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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Economic Effects of Our New Foreign Policy

Although few citizens apparently realized it at the time, our new foreign policy was clearly enunciated by Mr. Roosevelt in his annual message to Congress two years ago. He said then, "The Defense of religion, of democracy and of good faith among nations is all the same fight. To save one we must now make up our minds to save all." Obviously, he had then determined on a crusade to save the world for religion, freedom, prosperity, and security, and this crusade has now been announced to the people of the United States. Such was the burden of Mr. Roosevelt's recent message on the state of the Nation; and the announcement was emphasized by the following unequivocal assertion in the closing paragraph: "Our support goes to those who struggle to gain those rights or keep them."

Thus the United States of America has assumed a role that will dim the lustre of Don Quixote's fame. Poor Knight of the Woeful Figure, would he have been jealous of the new knight errant in his soon-to-be-shining-but-at-present-on-order armor, or would he perhaps have rejoiced to find that at last knight errantry had come to full flower. Here and now is real Chivalry; no pettifogging about after imprisoned maidens and dangerous dragons; no idle jaunt in search of adventure; but the real thing at last. Now, the world is to be saved, willy nilly, by the Don Sam Quixote. However, it is our editorial duty to think of Sancho Panza, of one-hundred and thirty-million Sanchos, more or less, and what effects the great new adventure will have on their economic welfare.

To perform this editorial duty, we must be realists, and who could be a better guide to realism than Mark Twain. In "The Mysterious Stranger" he commented briefly on war as follows:

"I can see a million years ahead, this rule will never change in so many as half a dozen instances. The loud little handful — as usual — will shout for the war. The pulpit will — warily and cautiously — object — at first; the great, big, dull bulk of the nation will rub its sleepy eyes and try to make out why there should be a war, and will say, earnestly and indignantly, 'It is unjust and dishonorable, and there is no necessity for it.' Then the handful will shout louder. A few fair men on the other side will argue and reason against the war with speech and pen, and at first will have a hearing and be applauded; but it will not last long; those others will out-shout them, and presently the anti-war audiences will thin out and lose popularity. Before long you will see this curious thing: the speakers stoned from the platform, and free speech strangled by hordes of furious men who in their secret hearts are still at one with those stoned speakers — as earlier — but do not dare to say so. And now the whole nation — pulpit and all — will take up the war-cry, and shout itself hoarse, and mob any honest man who ventures to open his mouth; and presently such mouths will cease to open. Next the statesmen will invent cheap lies, putting the blame upon the nation that is attacked, and every man will be glad of those conscience-soothing falsities, and will diligently study them, and refuse to examine any refutations of them; and thus he will by and by convince himself that the war is just, and will thank God for the better sleep he enjoys after this process of grotesque self-deception."

In the light of events during the past several months, it is no longer possible to doubt that the United States has gone far on the road to war. Only a naïve optimist can believe that the nation will turn back. Frankly, we advise those who are wise to prepare for the worst; and what is the worst? Probably the worst to be expected is a prolonged and extremely expensive war, perhaps a series of them, that will cause economic disturbances extending over several decades. What the end will be, no one can foresee in all detail, but it is certain to mean much less freedom, prosperity, and security here in the United States.

It is already apparent how our entry into the war may be arranged. Congress is now considering another blank-check bill that will permit the President to send America's newest and best weapons to England, to Greece, and to China, to anywhere in the world that he chooses to send them. As soon as our equipment has gone abroad, if the Germans and other aggressors are still successful, it will become apparent that this equipment may be lost to the enemy because our friends lack the man power to use it. Obviously, it will then be necessary for our Army and Navy to spring to the rescue, if they have not previously become involved for convoy or other belligerent duties.

Furthermore, it is highly probable that the people of the United States will have to shoulder the entire economic burden involved, in spite of any leasing or lending arrangements that may be made. Only four years ago, Winston Churchill made plain the English point of view in such matters when he said, apropos of England's debts to us for the last war, "Legally, we owe this debt to the United States, but logically we don't, and this because America should have minded her own business

and stayed out of the World War. If she had done so, the allies would have made peace with Germany in the spring of 1917, thus saving over a million British, French, American and other lives, and preventing the subsequent rise of Fascism and Nazism."

The Budget

If anyone who read Mr. Roosevelt's message on the state of the Nation failed to apprehend its true meaning, the budget message should have dispelled all illusions. Even before entering the new war, we are to spend in one year more than was spent in the most costly year of the last war. Apparently the "silly-old-fool" dollar sign has become virtually meaningless. Such is the effect of our present delusions of grandeur.

Furthermore, there seems to be no understanding nor even discussion of the grave risks that we are running. What if England is forced to capitulate despite our aid? Then we may be forced to undertake a protracted war in defense of this hemisphere, and the cost may strain, may even break, the Government's credit. Surely, if anything is clear in this confusing world today, it is the fact that the Nation's borrowing capacity should be conserved. Every last expenditure, save those for defense, should be cut, and cut to the bone. That this has not been done, has not even been attempted, is all too obvious.

SUMMARY OF THE NATIONAL BUDGET
(Billions of Dollars)

Account	*Fiscal Year 1940*	*Fiscal Year 1941 (Est.)*	*Fiscal Year 1942 (Est.)*
I. Receipts:			
1. Revenues:			
Internal Revenue	5.30	6.82	8.50
Customs	0.35	0.30	0.30
Miscellaneous Revenues	0.17	0.16	0.17
Total Revenues	5.82	7.28	8.97
2. Realization upon Assets	0.11	0.37	0.01
Less Social Security Appropriations	0.54	0.64	0.70
Net Receipts	5.39	7.01	8.28
II. Expenditures:			
1. Legislative, Judicial, Executive	0.04	0.04	0.04
2. Civil Departments and Agencies	0.95	0.96	0.96
3. General Public Works Program	0.54	0.57	0.50
4. National Defense	1.58	6.46	10.81
5. Veterans Pensions and Benefits	0.55	0.56	0.57
6. Aids to Agriculture	1.38	0.79	1.06
7. Aids to Youth	0.38	0.37	0.36
8. Social Security	0.38	0.43	0.46
9. Work Relief	1.86	1.48	1.03
10. Refunds	0.09	0.07	0.09
11. Interest on the Public Debt	1.04	1.10	1.23
12. Transfers to Trust Accounts, etc.	0.21	0.22	0.28
13. Supplemental Items	....	0.15	0.10
Total Expenditures	9.00	13.20	17.49
III. Net Deficit	3.61	6.19	9.21
IV. Debt Retirement	0.13	0.10	0.10
V. Gross Deficit	3.74	6.29	9.31

The accompanying summary of the budget facilitates the necessary comparisons. (Subscribers who wish to make a more extensive study will find this summary similar to that used in preceding years.) It is first necessary to note that the table does not include any estimates of the sums to be paid for equipment that will be leased or given to England and other nations. The President also stated in his budget message that additional funds for a civilian training program would be requested later.

We suspect, although it is manifestly impossible to prove, that the Treasury has resumed its former practice of overestimating the probable receipts. By April first, we shall have a more definite measure of the possibilities involved.

The amount requested for Civil Departments and Agencies is still about 50 per cent more than the 1937 total. Although the budget message speaks of reducing public works expenditures and of accumulating projects for the period of readjustment after the war, the General Public Works Program allocation is 60 per cent larger than it was in 1937. Aids to Agriculture are increased, in comparison with the 1941 fiscal year costs, and only the Work Relief estimates show a substantial reduction. These last expenditures should simply be eliminated, because it is obvious that we can no longer afford to maintain the privileged work-relief class among the unemployed in the station to which they have become accustomed. There is no apparent reason why they should not be reduced to the relief emoluments that are the perquisites of their less fortunate but no less unemployed or unemployable fellows.

The Latest Trial Balloon

Last week we commented briefly on the Federal Reserve Board's anti-inflation proposals. It now seems probable that these were only trial balloons intended to quiet inflation fears just before the announcement of the record-breaking budget. It will be recalled that Mr. Morgenthau's comment last fall regarding a substantial increase in the statutory debt limit touched off a minor inflation scare. With the background of Mr. Eccles' proposals, however, the suggestion in the budget message that the statutory debt limit be removed altogether, thus making the sky the limit, aroused not even a flurry of inflation fears.

Now, Mr. Jones, the powerful Secretary of Commerce and Federal Loan Administrator, has announced his opposition to the Board's scheme. He is reported to have said, "I haven't seen any indication toward inflation, and I don't see why we should expect any such tendency. I'm trying to get the banks to lend more." Mr. Morgenthau, apparently disturbed at the declines that occurred in government bonds after the Board's proposals were made public, is also expected to oppose the new inflation controls. Of course, the 1942 budget makes the Board's proposals more academic than practical, anyway.

What Next?

The Continuing Record

The latest available information regarding the more significant indicators of future trends is summarized in the following table. A plus sign indicates an advance in the indicator; a minus sign, a decline; and a zero, an unchanged position.

	Latest Indication
Private Engineering Contracts (December)	+
Machine-Tool Activity (November)	−
Orders for Steel Boilers (October)	−
Capital Goods' Stock Prices (Last Week)	+
Durable Goods' Employment (November)	+
Steel-Ingot Production (Last Week)	+
Prices of Metals and Metal Products (Last Week)	0

INDEX OF LIVING STANDARDS
(ADJUSTED FOR LONG TERM TREND)

	Latest Indication
New Capital Issues of Corporate Securities (November)	+
Velocity of Purchasing Media (December preliminary)	+
Carloadings of Heavy Products (Last Week)	+
Lumber Production (Last Week)	+
Harwood Index of Inflation (December preliminary)	+

The proportion of favorable to unfavorable indicators of cyclical trends has increased since the summary was published a month ago. Then there were eight pluses, three minuses, and one zero. In this summary, there are nine pluses, two minuses, and one zero.

BUSINESS

Index of Living Standards

The Institute's index of living standards advanced in December 1940 for the fourth successive time but failed to reach the high levels recorded during the first quarter of the year. The index will probably continue to advance during the next few months, when the demand for consumers' goods will be stimulated as larger Government defense outlays augment pay rolls. However, the President's declaration that "production of consumer or luxury goods in certain industries . . . must yield to our primary and compelling purpose" (the production of machines essentially for defense) suggests the possibility that the index may decline later in 1941. Our estimates of shortages of non-durable goods that may develop during the period of our national defense efforts were given on pages 204–205 of the December 2, 1940 bulletin.

Telephones in Use

Estimates based on reports of the Bell System indicate that there was an increase of about 1,100,000 telephones in use in the United States during 1940. This was the largest increase ever to be recorded. The total at the close of the year was about 19,640,000. The Institute's index (on the basis of 1926=100), which is adjusted for population growth, advanced from 121.3 in December 1939 to 127.7 in December 1940. The index for each month of the past four years is shown in the accompanying table.

INDEX OF NUMBER OF TELEPHONE STATIONS IN SERVICE PER CAPITA
PER CAPITA MONTHLY AVERAGE 1926=100

	1937	*1938*	*1939*	*1940*
January	108.0	113.6	116.9	122.0
February	108.3	113.7	117.2	122.5
March	109.1	114.2	117.8	123.1
April	110.0	114.6	118.1	123.6
May	110.4	114.8	118.7	124.3
June	110.8	114.6	118.8	124.2
July	111.0	114.6	118.9	124.3
August	111.3	114.8	119.0	124.8
September	112.0	115.4	119.6	125.4
October	112.8	115.9	120.3	126.2
November	113.0	116.2	120.7	127.0
December	113.2	116.4	121.3	127.7

Exports in November

The total volume of exports in November 1940 was $327,700,000 compared with $343,500,000 in October and $292,000,500 in November 1939. The following brief summary indicates the relative importance of the principal markets now available for United States exports.

UNITED STATES EXPORTS

Destinations	*November 1940 Value in Millions of Dollars*	*Per Cent of Total*
Canada	64.3	19.6
Mexico, South and Central America	62.7	19.2
West Indies	9.2	2.8
United Kingdom	102.4	31.2
Far East*	47.6	14.5
Other Destinations	41.5	12.7
Total	327.7	100.0

* Includes Australia and New Zealand, British India, British Malaya, Hong Kong, China, Japan, The Netherlands, Indies and the Philippine Islands.

THE FUNDAMENTALS

Supply

The steel-ingot production rate advanced one-half a point to 97.5 per cent of theoretical capacity last week. The *Iron Age* reported that: "Defense orders continue to play an increasingly prominent part in a volume of steel business which exceeds shipments, piling up larger backlogs and lengthening deliveries still further."

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Per Cent of Capacity	84.0	22.0	79.0	28.5	86.0	97.5

(Latest 1941 weekly data; corresponding week earlier years)

Contrary to the usual seasonal trend, electric-power production increased last week from 2,622,870,000 to 2,704,800,000 kilowatt hours. The gain in output com-

pared with production in the corresponding week in 1940 was especially great in the Central Industrial region. The increase there was 11.6 per cent compared with a gain of 9.4 per cent for all districts reporting.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Billion Kilowatt Hours	1.73	1.62	2.24	2.14	2.48	2.70

The automobile industry produced 76,690 cars and trucks last week compared with output of 87,510 units in the corresponding week of 1940. According to Ward's Automotive Reports the industry will soon resume production schedules that will bring output above the rate of 100,000 units per week.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Units (000 omitted)	68	19	72	50	87	77

The seasonally adjusted index of cotton-mill activity was 170.6 last week, 43 per cent higher than it was in the corresponding week a year ago.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	*	92.0	149.8	113.3	145.5	170.6

* Not available until third week in March.

Lumber production increased substantially last week and the adjusted index advanced from 126.3 to 142.1.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	137.7	41.7	83.1	48.6	136.4	142.1

Demand

Retail trade was somewhat less active last week, but, as a result of the general absence of surplus merchandise at the year end, demand in the wholesale markets is greater than it was a year ago. If retail prices remain within the present general range, sales of consumers' goods will increase in volume with the expansion in payrolls that will inevitably accompany the national defense activities.

Prices

The sensitive wholesale commodity price indexes advanced again last week. Moody's Spot Commodity Price Index was 171.9 on January 2 and 174.4 on January 9. The Dow-Jones Index of Commodity Futures closed at 57.08 on January 2 and at 57.66 on January 9.

FINANCE

The Harwood Index of Inflation

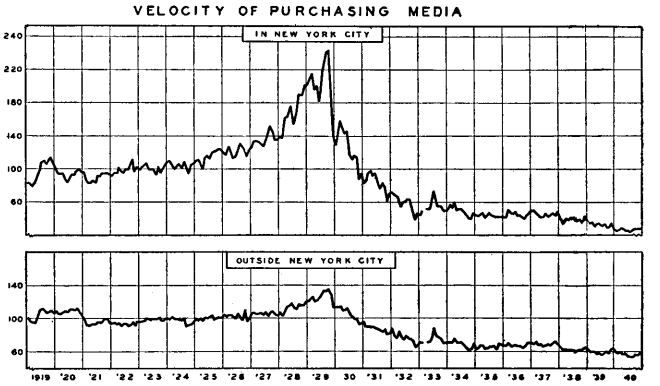
A gradual trend toward inflation during the final month of 1940 was revealed by the Harwood Index of Inflation; the Index advanced from 106.5 to 107.4. Investments held by the banking system increased nearly $600,000,000. (Virtually all of the increase was represented by additions to Government security holdings.) Loans on securities also increased about $170,000,000. Although the type of securities held as collateral by the banks to protect these loans is not specified, much of the increase was probably represented by Government issues. The Treasury issued new securities during the month, and, as is customary, the banks probably made purchases for customers' accounts that will later be paid for in installments.

The Treasury's accounts with the Federal Reserve Banks increased $200,000,000 as a result of new Government borrowing. The initial national defense series of short-term notes issued during December was discussed on page 222 of the December 30, 1940 bulletin. Until a definite policy of financing the national defense program has been adopted, it is understood that the Treasury's operations will consist largely of new ninety-day Treasury bill offerings. The total volume of Treasury bills outstanding has recently been approximately $1,300,000,000. The market will probably absorb twice this amount. In fact, the volume of Treasury bills outstanding during 1933 and 1934 was about $3,000,000,000. Income-tax receipts in March 1940 were $665,000,000 and will surely be much greater in March this year. Therefore, the Treasury may be in a position to postpone new large-scale financing operations until the second quarter of the year if this seems to be advisable.

Tax receipts are seasonally greater in March than in any other month of the year, and thereafter budgetary deficits will increase because receipts will be smaller and national defense spending will be larger. The inflationary trend may be gradual during the remainder of this quarter, but in the second quarter of the year an inflationary progression at a rate comparable to that during the period September 1933 to December 1936 appears to be inevitable.

Velocity of Purchasing Media

The accompanying chart shows the velocity of purchasing media for New York City, where there is a concentration of speculative transactions, and separately for the remainder of the country. The indexes, based on ratios of bank debits divided by checking-account deposits, are computed by the Federal Reserve Bank of New York.



Since the middle of 1933, when there was a short-lived inflationary boom, both the New York City and outside of New York City series have fluctuated within a narrow range. There was a barely perceptible upward trend in the recovery period from the end of 1934 to the end of 1937. During 1938–1939 and in the early months of 1940, the general trend was toward moderately lower levels, but the trend was upward during the final four months of 1940.

The dollar volume of checking-account transactions has increased during recent years, although this is not discernible in the indexes of velocity because checking-account deposits have increased greatly during the period. Substantial increases in the velocity of purchasing media usually accompany activity in the capital goods' industry. The recent upward trend of the two series apparently reflects this situation although to a smaller extent because of the abnormal increase in total purchasing media resulting from the Government's money-credit policies.

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