached their peak and thereby sustained the volume of exports. In the second half, however, exports declined, culminating in the lowest postwar export surplus to that date.52

50 Survey of Current Business, op. cit.
52 Almost all of this excess of goods and services was financed by federal grants. Private direct foreign investment was relatively strong in 1949 in continuation of a postwar trend. See Milton Abelson, "Private United States Direct Investments Abroad," Survey of Current Business, November, 1949; also Survey of Current Business, June, 1950, p. 18.
From 1939-1950 net foreign investment has equalled or exceeded 2% of gross product only in 1946 and 1947. While relatively unimportant, its decline contributed in some small measure to the recession just as its high levels in 1946-1947 added buoyancy to the postwar boom.\(^{53}\)

A policy of central bank monetary restriction beginning in late 1948 is also listed among the reasons for the recession. "With a rapid expansion in the supply of commodities, with a reduction in available credit and in the purchasing power of available funds, and with satisfaction already attained for the most urgent requirements, prices softened."\(^{54}\) In 1948 the money supply did not exhibit a consequential net change. During the first six months a substantial Treasury cash surplus, used mainly to retire a roughly equivalent amount of marketable debt mostly held by the Federal Reserve, resulted in a fall in privately-held deposits and currency outside the banks. In the second half the money supply expanded once more, but to a lesser extent than in the last part of 1947.

Reserve requirements were raised in February (for the first change since October, 1942), in June, and in September of 1948. The increase in the latter month was for the purpose of counteracting an increase in reserves stemming from a substantial gold inflow net of an increase in foreign deposits at the Reserve and from sales of government securities to the Reserve by non-bank holders. Rediscount rates were raised from 1.0% in the fourth quarter of 1947 to 1.50% in the last quarter of 1948. Federal Reserve policy, however, was hamstrung by the overall goal of a stable and orderly market for government securities and by limitations upon changes in reserve requirements. Commercial banks were able to replenish their reserves by selling securities to Reserve Banks. The main effect of Federal Reserve activity, therefore, was to reduce bank holdings of government securities by about $6 or $7 billion while loans to business and individuals rose by $3.5 billion. While the Treasury surplus was substantial, it did not prevent the growth of bank credit to the private sector. As Gerhard Colm observed: "Few economists would have expected a powerful inflationary


pressure during a period of substantial cash surplus in government budgets. Neither the wartime nor the postwar inflation could be effectively controlled by fiscal measures alone.”

The rate of expansion of bank credit to commercial and industrial businesses slackened in 1948. But while this rate dipped, greater lending by other financial institutions served as an important offset. In the twelve months ending October, 1948, life insurance companies, mutual savings banks, and savings and loan associations increased credit to private borrowers by $9 billion, of which almost half was borrowed by businesses. As Table 2 indicates, internal financing increased in importance in 1948 compared with the previous postwar years, although not due to tighter credit. Net new issues also rose substantially. It cannot be denied that the steps taken by the Federal Reserve in the year preceding the recession were anti-expansionary in intent. But they were limited in scope and scarcely more than of secondary importance as a factor in the downturn that developed.

Consumer credit controls were removed in November, 1947, and reimposed the following September. In that interval total consumer credit rose about $2.6 billion. But in the preceding ten months, in the presence of restrictions, it had risen slightly more than $2 billion. Not until January, 1949, did it start to decline. It is true that expenditures for consumer durables tailed off in the fourth quarter of 1948, but the drop was hardly precipitate and still at a level exceeding that of the first quarter. The extent to which this change was a product of the renewal of Regulation W or the prior satisfaction of consumer backlogs (indicated by a slackening rate of growth of durable sales in 1948) is difficult to determine. Automobile sale credit, for example, continued to run at advancing levels in this

56 Hamberg, op. cit., p. 4.
57 The question is posed by Hamberg: “... to what extent did the decline in the rate of bank lending to business in 1948 reflect a tightening supply of credit, and to what extent did it reflect a shrinking demand for loanable funds, or the shifting of business borrowing to other sources?” (Ibid.) He inclines toward the last two reasons. The lessening demand, he explains, was due to a drop in sales to consumers and a resulting heavy pile-up of inventories. Note, however, that while the demand for working capital slowed down, the demand for long-term funds remained strong throughout the year.
period. On the other hand, bank loans to consumers declined after September, lending some weight to the argument that the revival of the selective control slowed down the sale of durables.

It is the contention of one writer that: "The most important explanation of the recession . . . is an under-consumptionist one." 59 The proof offered is a decline in the ratio of consumption to national income and a decline in the rate of growth of consumption. The former ratio (stated in terms of the relationship between consumption and GNP as a "crude" measure of the average propensity to consume) was 71% in 1947, 68.7% in 1948, and 70% in 1949. The fall from 1947 to 1948 is taken "... as an indication of the downward drift in the position of the consumption function from its immediate post-war peaks." 60 This, it is maintained, resulted in a fall in the rate of growth of consumption, particularly important because the decline came at the same time that 1948 GNP was rising at a slightly higher rate than in 1947. Consequently the rate of accumulation of inventories increased, largely unplanned accumulation.61

This position is challengeable on a number of grounds. The admittedly "crude" consumption function used has very little meaning in the period chosen for comparison (1946-1947) when the functional relation between consumption and gross income (or any other measure of income) was non-existent. An unusually heavy rate of consumer expenditures would have occurred irrespective of changes in income levels (as many postwar forecasters,

59 Hamberg, op. cit., p. 7.
60 Ibid.
61 The annual rate of growth of consumption was 10.3% in 1945, 19.3% in 1946, 12.7% in 1947, 7.4% in 1948 and 1.5% in 1949. Why, then, no recession in 1947? "The piling up of inventories is . . . not always deflationary; it depends on whether such investment is of the planned variety. It depends also on the state of the ratio of inventories to monthly sales; if this ratio is well below the figure which businessmen are accustomed to maintain, even unlooked-for inventory accumulation will not necessarily be deflationary." Ibid., p. 8.

Now the inventory-sales ratio for 1947 was well below the pre-war average. While it rose in 1948, it was still comfortably under the pre-war average and was considered neither excessive nor deficient (see Economic Reports, 1949 edition, Part I, p. 19). This was the case for total inventories or manufacturing, wholesale or retail inventories individually (see Economic Report of the President, January, 1953, p. 186). The failure of an inventory recession to develop in 1947, it seems, is best explained not solely in terms of a low ratio (a ratio which necessarily varies inversely with the business cycle) but in terms of the strength of general inflationary pressures (including a substantial rise in the export surplus) which, by contrast, had largely subsided in 1948. See, however, Hamberg, op. cit., pp. 9-11.
private and government, discovered) just because goods became available. Furthermore, the propensity to consume GNP should vary inversely with the business cycle. A lower figure for 1948, therefore, is hardly indicative of underconsumption. As Gordon has said, "...it is somewhat misleading to speak of a marginal or average 'propensity' to consume or save when relating consumption to the gross national product. The sum of the diversions measured by the difference between GNP and C is not a homogeneous total."  

The decline in the rate of growth of consumption by quarters is clearly indicated in Table 4. After the second quarter of 1948 a steady fall began. But to equate this development with underconsumption in any but the narrowest definition of that term is not well-conceived. Thus, almost all of disposable income in the second quarter of 1947 was consumed. "So large a relative expenditure at high prosperity levels could not be expected to continue for long, and ... began immediately to fall back to more reasonable relative levels. The war-induced abnormal increase in consumption expenditure relative to disposable income from 1946 to 1947 accounts for the reduced acceleration. ..."  

It cannot be denied that the slowing down of the rate of consumption expenditures contributed to the inventory recession. But so did the leveling off and eventual decline in prices, the end of sellers' domination over many markets, and the extraordinary rate of postwar capital investment. All helped change short-run expecta-

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62 Gordon, Business Fluctuations, p. 86. It has been argued that consumption should have been contrasted with disposable rather than gross income and that quarterly data should have been cited instead of annual data (Bratt and Ondrechen, op. cit., p. 98-99). As Table 4 shows, the "propensity to consume" disposable income fell more in the first half of 1948 than in the second half and actually rose in the last quarter of 1948 (when disposable income fell). Moreover, it continued to rise during the recession as did the GNP "propensity." But this is not an adequate indictment of the consumption function chosen. Theoretically, a national income propensity is not only possible, but is the one Keynes first projected. Also, as income falls cyclically, it is to be expected that consumption will decline proportionately less. This is the meaning generally given to the cyclical consumption function. Quarterly data are more representative of swift cyclical changes, it is true, but in this instance are only a minor consideration. Much more important, in addition to factors mentioned above, is that the consumption function chosen was not corrected for price changes and population growth. See, however, Hamberg, "1948-49 Recession Reexamined: A Rejoinder," Economic Journal, March, 1953, pp. 105-106.

tions with regard to inventories.\textsuperscript{64} Lastly, it should be noted that consumption expenditures began to increase in the second quarter of 1949 (setting a new record quarterly-seasonally-adjusted-annual rate) and continued to increase for the remaining two quarters.

\begin{table}
\centering
\caption{Percentage Distributions of Gross National Product and the Rate of Consumption, Seasonally Adjusted Quarterly Totals at Annual Rates, 1947–First half 1949.}
\begin{tabular}{|l|c|c|c|c|c|}
\hline
Year and quarter & Consumption (billions of dollars) & GNP (billions of dollars) & Disposable income (billions of dollars) & Ratio of C to GNP & Ratio of C to disposable income & Rate of growth of C \\
\hline
1947—1 & 159.5 & 244.0 & 165.4 & 71.2 & 96.4 & 2.1 \\
2 & 163.9 & 231.7 & 164.2 & 70.7 & 99.8 & 2.8 \\
3 & 167.6 & 233.1 & 171.7 & 71.9 & 97.6 & 2.3 \\
4 & 171.3 & 244.3 & 176.5 & 70.1 & 97.1 & 2.2 \\
1948—1 & 174.6 & 248.2 & 179.8 & 70.3 & 97.1 & 1.9 \\
2 & 177.5 & 257.8 & 187.3 & 68.9 & 94.5 & 1.7 \\
3 & 179.7 & 263.2 & 193.0 & 68.3 & 93.1 & 1.2 \\
4 & 179.8 & 267.0 & 192.8 & 67.3 & 93.3 & 0.06 \\
1949—1 & 178.7 & 260.6 & 188.8 & 68.6 & 94.7 & —0.60 \\
2 & 180.2 & 258.6 & 187.3 & 69.7 & 96.2 & 0.80 \\
\hline
\end{tabular}
\end{table}


so that 1949 consumption actually exceeded 1948 consumption. This occurred in the face of a decline in disposable income, leading S. S. Alexander to suggest that the average propensity to consume ceased to have significance in 1949,\textsuperscript{65} if indeed it had any significance throughout the entire unprecedented postwar period.

\textit{Mildness of the Recession}. The downturn of 1949 is of interest not only because it represented the first real interruption to the post-World War II boom, but also because it was relatively mild and of short duration. It remains to indicate why a sharper recession comparable to 1921-22 or 1937-38 did not develop.

\textsuperscript{64} It has been suggested that part of the fall in consumption from the fourth quarter of 1948 to the first quarter of 1949 was the result of consumers’ anticipations of a continued fall in prices. \textit{Income Stabilization for a Developing Democracy} (New Haven, 1953), ed. Max Millikan, “The Role of Economic Forecasting in Income Stabilization,” by E. E. Hagen, p. 181.

First, built-in stabilizers played a mitigating role. The progressive income tax automatically resulted in lower revenues as income declined, in addition to which the downward rate changes of the Revenue Act of 1948 were effective even though this was fortuitous rather than conscious. Again we are confronted with the fact that effective implementation of counter-cyclical measures depends upon proper timing and that proper timing depends upon accurate economic forecasting. If the Administration had been allowed to follow its own proclivities, tax rates would not have been lowered as opportune as they were. On the other hand, the sponsors of the Revenue Act of 1948 at no time based their case on a sound appraisal of economic events. Beginning January, 1954, Federal personal income tax rates were reduced by an amount estimated to add $3 billion to disposable personal income for the year as a whole. In this instance the Administration reconsidered an earlier desire to postpone the tax cut and, by September, 1953, urged that it take effect as scheduled.66

Another of the built-in stabilizers, unemployment insurance benefits, automatically responded as the number of unemployed increased. From 1948 to 1949 private wages and salaries dropped $2.7 billion, but unemployment payments rose $1 billion. Outlays to the aged and infirm, deriving from the social security program and increasing when more people leave the work force of their own volition as jobs become fewer, also undoubtedly helped to damp the deflationary movement. Farm price support loans not redeemed by producers and taken over from private banks by the Commodity Credit Corporation increased markedly in 1949. The average level of farm prices fell 24% from January, 1948, to December, 1949, contrasted with more than 50% in the twelve-month period after World War I (1920-21). Government spending in price supports rose from $300 million in mid-1948 to about $4.3 billion in early 1953.

66 Personal income dropped $8.1 billion from the second half of 1948 to the second half of 1949. Personal federal income tax payments declined almost $2 billion in the same period, while the rate of corporate profits tax accruals fell $2.4 billion. "The automatic reduction in Federal income taxes was the major reason why this 8.1 billion-dollar decline in total personal income was accompanied by a decline of only 6.4 billion in disposable personal income." Midyear Economic Report, July, 1952, pp. 109-110.

Personal income fell a mere $200 million from the first half of 1953 to the third quarter of 1954. Personal federal income tax payments declined by over $3 billion in the same period, while the rate of corporate profits tax accruals fell about $5 to $6 billion. The elimination of the excess profits tax was crucial in the latter case.
1950. All of these new compensatory features aided in limiting the extent of the decline. But as Professor Hansen has remarked: "Built-in flexibility . . . is powerless to promote a positive recovery from a depressed level." 67

From the second quarter of 1953 to the third quarter of 1954 private wages and salaries declined about $3.7 billion, but unemployment benefits rose about $1.5 billion. Payments deriving from the Old-Age and Survivors' Insurance Program rose too and were accelerated in the last quarter of 1954 due to benefit increases stemming from recent amendments to the Social Security Act. Unlike 1949, the Commodity Credit Corporation reduced its farm price support acquisitions. Government spending in price supports declined substantially over the course of the more recent recession.

Government purchases of goods and services established a new peacetime record in 1949 when they totalled almost 17% of gross expenditures. After three successive years of an excess of cash receipts, a deficit developed. These increased expenditures, by far the most important single sustaining force in the economy during the recession, included federal increases for defense, foreign aid, and public works, and state and local increases for public works. Only the government sector of the economy substantially increased its outlays in 1949. In terms of budget years, the European Recovery Program began in the first half of fiscal 1949, and aids to agriculture were at high levels both in fiscal 1949 and 1950. The budget for fiscal 1949 was increased as against declining expenditures in the three previous fiscal years. Coupled with the decreased volume of receipts due to the Revenue Act of 1948 and the recession, the result was a net deficit in conformance with modern fiscal theory. On a calendar basis there were state and local cash deficits also.

In sharp juxtaposition to 1949, government purchases of goods and services declined markedly in the 1953-1954 downturn. From a peak of $86.6 billion in the second quarter of 1953, they fell to $75.6 by the third quarter of the following year—an overall fall of 13%. All of the decline was attributable to the federal sector, more in fact than the figures reveal since state and local govern-

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67 Hansen, op. cit., pp. 544-545. "It is important to note that no emergency Government programs were adopted to deal with the 1949 recession. The 'automatic stabilizers' accounted for about half of the 6-billion-dollar increase in Federal cash expenditures between 1948 and 1949. The remainder was for purposes other than stabilization, such as foreign aid." Midyear Economic Report, op. cit.
ment expenditures increased almost 14%. While some of the decline in Federal outlays was the result of the cessation of fighting in Korea and was planned, a significant part was apparently unforeseen. Thus the President's economic report in January, 1954, states: "A moderate decline in Federal expenditures may be expected in 1954. Most of the anticipated reduction will take place in national security expenditures . . . but in addition a slight drop may occur in outlays for non-defense programs. By mid-1954 these changes may bring the annual rate of total Federal expenditures for goods and services about 2 billion dollars below the rate at the end of 1953." In actuality the rate fell by $8.5 billion in the period cited, including a fall of about $3.5 billion in non-national security programs (mostly reflecting the decline in outlays for farm price supports).

It is evident, then, that the 1953-54 downturn was more than an inventory recession. It was characterized not only by sharp inventory liquidation and a moderate fall in equipment expenditures as in 1949, but also by a substantial drop in federal outlays for goods and services. Nor can it be likened to the reconversion year of 1946 since the two wars are not comparable expenditure-wise and the amount of reconversion had been considerably less in the more recent instance.

The fact that consumer demand was sustained was another reason for the mildness of the 1949 recession. Total personal income dropped only $3.6 billion in 1949 to about $206 billion. Dividends and transfer payments actually increased while wages and salaries remained almost constant. Only proprietors' and rental income declined to any degree in the nonagricultural sector. In fact, total nonagricultural personal income rose by over one and a half billion dollars. The very slight fall in disposable income (by $1.2 billion) can be attributed to these developments and the reduction in personal taxes. Total consumption expenditures increased by $2.7 billion in 1949 to a record total of $180.6 billion. Spending for non-durables turned down slightly, but outlays for durables (particularly for automobiles, more of which were produced than ever before) and services rose. A tendency for consumer durable purchases to sag in the first half was more than offset by the complete withdrawal of Regulation W in June. In 1948 consumer expendi-

tures were 68.7% of gross product while in 1949 they rose to 70%. Thus, "... consumers in general not only did not suffer in 1949 but may have enjoyed a real flow of goods and services larger than in 1948." 69 In addition to the small decline in disposable income, consumer prices fell, so that the real flow of goods and services increased about 1.6%.70 Most of this increase in consumption, despite decreased production, was due to the large reduction in inventories which led to a rise in the flow of products and services to final buyers. Of course, not all consumers were better off, especially those who were unemployed and those in agriculture where income declined by over $5 billion.

As in 1949, consumer demand in 1953-54 was well maintained. Total personal income this time fell almost imperceptibly. A decline in wages and salaries of over $3 billion from the first half of 1953 to the third quarter of 1954 was almost completely offset by a rise in dividends, interest, and transfer payments. Proprietors’ and rental income was virtually unchanged (in contrast to 1949), although farm income was down substantially from its peak in 1952. Disposable income rose from $250.4 billion to $253.2 billion (an all-time peak) due to the stability of personal income and the reduction in personal taxes. Total consumption expenditures increased by about $4 billion to a record rate of nearly $235 billion, paralleling a similar development in 1949. Spending for nondurables rose after a slight decline through the first quarter of 1954, while outlays for durables (especially for automobiles) fell by almost an equivalent sum. This was exactly opposite the 1949 experience. An increase in spending for services in continuation of a postwar trend accounted for practically all of the growth in consumption spending, although the rate was down somewhat.

While net personal saving decreased in 1949, net liquid saving (currency and deposits in banks, bonds, and stocks minus net increases in debt) grew substantially for the first time since 1946. This growth basically reflected repayments on consumer debt in excess of current consumer borrowing (although at the end of 1949, 29% of all spending units had no liquid assets compared with lesser proportions in the three previous years). By the third quarter of 1954, net personal saving was down slightly from the rate achieved in the second quarter of 1953 (but only after a rise

69 Joint Economic Report, op. cit.
70 Survey of Current Business, op. cit., p. 3
through the first three months of the former year). Liquid saving in the first half of 1954 was much greater than in the same period of 1953, again due to a shift from expansion to contraction of consumer debt.

Other factors which contributed to the mildness of the recession of 1949 included an increase in the volume of mortgages purchased by the R. F. C. and payments to veterans. Even more important, as Slichter indicated: "... there had never been a boom of the dimensions of the recent one which was not accompanied by vigorous speculation and a rapid rise in debt. The recent boom, however, was conspicuous for the absence of speculation, and the rise in debt was moderate." 71 Regulation of security exchanges and of the issuance of securities by the S. E. C. and the margin requirements of the Federal Reserve Board played a vital role in curbing speculative activity. The ratio of personal and corporate debt to income was not unusually high, while personal and corporate liquidity was much larger than debt.

Private investment, except for inventories, largely sustained itself in 1949, as was previously shown. In this respect the unfulfilled demand for housing and general construction was especially important. As in the early 'Twenties, the economy seemed to be in the upswing phase of the building cycle which typically modifies any general business downturn. Furthermore, investment forecasts were immeasurably improved by the development of widespread samples of businessmen's intentions regarding outlays for plant, equipment, and inventories. "Knowledge of the prospect in that direction is one of the most important keys to the short-run outlook." 72 It is hard to determine how much weight businessmen give to forecasts of any kind, but if the McGraw-Hill and Dun and Bradstreet publications are at all representative, investment plans are carefully followed.

In 1953-54 private investment was at high levels except for inventories and equipment. Again residential construction was a major source of strength and to a greater degree than in 1949. Important factors here included the increased availability of mortgage funds, lower down-payments, and longer term mortgages. Most of the increase in private housing was under Veterans Administration-guaranteed loans. Revised housing legislation, effective

72 Council of Economic Advisers, Fourth Report, p. 31.
in August, 1954, liberalized F.H.A.-insured mortgages as well. In both recessions state and local government purchases of goods and services rose, as they have quite generally since the end of World War II. Net foreign investment, which was a contractive factor in 1949, shifted favorably by over $2 billion in 1953-54 as a result of an increase in exports and a small reduction in imports (not financed by U. S. grants or gifts).

The part played by the monetary authorities in both recessions should be mentioned. Cheap credit was maintained in 1949 by several reductions in reserve requirements and by easing the terms and availability of credit to private and governmental borrowers. Long and short-term interest rates declined and commercial bank loans expanded, particularly in the second half of 1949. In the first half of 1953 restrictive monetary and debt management policies had "... a more potent effect than was generally expected." 73

In May and June of that year, however, Federal Reserve Banks added over a billion dollars to their holdings of government securities. Between August and December more government securities were purchased by the Reserve System. Reserve requirements were reduced several times between July, 1953, and July, 1954. Discount rates of Reserve Banks were lowered both in February and the spring of 1954. Interest rates began to decline after June, 1953—a decline which "... has been as sharp and as widespread as in the comparable phase of any business downturn since World War I. It has extended throughout the credit market, affecting in varying degrees all types of paper and securities." 74

Last, but not necessarily least in importance, the actions of businessmen and the existence of collective bargaining on a wide scale were restraining influences. The general reaction to lower profit margins did not take the form of accelerated cutbacks, price cutting, wage reductions, and layoffs. Those that occurred were relatively moderate. In the words of the Council of Economic Advisers: "... businessmen all throughout the postwar period, and particularly during 1949, exhibited far more economic understanding translated into practice than in those past periods which presented them with somewhat comparable difficulties. To be sure, there were mistakes of price policy and other policy during the inflationary boom. But in contrast with the period following World

War I, the management by business of its inventory and pricing policies was definitely superior. Similarly, the fact that business knew enough not to react to the first signs of the downturn by wage cuts or by layoffs (beyond the minimum in the face of dwindling markets) was a sustaining factor. . . .” 75 The same was generally true of the 1953-54 recession.

The strength of business confidence in both postwar downturns was undoubtedly the result of a better economic atmosphere than had prevailed in previous times. New elements of strength included collective bargaining on a wide scale and with public support; minimum wage and maximum hour laws; old age and unemployment benefits; payments to veterans; the farm price support program (of greater significance in 1949); regulation of security exchanges and the issuance of securities; maintenance of cheap credit by the monetary authorities; adjustment of taxes to the specific economic situation; and others. Special mention should be given to the trade unions which were stronger than during other recessions and probably restrained some employers who would have otherwise reduced employment as a matter of course, and to the farm price support policy which guaranteed against disastrous drops in the market demand of farmers such as occurred in 1920 and in the early 'Thirties. Under other circumstances businessmen might have acted differently and unions might have lost membership (as during other downturns). Again under other circumstances, such as a sharp fall in capital investment, the recessions might have been immeasurably more severe and prolonged. These circumstances, however, did not obtain in either 1949 or 1953-54.

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75 Council of Economic Advisers, Fourth Annual Report to the President (Washington, D. C., 1949), pp. 27-28. It may be of interest to note that this report was written after Edwin G. Nourse had left the Council.