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ECONOMIC PROBLEMS OF PARTIAL MOBILIZATION

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14 January 1953

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Mr. Leon H. Keyserling, Chairman, Council of Economic Advisers, was born in Charleston, S. C., 22 January 1908. He received an A.B. degree from Columbia University in 1928 and an LL.B. from Harvard in 1931. He was an assistant in the Department of Economics at Columbia, 1932-1933; attorney, Agricultural Adjustment Administration, 1933; secretary and legislative assistant to Senator Robert F. Wagner, 1933-1937; general counsel, U. S. Housing Authority, 1937-1938; deputy administrator and general counsel, U. S. Housing Authority, 1938-1942; acting administrator, U. S. Housing Authority, 1941-1942; acting commissioner, Federal Public Housing Authority, 1942; general counsel, National Housing Agency, 1942-1946; vice-chairman, Council of Economic Advisers, under the Employment Act of 1946, 1946-1950; Chairman since 1950. He is the author of various monographs, articles, and essays on full employment, economic stability, housing and related subjects, and contributor to *Saving American Capitalism*, 1948. He won second prize (10,000 dollars) in the 1944 Pabst Postwar Employment Awards for essay, "The American Economic Goal; A Practical Start Toward Postwar Full Employment." Mr. Keyserling is a member of the Phi Beta Kappa fraternity.

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CAPTAIN HAYES: Our lecture this morning is on economic stabilization in our time and on the methods of insuring it for the future. Our speaker has done a great deal in this sort of economic crystal gazing for a long time and with considerable courage and success. In 1944 he won the Pabst Postwar Employment prize of 10,000 dollars with an essay entitled "The American Economic Goal: a Practical Start Toward Postwar Full Employment." He has been a member of the Council of Economic Advisers since it was created in 1946 and has been its Chairman since 1950.

He is no stranger to this college, as he has given us considerable help in participating in seminars and in group discussions. So I am glad to welcome and to introduce Mr. Leon H. Keyserling, Chairman of the Council of Economic Advisers, who will address us on the subject of "Economic Problems of Partial Mobilization."

MR. KEYSERLING: Thank you very much for the generous introduction. I had hoped to stay over for lunch today and meet with a few of you, but I am in a rather peculiar situation. I have to make a new landing, shortly, or possibly a new take off; and that has sort of mixed up my schedule a little bit. However, I hope that in the question period after this talk today, we may be able to cover some of the things that I may not have covered in the more formal lecture.

I want first of all to quarrel a little bit with the subject that was announced for my talk. Not too long ago I was at a dinner where I had to make a talk. Someone turned to my wife and said, "What is Mr. Keyserling going to talk about?" She said, "I don't know, except that it certainly will not be the subject assigned to him."

Now, just in one respect I am not going to talk about the subject assigned to me, because, as I heard it, it was economic stabilization. From the very beginning of the new defense program in mid-1950 I have been one of those who were a little skeptical as to whether our primary job in the economic field was stabilization. I have thought our primary job was production. So I shall talk of the "Economic Problems of Partial Mobilization."

Of course stabilization and production are interrelated, but I felt then that it is like the difference between these new stabilizers which have been put upon large vessels crossing the ocean, to prevent them from wallowing too much, and the turbines or other motors which drive the ship through the water. The basic equipment of such a boat is the

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motors which drive it through the water. The stabilizers are interesting and helpful, but secondary. And woe betide the vessel if it tried through its stabilizers to keep afloat in a heavy sea without moving forward. If it tried to remain stationary, it could not be stable; and, far more important, it could not get to the port which it was seeking to reach.

That is a point which has gotten me into some hot water from time to time. But I think it is an important point in economic policy. I think it is an important point relating to military policy, although, I am not going to touch upon that. And I think it is very important to an understanding of what makes the American economy tick, and what makes it not only actually but potentially better able than any other economy in the world to support whatever industrial and other economic burdens may be forced upon it by the turn of world events.

I had the pleasure of talking out here just about the time of the commencement of the Korean struggle, and just at a time when there was a great deal of controversy and discussion about economic policy. There were those who felt that a defense program of the size contemplated at that time would impose so heavy a burden upon the domestic economy that in the long run the economy--the civilian economy, the industrial economy--might be weakened to the point where we would be in danger that the underlying defense effort would have insufficiently strong productive power behind it.

Therefore there were those who on that ground sought to do one of two things: either to shape the defense program to their estimates of what the civilian economy could stand, or to undertake in the field of the civilian economy an excessively restrictive program in the thought that it was the only way to satisfy the contemplated defense build-up.

I disagreed with that at the time; I vividly recall that some of that disagreement was the subject of a rather interesting debate which I had here, as I say, less than three years ago. I made the point, first, that it was not my job as the President's economic adviser to have anything to say about the size of the defense program. The size of our defense program ought to be determined by a complex of military and civilian advisers of whom I am not one. The point I made was that, short of that level at which the defense program imposed a seriously weakening burden on the economy, it was not the job of economists to stop being economists and become pretenders or medicine men or magicians, warning, contrary to what seemed to me to be the facts, that the American economy could not stand what it seemed to me very clearly it could stand, provided only, of course, that it was necessary for it to stand it in terms of national and international policy, which, as I say, is outside my field.

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I made certain projections in the middle of 1950 as to what it seemed to me the economy could accomplish over the next two or three years, as the defense program was then projected. And it seemed to me that if we undertook to build up our productive power at the same time that we built up our military strength, we would have, after getting over a reasonably quick hump, an economy strong and productive enough to carry what is called the industrial mobilization base, or that part of our industrial economy that supports the defense program and related programs, and to carry also a level of civilian supply which would do two things: first, keep our general economy in good shape; and, second, provide the people with sufficient goods for the long pull, so that they would not be so hard pressed that they would turn against the defense program on the ground that over a long pull, short of total war, they would suffer deprivations which could have been taken advantage of by those who agitated upon the people's feelings.

That does not extend to the question of how much I thought the American people ought to take. It simply goes to the political fact that for a long and enduring program it didn't seem to me too wise not to try to satisfy all three sides of the triangle--the industrial side, the military side, and the civilian side--if we could. The question was whether we could.

I did not mean by this that for reasons of satisfying the other two sides of the triangle--the industrial build-up and the civilian side--the defense program should be cut back below the necessary level as properly determined by those of whom I am not one. As a matter of fact, there have been occasions throughout this period when certain restraints were put upon the defense build-up, which were undertaken, at least partially, in the thought that our economy required these restraints. I felt differently, and I expressed my differences at that time.

Let us look a little more specifically at what happened over this three-year period, and its lesson for the future.

I have made some reference to the three sides of the triangle. Any economy may be regarded as a force working within a three-sided island, which has to protect each of the three sides where it is exposed. The forces working within the triangle are our underlying resources--our productive resources, our labor force, our plant and equipment, our managerial skills, our financing system, and our over-all institutions as they are deployed through the instrumentality of Federal, state, and local governments.

The three sides of the triangle which need to be served are, first, the servicing of 155 million people with the needs of life--food, clothing, recreation, education, medical care. We must remember that in the United States what we call the needs of life would be called niceties or luxuries

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in other countries, because the standard of living has been a thing which expands with the power of an economy. So the first great purpose of any economy is to service the people with the ultimate objectives of consumption.

The second great objective of any great economy, regardless of its form, is the building up of its tools and equipment, because that is the source of production for consumption. Those tools and equipment exist in the railroad track, in the factories, on the farms, and everywhere else where material of one kind is transmuted or transformed into material of a more useful kind by the industrial process.

Any economy must remember that, while it is serving the consumers, it must at the same time, whatever its annual output of production, service the building up of its productive facilities; if it doesn't do that, it is squandering its sustenance. If it consumes at so high a rate that it doesn't leave a large enough part of its production over to go into the expansion of plant and equipment and the improvement of tools, then it is squandering its sustenance and is getting weaker rather than stronger. That is the second side of the triangle.

The third side of the triangle consists of all those things which the Government does for the people, things that the people want to do together with the Government rather than doing separately. Those include all the things which the Government does to command part of our annual resources, whether it be education or roads or whether it be national defense.

Those are the three sides of the triangle, which our productive force operating at the center must serve; and the balance in which it serves those three sides determines the over-all condition of the economy and its future.

In 1948 which was the boom year before Korea--and I will take 1948 rather than 1949 because in 1949 there was some economic recession--how were those three sides of the triangle being served? I will have to express this in dollars, but I will express all of the dollars in the 1952 price level, as indicating a uniform basis for the comparisons that I am making in terms of our real wealth. In other words, if I say that something that was 5 dollars is now 10 dollars, it doesn't mean a 50 percent change with inflation. If I say that something is 10 which was 5, it means that the actual production in terms of tangible goods is twice as great as it was at the time when I say it was 5. I have adjusted all these figures to a uniform price level. I have taken the 1952 price level because that is the most recent. But if I had taken the 1948 price level, or if I had taken the 1862 price level, I would have used different figures, but the relationships would be the same and the situation would be the same.

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In 1948 the total output of the economy was in the neighborhood of 275 to 285 billion dollars. That was the total value of all the goods and services, of all the economic wealth, that we produced, or, to put it in another way, converted from one form of wealth into some more useful form of wealth. That is what we call the gross national product.

That gross national product was being divided among the three sides of the triangle approximately as follows: Roughly speaking, about one-seventh, or 40 billion dollars plus, was going into business investments or capital formation; in other words, the building up of our productive tools to produce even more of the things we need than we produced in the previous year. And about one-seventh, or 40 billion dollars plus, was going into programs of the Government, including national defense, which then was running about 12 or 13 billion dollars a year. That left about five-sevenths of this 275 to 285 billion dollar pie for consumption. About five-sevenths, or about 70 percent, was close to 200 billion dollars. That is the way the economy was functioning in 1948.

After the Korean outbreak in mid-1950, there was a vast acceleration of the defense program. That raised the question as to how these three sides of the triangle should be re-related; and I have already indicated the conflicting thoughts as of that time as to what might be feasible.

I want to underscore again that the conflict in thought was not between those who felt that the defense program ought to be lower and those who felt it ought to be higher. It was between those who felt that the three sides of the triangle in their entirety could be longer and those who felt that they had to be shorter. It was not an issue at all of the size of the defense program. It was an issue of what the economy could support, and from that might be drawn certain implications about the defense program.

Well, in mid-1950, at which time the output of our economy was rather similar to the 275 to 285 billion dollars that it was in 1948, because we had had a slight recession in 1949 and then the beginning of a recovery in early 1950, I felt that with some intensification of effort we could expand the output of the economy by more than the then-projected size of the defense program, not overnight, but within a year or a year and a half, and thus be relieved of the stresses and the strains of the program, and thus make it more feasible to continue the program insofar as in the judgment of the appropriate persons it remained necessary to do so. And that raised the question of controls.

Now, it is perfectly obvious that the function of any economic control in the final analysis is to redeploy this force that you have at the middle of the triangle among those three sides. That may seem an oversimplification of the purposes of controls; but there isn't any kind of control, direct or indirect, that doesn't have that purpose.

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For example, if you control the flow of materials through allocations, you are obviously, to take one example, shifting the flow of steel from the building of new hotels to the building of weapons of one kind or another, or to building steel plants because you want to expand the steel capacity. In either event by that particular control you are trying to redirect these resources, your productive resources at the center of the triangle, among the three sides.

That may not seem as obvious with an indirect control such as taxation. But there again it is true that, if you increase the taxes on consumers, for example, by raising the personal income tax, then you are doing it, at least in a defense period, in the thought that, since consumers will have less to spend because the taxes are higher, you get less inflationary pressure or less social resentment. You divert part of your resources away from consumption over to the servicing of the industrial mobilization base or to servicing the defense program.

That is also true of price and wage controls, although it is sometimes not recognized by those who do it, before they do it, and consequently the program is not very systematic. But its final and fundamental purpose is to ease this rationing of resources when you don't have enough resources in an emergency to cover fully all three sides of the triangle.

Now, the question arose: In a period like that immediately following the Korean outbreak what relative emphasis should be placed upon the reallocation of this productive force among the three sides of the triangle, and what relative emphasis should be placed on increasing the force so that you could service all three sides of the triangle better? And that was a very important issue of economic policy, and to a degree of military policy, just in the middle of 1950 and for some years thereafter.

One might say that there isn't any conflict at all between those two purposes. Why not have a maximum control program, which is designed to reallocate your existing resources, and maximize production together at one and the same time? Well, the answer is that you can't have a maximum of both at one and the same time, because, while they are to a degree supplementary, they are to a degree inconsistent in the productive kind of economy that we have.

In other words, you can carry a wage freeze to the point where you have no machinery within the functioning economy for the reshifting of labor. Let us take an example. Suppose wages were absolutely and permanently frozen in 1950 at a time when wages in the steel industry were much lower than wages in the automobile industry, at the very time that you wanted more workers in steel and less workers in automobiles. Well, you could have frozen them completely; but then you would have had to conduct a forced manpower program for getting your workers transferred from automobiles to steel. One control would have led to another.

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The only way you could do it in a time of partial mobilization would be to put a chain around the leg of everybody in the country and pull them from one place to another through forced central direction. There would be nothing left of flexibility in the functioning economy to do the job through the tools to which it was accustomed. And one of those tools is differentials in wages. I take that as just one example.

The same thing is true in the price field. You could have frozen absolutely the prices in the entire economy. But if you had done so, you would have frozen certain maladjustments of relationship between different types of production, particularly since some of those groups had gotten earlier into defense production. In other words, the price device and the wage device are two tools which in our kind of enterprise system you want to have functioning.

Even during World War II, at a time when we had an immensely more difficult job reallocating our scant resources, we still left the economy functioning to a degree. We had stabilization formulae, but we did not have absolute freezing. That applies not only to prices, but to wages and other things.

There are other respects in which, if controls are carried too far, they will interfere with production, although, controls to a degree are necessary in these kinds of times. That is an illustration of the difference between the stabilizers and the turbines that drive the ship. You don't want the stabilizers so heavy or taking up so much space or so costly that you can't afford to put enough into the motor.

Well, I think these decisions were made on a fairly rational basis, although, since there was a tendency to fight the last war rather than to get ready to fight the next war in more fields than one, I think there was a tendency to move to controls a little bit too much like the World War II pattern, not recognizing that in this kind of limited mobilization it was a very difficult thing. I personally happen to think that a good deal more emphasis could have been placed upon expanding production. But I think a reasonably good job has been done.

What has happened in consequence of the clash and reconciliation of these two competing objectives? I wish I had mentioned these figures a little earlier, because it is so long since I cited the other figures that you may not get the comparison. Anyway, the American national output in 1948 was 275 to 285 billion, of which the sum of about 40 billion was going to investments and about 40 billion to government programs, and about 200 billion to consumption.

Where did we stand in the last quarter of 1952, or as we enter upon 1953? In real terms, measured in the same price level, the national output has risen from the 280 billion dollar figure--I take that as the

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middle--in 1948 to 355 billion dollars now. In other words, our national annual output in this four-to-five-year period has risen from 280 to 355, which is a rise of 75 billion dollars.

That is a perfectly staggering thing. I mean, when you talk about 75 billion dollars, most people in most countries in the world would think they were talking about the whole output of an economy, or 5 or 10 times the output of an economy. But that is simply the rise which has taken place in the output of the American economy over this, let us say, period of four and a half years, from 1948 to 1953, in constant prices. If you divide that by four, you get an annual increase in our national output of 15 to 20 billion dollars.

The increase in the defense program over the same period of time, or in the programs of the Government--because the increase in the programs, of the Government has been about the same as the increase in the defense program--this figure of 40 billion which I have cited, has risen to 80 or 90 billion, depending upon how you calculate it, at what point of time, and what kinds of government programs you include. But for our very rough purposes this will do.

A very startling fact about the American economy is that our national output in these four or five years has increased by considerably more than the increase in the defense program. In consequence of that, not only have we not stripped the civilian supply, but in addition we have not stripped the resources available for building up the productive base of the economy. The level of investment in plant and equipment and of the sharpening up of tools is running at a much higher annual rate, and will run at a much higher rate in 1953, than it did in the boom year of 1948. So we are constantly further increasing our productive capacity.

In summary, then, as of now, instead of having a 280-billion-dollar output, we have a 355-billion-dollar output. Out of that 355 billion dollars you might take, let us say, in round figures, 80 billion for servicing that side of the triangle represented by the national programs, the public programs, including defense. That leaves 355 minus 80, or 275 billion. So that you have 275 billion for consumption and for the industrial build-up, whereas you had 200 plus 40, or 240, in 1948. So we have a higher level of consumption now and a higher level of industrial build-up than we had in 1948.

That has been done by placing sufficient emphasis--I don't think it has been sufficient, but anyway, it has been done by placing considerable emphasis--upon the expansion of production, particularly on the expansion of the steel output, the electric power output, the petroleum output, the chemical output, and all those other things most closely related to the defense program.

Some of you may say: "The total output has increased by more than the defense program," but does that apply as to the specific items which a defense program utilizes? In other words, it wouldn't make much difference, it wouldn't be very significant, if our total output had increased more than the defense program. But if the increase in steel production, let us say, had been zero and the increase in defense products needing steel had been 50 times it would make a great deal of difference. I am just taking arbitrary figures as an example. In other words, you can't add steel and wheat together for the purpose of dividing that sum again, and the total output then would be irrelevant. But in this case the total output figure is a very good measurement of the amount by which there has been an expansion not only in the over-all economy, but in these specific areas, which is at least equal to the defense build-up and has in some respects exceeded it.

In other words, with respect to steel, we have a larger steel supply now flowing to civilian and industrial purposes than we had in 1948, because we have had an enormous expansion of capacity. And that is true in these other lines, which I haven't time to mention now.

Let us examine the implications of this phenomenal change which has taken place in the economy. But let me say first that in some respects it is a more remarkable and a more significant industrial accomplishment than occurred during World War II, for these reasons.

One of the reasons given by those who in mid-1950 were so dubious of my estimates of what we could produce was this: "Well, this situation in mid-1950 is very different from the situation at the start of World War II. At the start of World War II we had not completely recovered from the depression. We still had 7 or 8 million unemployed. We had a lot of unused and slack resources. This time we are starting out in mid-1950 without any slack resources."

I tried to persuade them that it was not so. In the first place, while the actual unemployment in mid-1950 may have been only 3 or 4 million, as against the 8 or 9 million that we had in 1939, I felt that this was more than made up by the fact that, at least so far as our intentions went, the build-up of the armed forces was projected at only 3 or 4 million in round figures, whereas in 1944 we had 12 million in the armed forces. Therefore I felt that in terms of the labor supply in the partial mobilization we had more abundant resources than we had had during World War II.

I also pointed out in certain other respects, in terms of technology, which is really the great nonsecret weapon in the American economy, that, if the program were a well-ordered one, there was no reason why we couldn't do an even better industrial job than we had done in World War II.

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The second reason why the accomplishment is in some respects more remarkable is that we have done it, not under the forces and pressures of a full war economy, but under pressures, more intense than those of 1949, but nonetheless in the gray period between peace and war. In other words, the accomplishment has been without the forces and pressures of 1944.

As an illustration of that, the work week in industry in 1944 was about 48 hours. It is now about 40 hours. In other words, we are now producing a national output not only larger than in the year 1948 but even larger than in the peak year 1944. If I recall correctly, the national output in 1944, again measured in current prices, was about 310 billion dollars. As I said, it is now about 355 billion. So we are not only as high as I said we were above 1948, but in our total national output we are about 40 billion above the peak war year 1944.

And it is being done with a 40-hour week rather than with a 48-hour week, which is a tremendous differential. It is being done without having in the working force an excessively large number of women and minors, whom normally you would prefer being elsewhere, but who were drawn into the labor force in 1944. So a much greater productive economy now is being accomplished at a more leisurely pace, much more sustainable.

But, anyway, despite the fact that we have done that job, we have that differential between the work week now and the work week in World War II. We have there alone, aside from our growing technology, a possibility of increasing the labor input by one-fifth or 20 percent, without taking additional people into the labor force. We have population growth. We have our technology, which is expanding more rapidly than it was.

But, aside from the possibility of total war, assuming that we move along in this gray period for a while, we are moving at a well-gaited pace. We are moving now into a situation where it should be possible shortly to remove practically all of the direct controls, so long as we maintain adequate fiscal measures, adequate tax measures, and adequate credit measures, to dampen down inflation and increase our national production a little further.

Looking a little further into the future, I would like to make some predictions now, since I won't be here for them to catch up with me. But here they go.

Ten years isn't such a long time in history now, so let us move on to 1962. All I am saying is apart from a general world conflagration, not because I am making any prediction on that score, but only because that is something that everybody has something to say about, but nobody has any relevant data about. So I am going to assume that we are going to go along in as good a situation as we have now.

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We have a national output now of 350 billion dollars. I believe that within 10 years, by 1962, we can raise that from 350 to 475 or even 500 billion, measured in the same price level, that is, without inflation. I arrive at that, not by lengthening the work week, but merely by factoring in the normal growth in population, the normal growth in the working force, and what I call the normal growth in technology. The actual technological increase that I use for productivity increase is about 2 percent a year, which is more conservative than, and which is less than, we have done in the last few years; this doesn't take into account the practical application of science and invention, and makes no allowance at all for the fact that certain types of energy not being now used for industrial purposes may at least begin to be used within the next 10 years. So it is a very conservative estimate.

On that very conservative estimate I assume that the American economy, if it remains healthy, can raise its national production at an annual rate which would bring us to 475 or even 500 billion by 1962. And, while that may be completely wrong, every forecast I have made in the past as to our national output growth has understruck the mark. Some of them were much less conservative than I think this one is.

If we do it in that time, it isn't something which we will do in 1962, in 1960, or in 1956. This is something that you begin doing now, because where we are in 1962, barring an international conflagration, will only be the composite of all the private economic policies and all the public economic policies between now and then. In other words, this is not talking about something that is going to happen six months from now, where the situation is already frozen, the die is already cast.

But if we follow wise private economic policies and wise public economic policies--it depends on what people do and I am not getting into any argument about what the policies might be--then a nation as great and strong as ours has the power to achieve that level of production without increasing the work week, without the force and pressure of a war economy, and without the kind of controls that we now have.

With that kind of national product this would follow: The question of what part of our resources we should put into national defense--I define national defense not only as our own military build-up, but as the participation which we think is necessary in other defense activities and economic activities throughout the free world--in my judgement from now on out is largely outside the realm of economics.

If we should decide that in the interest of optimum national security--I am not talking about full mobilization; I am not talking about a war program--if we should decide upon an appraisal of the international situation that, in accord with the philosophy of what we call partial mobilization, the defense effort should be 5, 10, 15, or 20 percent

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faster than it now is, or larger than it now is, it is so well within the capacity of our economy to stand such an effort that it should not be set aside on economic grounds, because the productive power of our economy, even at that rate of defense expansion, would more than cover the acceleration that I am talking about.

So far as saying it would require higher taxes, taxes are simply the distribution of a burden which is imposed by the size of the program. In other words taxes are higher now than they were in 1948, but industry still has more goods and services for the building up of its capital equipment, and consumers have more goods and services. Taxes are simply a measure of the deployment of these resources. If you increase production so that you have more left over from two sides of the triangle, for servicing the third side, represented by the defense program, then you have more; and if you haven't done that, you haven't any more. Taxes simply determine whether you impose this burden in one particular pattern or another pattern.

Well, anyway, over the next few years, if our national objectives should require the expansion of our defense effort, we can well afford it within our economic resources without strain, and, in fact, have a larger product available for civilian purposes and for our industrial build-up than we had over the past few years. The demonstration of that is so near in our experience since 1950 that it should no longer be challenged, because those who said otherwise in 1950 have been discredited by the evolving facts between then and now.

Now, on the other hand--and I want to make clear that I am not arguing for expansion of the defense program, because that is not my job--if the best judgment of those who are responsible is that we can afford to get along with a smaller security program, that it will be adequate to protect our national security, then obviously, and you won't misunderstand me--the defense program is wasteful in a purely economic sense. It doesn't build up our productive resources in the way that a steel plant does or raising crops does. Obviously, if we didn't need any defense program, we wouldn't want any. But we don't live in that kind of a world.

But if the judgment of those who are qualified is that a smaller defense program, in a situation where we have to make a calculated judgment based on calculated risks, is adequate, then we should not shrink from reducing the size of the program on the ground that if there is a reduction of defense spending, this economy will go into a tailspin and we will get the largest depression we ever had.

I don't have time to say much about that, but that is another area where I have had some differences with a few people, who, at the very time that they excoriate public spending as inflationary, will in their next breath say that as soon as public spending drops off, we are going

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to have a depression. I can't understand the trade magazine which on its blue page says that this economy is being ruined by public spending, while on its red page it says that just as soon as public spending levels off, we are going to have a big depression, which will ruin us, too. Both of those things can't be true.

I don't think either one is true. I think that if the defense situation should call for an expansion of the program, the economy can well stand it, for the reasons I have given. Again, if the international situation permits a reduction of the program, we should be mindful of the fact that between 1944 and 1946 the defense spending was cut by an annual rate of 100 billion dollars in current prices, and, nonetheless, the economy went on from 1946 to 1950, before Korea, with the level of defense spending, measured in current prices, being about 12 billion, 14, or 15, rather than the 115 billion that we had, without a recession and without a depression, for reasons which I won't go into detail on now, but which are still fully operative in the American economy.

It wasn't simply the backlog created during World War II. We might take a look at this backlog question. It is clear, as we are moving into 1953 now, the fact that there is a demand in the American economy for about 1.25 million houses and for about 5.5 million automobiles, or more than last year, and for more food and other things, shows that it is a by-product of the current condition of the economy. It certainly is no longer a by-product of shortages created during World War II.

I think the economy is moving forward under sustaining forces and policies quite different from those that were operating before World War II, quite unrelated to World War II. I think we have a flexibility in our national policy which would enable us to either expand or contract the defense program by whatever the people who were responsible thought should be done. But nothing would be more wrong than to do it on what I call economic grounds. It would be wrong on economic grounds to retard the program contrary to the best appraisal of the groups who have determined it, when our economy can well stand the cost of expanding. It would be wrong on economic grounds to refrain from cutting the program if our national security permits us to cut it, on the ground that to do so would cause a depression. Therefore, there is a rare opportunity for those who have the responsibility for making that decision on the ground that it should be made on, and that is on the ground of national security.

We have a lot of discussion in our kind of economy. There always should be, because it is a free economy. There will always be those who, whatever the level of the national program is, will feel--and quite properly so--that they would like to pay somewhat less taxes and they would like to be relieved even from the very moderate level of restraints which they are now suffering. That customary rate of agitation will persist. As a matter of fact in 1949 when the level of defense spending

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was 12 billion, it was said--and again, I didn't know anything about what it ought to be--that if we went from 12 to 13 billion, the economy was going to be ruined and we were going to have uncontrollable inflation. And that kind of economic argument was used by pseudo-economists to erect themselves into the level of what they should not be--potential advisers in other fields of government programs.

The job of an economist is not to project his prejudices into other fields. He should try to give an objective picture of how other programs will impact upon the economy. He should do that in an objective manner, not by using some sort of mystical concept of his genius to foist his ideas on that subject upon other makers of policy. And that is rather easy to do, because some people have very mystical ideas about some of these economists, or pseudo-economists.

Now, just a word about policy.

I think that the most important thing is to keep rather bright and fully released from the scabbard what I regard as the American economy's nonsecret weapon--its productive ability. So if we adopt an economy policy which in the interest of saving 10 dollars, loses 100 dollars of national product, then in the net we have lost 90 no matter what the books show. Every national policy ought to be measured against the question: Does it maximize in terms of incentive, in terms of drive, in terms of imagination, our productive power?

That is particularly applicable to taxation. After all, the national budget is only one of the many accounts of the Nation in the economic sense. Whether investors are spending more than they earn, whether business is borrowing to invest or has a surplus after it invests, whether consumers are saving or going into debt, are other national accounts which are bigger than the Federal budget. These other budgets are way above 200 billion dollars and the Federal budget for this year was only a 70- or 80-billion-dollar account.

You have all these accounts. You have to look at all together. Just as in a large business corporation, you don't necessarily say that it is going to the dogs because one department runs a deficit if the corporation as a whole is running a surplus. You might even decide that it was in the interest of the corporation as a whole to run a deficit at one point in the accounts in the interest of the other parts.

That is not an exact analogy, because in our private enterprise economy our Government and the people are not fused in the way that one corporation is fused. Nonetheless, it certainly is relevant. At least it shows that before you decide what you want to do about the Federal budget, you have to look at the whole economy. You have to look at the national and international situation. You have to look at what you can do to reasonably maximize production.

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To take a very simple case as an example, the repeal of the excess-profits tax might cause a loss of 2 billion dollars revenue. I am just taking that as an arbitrary figure, not advocating repeal of the tax. If the repeal of the excess-profits tax should cause a loss of 2 billion dollars in our national revenue, and therefore a 2-billion-dollar-larger deficit next year, yet if it could be reasonably demonstrated that the repeal of the tax, through its effect upon investments and incentives, would enlarge our national product by 10 billion dollars in that year, it seems to me to be manifest that we would have an 8 billion dollar net gain from that point of view.

If you look only at the deficit of the Federal Government, you certainly get a very unclear picture. Don't misunderstand me. I am not arguing for an inflated budget. I think we can raise enough taxes to balance the budget. In fact, I advocate that we get it in better balance than we have. But I am saying that we ought to examine the basic elements of national policy.

I think we have to examine all these policies primarily in terms of how much they can add to our productive output. If we follow the right policy in this respect, if we realize that certain types of deficits are rather defensible in the very nature of our system, we will see that they do have to receive some public support, that we have to receive certain types of education if our people are to have the skills which will produce that real base.

I think in a sense that is why we have a so much more productive economy, technologically and in other respects, than other countries. If we don't take the narrower view, but blend all these things together, realizing that they are all part of our productive strength, we can get up to 475 or 500 billion dollars of production within 10 years by a rather substantial rate of annual growth. In other words, it is a basic issue of economic policy.

There is within this field of economic policy those who urge that we try to maximize production by placing an excessive reliance upon controls for longer than we have to, and by trying to get that by stockpiling and by forced mobilization of all sorts of people all over the country, not just in the Government, but in business and labor and other kinds of organizations, so that this great nonsecret weapon of the United States will be fully used. I do not agree.

Now, I said in 1950: "We can outproduce the Russians. We can never hope to outcontrol them." We can never hope to outcontrol a nation where every ounce of brain is within the ambit of the state, where every individual is controlled, not only because of the tightness of the system, but because the individual has no value, no more value than a gallon of gasoline or a pound of steel. We are never going to be able to outcontrol the Russians, but we can outproduce them.

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We can outproduce them to an extent that will more than make up for their more-highly managed system. That managed system in the long run has more disadvantages than advantages, because I believe it stultifies initiative, inventiveness, and true science, the things that enable us to do things in a better way. So I think they have that handicap. But they have certain short-run advantages in the tightness of decision with which they can do things.

Their great disadvantage, which was shown in World War II and I think will be shown again even without total war, is in our greater productive power. If we ever release the brakes on that, we will at the same time release for whatever use we want to make of it that ability to produce which makes American industry so strong. We might need to have some material controls for a while. I think we might need reasonably high taxes. Above all, we will need self-control all over the country, which does not fall for what I regard as this rather superficial, extravagant talk about the kind of false economy which weakens this productive weapon that we have now, and which weakens our determination to move forward vigorously, using whatever amount of our resources we need to meet this great world problem that is confronting us.

I will be glad to answer any questions which may have been raised by this very rambling and disorganized presentation.

COMMANDER ENGLISH: You made a prediction as to what our 1962 gross national product will be. How much of that do you think is going into the expansion of capacity, plant facilities?

MR. KEYSERLING: I didn't attempt to break down my 1962 prediction of gross national product into its component parts. I couldn't make any prediction as to what part in 1962 would be going into government programs, including national defense. So I just gave an over-all figure on how much we can expand our national product.

But as to the ratio between our consumption and investment, our fundamental private investments usually run in the area of about one to five compared with consumption. In other words, in a healthy economy we should be putting somewhere around 70 percent of our national product into consumption and about 14 to 15 percent into private investment. That is about the five-sevenths and the one-seventh that I referred to in the 1948 situation.

So, if we had 500 billion dollars of national product in 1962, I don't know what you would figure the government section of that, I would regard that as a prediction--and I am not making any. So let us take this figure that I gave just for arbitrary purposes. It might be more and it might be less, but it wouldn't change the picture terribly.

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If you subtract 80 billion from 500, you have 420 billion. If you take out of that 420 billion consumption and investment about in the ratio of five to one, you get about 350 billion dollars of consumption and about 70 billion dollars of investment.

So you get 350 billion dollars of consumption. Of course, you have population growth; but even with the population growth, there will be, barring total war, an enormous further increase in the American standard of living over the next decade, as there has been over the past decade or over the past two decades. Contrasted with 1929, which was the last year before the depression, or with before World War II, the standard of living has probably increased about 50 percent, even allowing for population growth and price changes. In some commodities it has increased even more than that.

Of course, all this depends upon our having a healthy and growing economy and not running into another large depression. I haven't any time to outline the reasons why I don't think we are going to run into another large depression. But I don't think we are.

You may have noticed in the last issue of "Life" magazine an article by the editors of "Fortune" magazine in which they cite the stabilizing forces which have been built into the economy over the last decade or two. It is very interesting to me, who has been in the Federal service for 20 years, to recall how bitterly contentious a lot of these things were when they were initiated and how commonly accepted they are today.

There are some differences of degree and shading in broad outline, but still it is very interesting to read that article in "Life" magazine by the editors of "Fortune" and see the way in which they cite our farm price support, social security, collective bargaining, and even the larger tax structure as stabilizers within the economy. Those things gave them assurance that we would not have any major downturn.

I don't think we will have a major downturn, but I don't limit it to these things. I think, in addition to these changes in the structure of our economy and public policy, there have been great changes in private economic policies which are even more important. Businessmen have a much better understanding of pricing policy, wage policy, and investment policy. They are making a much closer study of how the over-all economy works than they did 20 or 30 years ago. That is a great stabilizing force. I think those are some of the reasons why we didn't have a serious economic downturn after World War II.

Then, in the third place, more important than these private policies or public policies, or equally important, is the psychological factor. We might call it the political factor. It has nothing to do with parties. It is that I don't believe we could have a small downturn in the United States without action being taken much more rapidly and much more

comprehensively than it was in the years between 1929 and 1933. I believe that will be true no matter which party is in power.

For these three reasons I think we are going to have a reasonably stable economy. There may be some minor ups and downs, but I think it will be reasonably stable, an economy in which you can well raise your national output to 475 or 500 billion in 10 years, if we don't have a major war. If we do have a major war, we will have an entirely different range of problems, and then nothing of what I have said here will really be relevant.

QUESTION: It is often said that the Russian policy is one of great fluidity, in which the Russians envision a depression here which might be created by Russian acts; that this could be maneuvered by a change in the intensity of the cold war. However, I would conclude from what you have said that no action of that sort in Russia would have much effect upon the gross national product or the growth of it and the health of the economy here. Is that right?

MR. KEYSERLING: I think that the concept on the part of anybody in the United States that Russia is calling the tune on the American economy is dangerous and fallacious. I think Russia calls the tune on international economic relationships to a degree, because any aggressor always has the initiative to a degree. I mean, the bully, the troublemaker, the disturber, always has some initiative. There is no way we can avoid that, because we are not a bully, we are not a troublemaker, we are not an aggressor. We just have to live with that. But I think the idea that they are calling the tune on our economy is all wet.

The best way I can illustrate that is to cite the inconsistency of some of the people who are saying it. I referred to that inconsistency in another way a little while ago.

At one and the same time some of the same people who are saying that if there should be a reduction in the intensity of the cold war or in the level of the defense spending, we would be wrecked or seriously disrupted by depression, some of these people are saying at one and the same time, and have been saying, that inflation is a greater danger to us now than Stalin. They say that if we continue our present rate of defense spending, it will in turn wreck our economy, which in turn will wreck us. In other words, the same people are at one and the same time saying that if we step up the cold war or continue the cold war, we will be wrecked by inflation; and that if Stalin should slow down or retard the cold war, he could wreck us by deflation. Both of those things can't be true. It seems to me absolutely morbid psychology to think that a nation as strong as ours and with as much brains as we have could fall into that kind of trap.

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I have found that special agitators in this economy--I don't mean agitators in the subversive sense, but agitators for a change in the tax policy or a change in controls--are for selfish reasons using those two arguments alternately at one and the same time. When they are talking about taxes, they say we must have lower taxes or there is danger of a depression. When they are talking about controls, they say we must have less controls because there is no danger of inflation. When they are talking about the defense program, they say the danger of inflation is terrific; that unless we cut down on the defense program, we are going to be ruined by inflation.

I think you have to analyze those arguments and see whether they are consistent or inconsistent, to see where they are going to lead us. I don't believe that this economy is going to be ruined indirectly by Stalin either by inflation or deflation.

In the middle of 1950 a lot of people were saying that inflation was a greater danger to us than Stalin. I think one of the most dangerous things was saying that, because the implications of that were clear. The implications of that were that if we just kept a healthy economy, didn't do anything else but that, it was the best way to protect ourselves. We would have forgotten, if we had followed this idea, that all things are not equal. I mean, you could have a wonderfully strong productive economy in terms of 40 percent of the families in the country having acquired television sets in the last two or three years, but that would not be a strong economy in the international sense when we got into a jam. Nor do we require 1.25 million new houses a year, although it is nice to have them when we can.

I think the argument that inflation was a greater danger to us than Stalin was in itself a danger to us. Let us remember the spurt of inflation which occurred in 1946 from abandoning controls too rapidly after World War II and the spurt of inflation which occurred after the Korean outbreak, particularly after the Chinese intervention in late 1950 and early 1951. These two spurts of inflation were not generalized. For almost two years, from February 1951 until now, we have had a remarkably stable price level for a big, powerful, moving economy like ours. There has hardly been anything like it in industrial history. We have had a remarkable stable price level for two years, and we have had that with the lowest level of unemployment that we have ever had in peacetimes and the highest level of production that we have ever had in peacetimes. We have had one of the most rapid increases in production we have ever had in peacetime. As we move into 1953 the price level in most lines of business activity is stable; I think it is going to stay stable without a great deal of control.

We have built up the productive power to take care of this defense program, of our civilian and industrial needs, and a high level of

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employment without inflation. Therefore I think that as of today the argument that we are threatened by inflation and therefore we should hold down the defense program is foolish, just as I said it was foolish in 1950. I think, conversely, that the argument that we are going to be wrecked by depression in the event of a cessation in the armament activities is equally wrong.

Suppose we have a budget now which runs us--the total Federal budget is about 80 billion dollars--I am just talking in round figures, the President suggested 79 billion. Suppose we have a diminution of the cold war pressure--I am just taking arbitrary figures now--within two or three years so that the over-all cut would be 20 billion dollars. I can't in the kind of world we live in imagine a larger over-all cut than 20 billion. That looks to me to be a fairly liberal estimate. I don't care whether you say 20 or 30, but let us say 25.

Now, suppose there is a cut of 25 billion dollars. In 1946 the defense outlays were about 100 billion dollars less than in 1944. All this is measured in today's prices. That 100-billion-dollar decrease came in a 300-billion-dollar economy, whereas this 25-billion decrease would come in a 350-billion-dollar economy. So on an absolute basis it would be one-fourth as much, even if it were as much as 25 billion. In relative terms 25 billion would be one-fourteenth of a 350-billion-dollar economy, whereas the 100 billion was one-third of a 300-billion-dollar economy.

There were certain other different factors, such as the shortage of articles throughout the world. However, I think they were not a very great factor in 1949 and 1950. We were not eating more in 1950 than in 1939 because we had gotten so hungry during World War II, in that five-year period and therefore everybody was eating more than in 1939. The whole economy had changed. It was not just a by-product of World War II. It was much more of a fundamental change than that.

I believe that, since we successfully accomplished a reduction of 100 billion dollars in our annual level of defense spending, if that, compared to the total output of the economy, was perfectly possible without making us quake in our boots, a 15-, 20-, or 25-billion-dollar reduction now, which will be only one-fourteenth, can be accomplished without our going to h--- in a handbag. I don't think we are going there. That doesn't mean that we won't have any problems. There will be problems, but they won't be bigger problems than the ones we surmounted in the past.

I think that for business to be alternately and simultaneously telling the American people on the one hand that we are going to be ruined if Stalin intensifies the cold war, and that we are going to be ruined if Stalin decelerates the cold war, and that most assuredly we

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are going to be ruined if we keep it where it is--you read those three different statements at the same time, and sometimes in the same magazine-- I don't think the American people ought to get into that state of mind, because they are too great a nation to be put in that state of mind.

DR. HUNTER: You have presented very persuasively the thesis that the problem of stabilization is secondary to the problem of expanding production. There is said to be a substantial minority of the population, of which I believe everyone here is a member, which is bearing an undue proportion of the stability and getting an unduly small measure of the expanding production. But without reference to the present audience, I wonder if you would discuss this problem of the distribution of the national product, with particular reference to the so-called fixed income groups, and in relation to the measure of price inflation which seems essential to insure expanding production.

MR. KEYSERLING: Well, there has been a lot of sense and nonsense mixed together in discussing that problem. I will take the nonsense first, because I have a bias toward nonsense.

Take the simple statement which you often hear in the form that, if the dollar is worth 40 percent less than it was, in 1939, everybody has 40 percent less in real terms. Nobody puts it in those words, but that is the substance of it. You have to admit, after all, that when anyone in one of these groups speaks about the shrinkage in the value of the dollar, the man on the street gets the impression that somebody is trying to tell him that because the dollar is worth 40 percent less, everybody is worth 40 percent less.

Of course that is not true. The dollar is the counter with which you measure goods. Over-all, if you are dealing in averages, everybody is worse off or better off--depending upon the size of the national product produced each year, divided by the number of people in the country. I mean, that is just basic economics, like two and two makes four. If the national product is increasing faster than the population, and if there is a method for distributing those goods and services, then on the average people are better off. If the national output is increasing faster than the population, whether we have moved into an economy which is using different counters, or counters of different value, for playing the game, is not of primary significance.

What is happening in our economy is obviously illustrated by the figures I have given you. On the average people are better off. They are better off than they were 20, 15, 10 years ago, because more is being produced and distributed among them. We have more houses, more food, more recreation, more clothes, more electricity, a shorter work week; and I could go on citing ad infinitum the present increase in electric power, in the number of radio sets, the number of automobiles, the amount of savings, and so on, in real terms.

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Now, to come to the second question, how has that hit different parts of the population? There again the general trend has been toward an improvement of income distribution, if you define improvement as more going to those at the bottom and in the middle relative to those at the top. I am not defining it; I am just describing it. I think you can see that very quickly. I am not here to discuss social philosophy; I am here to discuss objective facts.

If you look at the figures on income distribution, in other words, who is getting this increased production, it is absolutely unquestionable that in the country there has been an enormous shift over the past 10, 15, 20, or 25 years toward a relatively larger part of the national income going to that majority of the people who live in the middle and lower income groups and a relatively smaller part going to those who are at the top. I could cite very elaborate statistics on that if time permitted.

That also not only can be verified by figures, but it is a matter of common observation, because everybody knows it, who travels around the country. I come from the southern part of South Carolina. When I think, not in terms of dollars, but in terms of real things, how much people are eating, how they are living, what they are doing, what they have to wear, and so on, and contrast it with the standard of living as I recall it 20, 30, or 40 years ago, there has been a fantastic change. Those are the people relatively who have benefited most. So there has been an improvement in income distribution.

Now, coming to the next question, despite all that, are there not some groups which have been hurt by the fact that the value of the dollar has gone down, while their incomes have not gone up, the so-called fixed income group? I am going to break that down into several parts.

I asked for some figures not too long ago on how many people there are in the fixed income group and I got the figure of about 17 or 20 million. I said, "Why are all these people in the fixed income group? Am I in there?" They said, "Yes. You are in there, because you have a fixed income. You are paid by the Government. Also because you are a white-collar worker."

I said, "In the first place, the salary that I have been getting has changed over the years. In the second place, the fact that I am a white-collar worker doesn't put me in a fixed income group, because I have some other income."

There are other confusions. One occurs when we say that the fixed income groups are those whose income has increased less rapidly than other groups. In other words, it is sometimes said that the income of the white-collar workers has increased less rapidly than that of the labor groups. That is a very different question from whether their

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incomes have been fixed, or in the alternative have increased faster than the price level. In other words, there are groups in the country whose incomes have increased faster than the price level and who therefore have a higher standard of living than they had 20 years ago. There are other who have not, because their incomes have not increased much faster than the price level.

Now, I think that when you iron all that out you will find that in our free economy it is just in the very nature of things, in a dynamic, fluid economy like ours, that some groups, competing with each other just as individuals compete, advance faster than others. It ought to be that some groups advance faster, because that is the way our economy works, just as some business groups make more than others, just as some whole industries are more prosperous than others. That happens all the time, I think.

That is an entirely different question from how many people there are who really and absolutely in 1953 are worse off than they were. There are some in that group, but really it is a small group. I mean, in real terms of the standard of living, in goods and services, those who are worse off than they were before this expansion started, are a much smaller group than most people suppose.

As to those, a goodly portion of them are people who suffer some disability, or who work very poor farm land, or who are unskilled, and so forth. That specific problem is one that the Nation ought to be able to take care of by improving their opportunity, by training them better, by seeing that they get more education, by seeing that their lands are replenished, by giving them a higher level of skill, and so on.

That is a process that is going forward. It can't be done overnight. Clearly that problem is not going to be solved by saying, "Oh, if only we could go back to the price level of 1939," because I believe in stable prices, and there is no way under God's heaven that we can go back to the price level of 1939, or to any price level much less than what it is now, because the price structure applies clear across the economy, and it can't be cut very much without a depression.

Such a depression, incidentally, would do the most harm to these very people whose difficulties evoke sympathy, because they are the weakest people in the economic structure. They are the people who have been failing to keep up with the increase in prices in times of prosperity. So certainly in the main they are the people who would be hurt the most in a depression, because they are the weakest part of the economy. They would include women who are living on what money they have inherited or on what they are getting in dividends. Those who complain that their dividends won't buy as much as they used to forget that if there should be a depression, their dividends would drop off entirely.

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Now, talking about buying government bonds, you hear that the government bond is not worth as much now as it was. Well, of course it isn't. But I always say, in the final analysis I have something here, a five-dollar bill, that I have in my pocketbook, that is just as much a government obligation as a bond. This five-dollar bill is a government obligation, even if it is not a bond. When the price level changes, the value of that bill changes. So I don't see any more reason why somebody who buys a government bond should be protected than somebody who holds a government dollar bill.

Every time there is a change in the price level, of course, the value of this bill changes and the value of the bond changes. The only way we can do anything about it would be to have an absolutely stable price level, which would have certain advantages.

I think that in the main, with all the inequities that the price level has, the way it has worked on the average over the years, it has contributed to the economic expansion and the degree of balance that we have now. We are better off. If we do not try to maintain absolute price stability at the expense of expansion, I believe we will be better off.

If there should come a rapid period of inflation, it may have to be relieved by some better control or a tighter policy. But there will be a lot of political opposition to that. A great many self-interest groups, both in the productive economy and elsewhere, would oppose controls being slapped on quickly.

I think there is a lot of confusion on this general question of what happens to the economy under a gradual rise of the price level. I think our economy is moving forward. There are some other fixed income groups, such as teachers and civil servants. Of course they do not have a fixed income in the sense that their income has not increased over the past 20 years. But a good many of them have had income increases smaller than received by the population in general, and so they are worse off than other groups. That is bad.

There are two ways of approaching that. There is the approach of trying to increase their money income. Or you can approach the problem by saying, "Let us throw the whole price level backward, so they can buy as much as before." But I don't think you can do it by throwing the whole price level backward. The only way you can throw the whole price level backward is by a depression. The only way to give these fixed income groups proper treatment is to adjust their incomes to the general picture.

DR. KRESS: Our time has run out. Thank you very much, Mr. Keyserling. There are a lot of question that haven't been answered, but I know you have another engagement.

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During the break one of the students said, "That is the kind of economist I can understand." So you have that to take away with you, sir. Thank you very much.

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