# AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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# RESEARCH REPORTS

## COMING EFFECTS OF CURRENT EVENTS

### *The St. Lawrence Waterway Project*

The President has mobilized the support of Administration leaders to push the Great Lakes-St. Lawrence waterway and power project through Congress as a defense measure. By this strategy he will have the benefit of the patriotic appeal and can avoid the necessity of a two-thirds majority vote in the Senate (required for ratification of a treaty). The proposal is being revived in spite of the existence of an impressive mass of recorded testimony by United States and Canadian experts that the undertaking is not justified on economic grounds. Competent authorities have pointed out that the waterway would be ice-bound five months out of the year; that the savings in transportation through the new channel would be much smaller than the interest on the lowest estimated investment; and that the cost of the power developed would be excessive.

Arguments for the undertaking as a defense measure ignore the charge that the narrow ship channel would be more vulnerable to aerial attack than is the Panama Canal; that its construction would require much material and labor needed for defense work; and, finally, the President's own contention that it is essential to give maximum aid to Britain now, not four years hence when the project might be completed.

The President's revival of the St. Lawrence waterway scheme suggests that he is unwilling to forego indulgence in New Deal experiments in the interests of national defense. Until the President and Congress make a determined effort to place the Nation's economy on a wartime basis, the defense effort will be hampered, just as the recovery program was, by contradictory measures tending partially to nullify progress toward the major objective.

### *Just Beginning to Spend*

Although expenditures for national defense since the program started reached the total of $5,623,000,000 by June 14, 1941, this is only a small fraction of total expenditures contemplated, and only 15 per cent of national defense appropriations already made by Congress. According to the most recent data available, appropriations classified as national defense items in the Federal budget (including the $7,000,000,000 lend-lease appropriation) have reached a total of $37,300,000,000. Although some of the appropriations made for naval vessels cannot be spent within the next year or two, most of the funds appropriated will be available for expenditure during 1941 and 1942. A brief summary of the apportionment of the national defense appropriations is shown below.

NATIONAL DEFENSE APPROPRIATIONS*

| | (*Billions of Dollars*) |
|---|---|
| Airplanes and accessories | 6.5 |
| Ordnance (guns, powder, etc.) | 7.2 |
| Ships, motor and rail equipment | 8.8 |
| New industrial facilities | 3.8 |
| Military posts, depots, fortifications, and defense housing | 3.3 |
| Other Army and Navy equipment | 1.8 |
| Miscellaneous (pay, food, reserve materials, etc.) | 5.9 |
| | 37.3 |

* This summary was compiled by the United States Department of Commerce as of May 17, 1941. Because of different methods used in classification, it is not identical with a similar table prepared by the Office of Production Management.

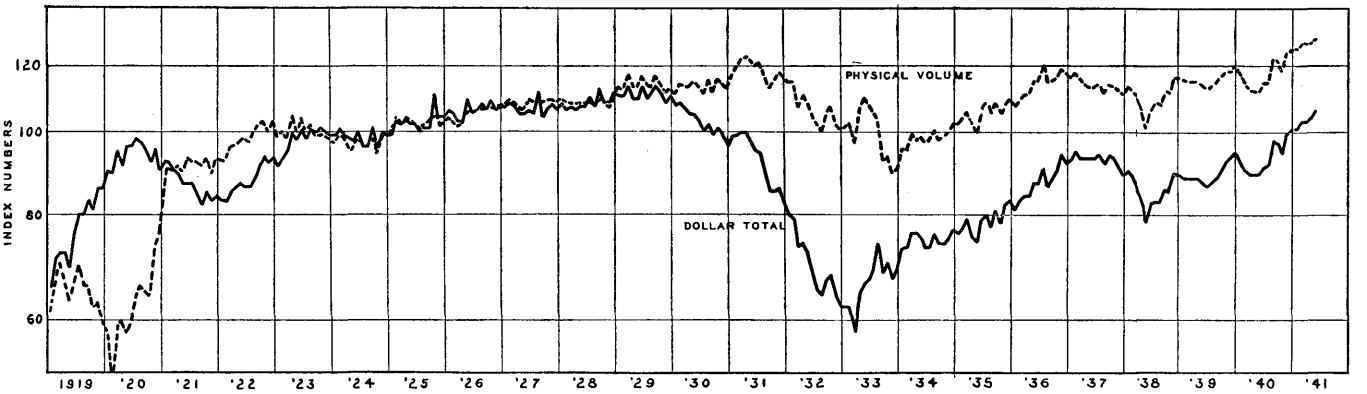
The United States Treasury has recently estimated the probable extent of new borrowings that must be undertaken in order to finance the budgetary deficits indicated as a result of the national defense expenditures. During the first eleven months of the fiscal year 1941, ending June 30, 1941, the Treasury had increased its debt $4,750,000,000, and in the final month it was expected to increase this to $5,430,000,000. The Treasury estimated that new borrowings for the fiscal year ending June 30, 1942 will total $12,767,000,000. According to this estimate, the Treasury will have to seek new funds during the twelve months beginning July 1 this year at a rate exceeding $1,000,000,000 a month.

The public statements of responsible Government officials indicate that they are much more aware of the dangers of inflationary deficit financing through the commercial banks than were those responsible for the Liberty Loan drives of 1917–1918. Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, has outlined the Government's policy as follows:[1]

"The Secretary of the Treasury has proposed that we raise at least two-thirds of the sums necessary for defense out of taxation, and with that purpose I am likewise heartily in accord. The rest should, so far as possible, be raised by the sale of Government securities

[1] Federal Reserve Bulletin, June 1941, page 509.

DEPARTMENT-STORE SALES




to the public, thus utilizing existing funds, instead of by sale of securities to the commercial banks since the latter method creates additional bank deposits. As I have indicated, we need to use existing funds, which are abundant. Expansion of bank credit which creates new funds would only tend towards inflation. . . .

"To the extent that we pay for defense out of taxes and through borrowing from savers rather than from the commercial banks, thus using existing funds and not creating new funds, we help protect the country against the hazards of monetary and credit inflation. To the extent that people pay taxes or invest in Government bonds, such as the new savings bonds, these funds will not be available for the public to bid up prices in the market place and they will aid in financing defense, thus avoiding inflationary effects."

As long as wages and other incomes continue to increase more rapidly than living costs, the annual increment of savings available for investment in Government obligations will increase. However, Congress will probably be asked to make additional large deficiency appropriations for national defense that will require revisions in the Treasury's estimates of new borrowings. There is therefore no assurance that the Treasury can avoid recourse to inflationary deficit financing through the commercial banks or by issues of new currency during the coming fiscal year.

## BUSINESS

### *Department-Store Sales*

The Federal Reserve index of department-store sales advanced consistently during the first five months of 1941 and in May had reached the best level recorded since the early part of 1930. The index is based on the dollar volume of department-store sales.

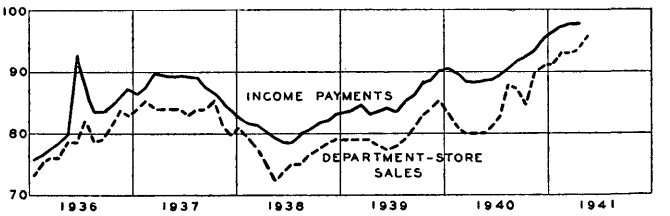
The accompanying chart in addition to presenting the index based on dollar totals shows the physical volume of department-store sales (obtained by adjusting the dollar totals for changes in retail department-store prices). The index of physical volume attained a record high level for the twenty-two-year period during the final quarter of 1940 and has advanced further during the first five months of 1941.

Although the average price of department-store merchandise has increased since the war began in September 1939, the change has not been great. Average prices increased approximately seven per cent during the period August 1939 to May 1941. Prices tended to rise during the first six months after the outbreak of the war, remained virtually unchanged from April to October 1940, and advanced fractionally during each month thereafter. Although the trends of the dollar-total curve and the physical-volume curve were similar in 1940 when price changes were moderate, the upward trend of the physical-volume curve has been less pronounced than the upward trend of the dollar-total curve during recent months when the rate of increase in average department-store prices has been higher than it was throughout most of 1940.

*Income Payments and Department-Store Sales*

The United States Bureau of Foreign and Domestic Commerce has compiled a monthly index of total income payments in the United States. This index represents changes in the combined dollar total of salaries and wages (including farm income), entrepreneurial income, rents and royalties, dividends and interest, and Government relief and benefit payments. The index affords one of the best measures of fluctuations in potential demand that is available.

**INCOME PAYMENTS AND DEPARTMENT-STORE SALES**




The index is shown in the accompanying chart for the period beginning January 1936. The figure for April 1941 (the latest month available) was 97.8 per cent of the 1929 monthly average. This compares with a low of 53.0 in April 1933. Although the index is adjusted for seasonal variations, it is not adjusted for population growth.

The dotted line on the same chart shows the index of department-store sales adjusted to the base that was used for the income payments (1929 monthly average = 100). As might be expected, the general trend of the two indexes has been closely parallel, but the month-to-month fluctuations have varied. Although intermediate movements of the two indexes are not so closely correlated that month-to-month changes in income payments can be relied on to forecast variations in department-store sales, a high level of income payments, such

as is currently being reported, assures a substantial department-store dollar volume.

### *Foreign Trade Trends*

The United States Department of Commerce last week reported that the value of merchandise exports for the month of April 1941 was $364,000,000. This total was approximately 14 per cent greater than the value ($317,000,000) in April 1940 and exceeded the April 1939 total of $228,000,000 by about 60 per cent.

Following the publication of the foreign trade data by destinations and by types of merchandise for March 1941, the Department of Commerce suspended the release of such analyses of foreign trade data, apparently for the duration of the emergency. Judging by the reports for the first quarter of the year, more than half of our exports, measured in dollars, is now being shipped to the British Empire, and the most important commodity groups are machinery and aircraft.

### *Postal Receipts*

The dollar volume of postal receipts during the first five months of 1941 exceeded the volume for the corresponding period of 1940 by 5.6 per cent. There was a somewhat greater-than-seasonal decrease during May from the April total, but receipts for that month were 4.3 per cent greater than they were in May 1940. The dollar volume of postal receipts is primarily an indicator of commercial activity. The monthly series for the first five months of 1941 and for earlier significant years are shown in the accompanying table.

POSTAL RECEIPTS IN FIFTY LARGE CITIES
(*In Millions of Dollars*)

| *Month* | *1929* | *1932* | *1937* | *1938* | *1940* | *1941* |
|---|---|---|---|---|---|---|
| January | 31.6 | 25.3 | 27.9 | 27.5 | 30.4 | 32.3 |
| February | 30.0 | 24.1 | 27.8 | 27.0 | 29.7 | 30.5 |
| March | 34.4 | 26.7 | 33.8 | 31.8 | 32.7 | 34.0 |
| April | 32.4 | 24.3 | 31.1 | 29.6 | 31.6 | 34.9 |
| May | 32.4 | 22.6 | 29.8 | 28.2 | 32.3 | 33.7 |
| June | 29.3 | 22.0 | 29.6 | 28.0 | 28.7 | |
| July | 29.1 | 23.8 | 26.6 | 24.6 | 27.6 | |
| August | 29.3 | 23.9 | 26.3 | 26.6 | 29.0 | |
| September | 30.5 | 25.8 | 30.0 | 29.5 | 30.3 | |
| October | 35.7 | 26.7 | 31.7 | 30.9 | 35.2 | |
| November | 32.7 | 26.1 | 30.7 | 31.4 | 33.2 | |
| December | 40.8 | 33.1 | 42.0 | 42.5 | 45.4 | |

## THE FUNDAMENTALS

### *Supply*

The steel-ingot production rate was unchanged last week at 100 per cent of theoretical capacity. The current situation in the steel industry was summarized by the *Iron Age* as follows: "A further expansion of Government projects will create new demands for structural steel, reinforcing bars and other products. Large orders for shells, forgings, cases, primers, and fuses are to be bid on soon, and further expansion of plants is being considered by aircraft parts makers, machine-tool builders, and other industries. Additional steel will be required for the forthcoming cantonment program. Orders for the British will pile in on top of all other growing defense requirements. Several important steps which were taken at Washington in the past week tend to emphasize the stringent situation in which many nondefense industries will soon find themselves if they have not already been seriously affected. The growing shortage of scrap has now reached a point where the efficient melting of steel has been affected in some districts. Scrap stock piles at mills are being reduced as incoming tonnage falls short of consumption. Unless methods are speedily found to increase the supply of scrap, a critical situation may develop within the next several weeks."

| | *1929* | *1932* | *1937* | *1938* | *1940* | *1941* |
|---|---|---|---|---|---|---|
| Per Cent of Capacity | 96.0 | 22.0 | 75.5 | 27.5 | 87.0 | 100.0 |

(Latest 1941 weekly data; corresponding week earlier years)

There was an increase of 14.7 per cent in electric power produced last week compared with output in the corresponding week of 1940. Outstanding gains (21.6 and 20.3 per cent, respectively) were reported from the New England and Central Industrial regions.

| | *1929* | *1932* | *1937* | *1938* | *1940* | *1941* |
|---|---|---|---|---|---|---|
| Billion Kilowatt Hours | 1.70 | 1.44 | 2.21 | 1.99 | 2.66 | 3.06 |

The automobile industry produced 134,682 cars and trucks last week, slightly more than the preceding week's output of 133,645 units. Labor disturbances, as well as material shortages, suggest the possibility that the present high rate of production cannot long be maintained.

| | *1929* | *1932* | *1937* | *1938* | *1940* | *1941* |
|---|---|---|---|---|---|---|
| Units (000 omitted) | 128 | 44 | 112 | 42 | 94 | 135 |

The Nation's cotton mills were active last week, and the seasonally adjusted index was only slightly below the record high level established in the preceding week. Last week's index was 171.8 per cent of estimated normal, compared with 172.8 (revised) in the preceding week.

| | *1929* | *1932* | *1937* | *1938* | *1940* | *1941* |
|---|---|---|---|---|---|---|
| *New York Times* Index | 121.0 | 72.4 | 143.8 | 92.1 | 113.4 | 171.8 |

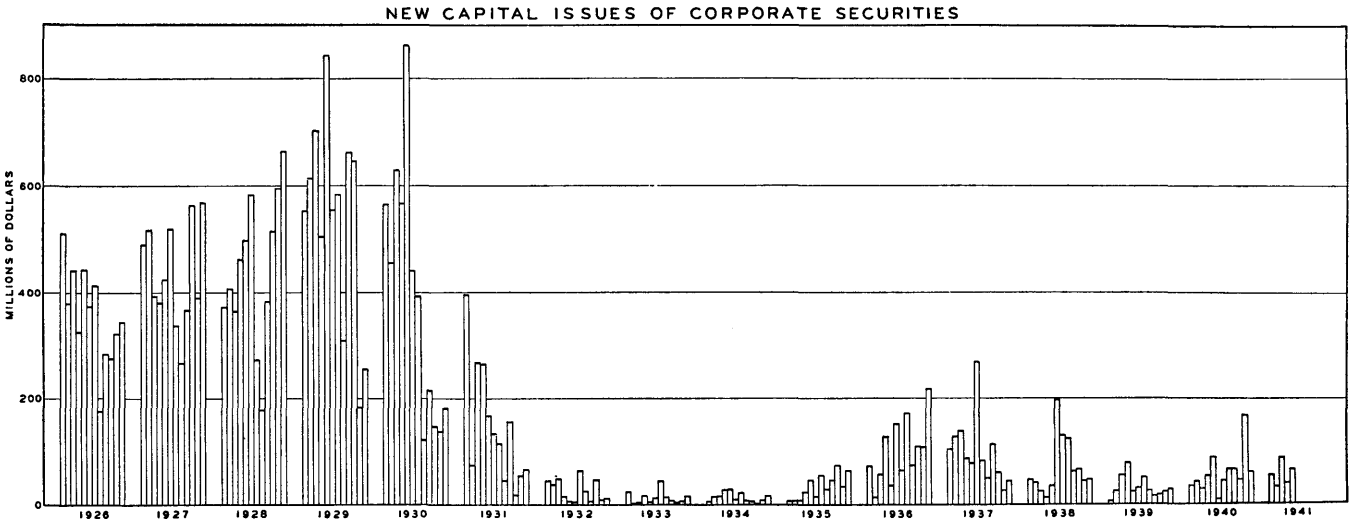
Lumber production increased slightly more than seasonally last week and the adjusted index advanced from 114.0 to 114.3.

| | *1929* | *1932* | *1937* | *1938* | *1940* | *1941* |
|---|---|---|---|---|---|---|
| *New York Times* Index | 131.1 | 38.6 | 96.6 | 65.4 | 106.9 | 114.3 |

### *Demand*

Reports from retail establishments were more favorable last week than they were in the preceding week. The value of department-store sales was 13 per cent greater than it was in the corresponding week of 1940. Although demand for products for defense will presumably be limited only by productive capacity this year, demand for consumer goods may be curtailed if the Government succeeds in its announced endeavor to discourage civilian purchases by curtailing the public's buying ability. An indication of the steps that may be taken is contained in the following statement from the June issue of the Federal Reserve Bulletin (page 496):

"Measures for curtailing consumption include direct limitation of production, as in the case of automobiles, and other less direct methods such as the proposed limitation of consumer demand by further increases in taxes. Some of the taxes proposed would be selective in character, designed to restrict consumer purchases of automobiles and various other durable goods using materials required for national defense purposes. Regulation of consumer credit is another step under discussion as a method of limiting such purchases. The Treasury's program for sale of Defense Savings Bonds to the general public is designed to encourage savings and channel the funds into defense expenditures rather than have them augment demand for goods during the emergency."




## *Prices*

The sensitive wholesale commodity price indexes remained about unchanged last week. Moody's Spot Commodity Price Index was 198.1 on June 12 and 199.0 on June 19. The Dow-Jones Index of Commodity Futures closed at 70.94 on June 12 and at 71.48 on June 19. In spite of the substantial increase in the spot commodity price average that has occurred since the war started, Moody's Spot Commodity Price Index at its present level is about five per cent lower than it was at the height of the 1936–1937 inflationary price advance. The futures index is now within two per cent of the high point recorded in 1937. Apparently the reason for the different relationships of the two indexes to their 1937 records is that the spot commodity price index has a wider representation of commodity items than the futures index that primarily reflects changes in prices of agricultural commodities. The prices of agricultural commodities have advanced more substantially during recent months than has the general commodity price average.

# FINANCE

## *The Harwood Index of Inflation*

The Harwood Index of Inflation in ratio form declined from 108.0 at the end of May to 106.6 for the latest week for which bank data are available (June 11, 1941). The money-credit situation is now almost completely dominated by Treasury policies, and the decline in the Index was the direct result of Treasury operations.

The commercial banks actually increased their holdings of Government securities approximately $300,000,000 without any corresponding increase in their savings-type liabilities. However, the inflationary effect of the new demand deposits thereby created was more than offset by an increase of somewhat more than $600,000,000 in Government deposits with the Federal Reserve Banks and in "special depositaries account of sales of Government securities." The Treasury's accounts with these depositaries increased from $1,147,000,000 on May 28 to $1,746,000,000 on June 11. The increase in Government deposits indicated the withdrawal of purchasing media from the total available to the public.

The increase in the Treasury's current general fund position was made possible by heavy Treasury borrowing. In addition to sales of $170,000,000 of Savings Bonds, the Treasury disposed of an issue of $660,000,000 of new National Defense Bonds. The conditions of sale of Savings Bonds provide for their purchase from savings, and a large proportion of the national defense issue was also purchased by savings institutions and individuals and was paid for without creating new deposit credits.

A further decline in the Index may be expected later in the month when receipts from the second installment of the income tax effects the transfer of more funds from private to public accounts.

## *New Capital Issues*

Although the volume of new capital flotations remained small during May, it at least exceeded the April total. The total for May was $64,000,000, compared with an aggregate of $39,000,000 in April. More than half of the new issues ($37,000,000) were offered by the railroads to finance the purchase of new equipment. Only $4,000,000 was borrowed by the public utilities, and the remaining loans were made to finance industrial plant expansion.

The volume of new capital issues during the first four months of 1941 was about the same as the total in the corresponding months of 1940. The chart reveals no tendency of corporate financing to revive to the level typical of the 1926–1931 period. Ordinarily in a time when there is a need for expanding the Nation's industrial facilities, the financing would be accomplished by new capital issues of private corporations. However, the Government is able to borrow money at a lower coupon rate than is the private corporation, and corporate executives apparently prefer to obtain funds for the expansion of facilities for national defense production from Government agencies.

The chart at the top of the page shows the volume of new corporate financing in the United States by months and facilitates comparison between the flow of new capital into industry during recent months with that during the corresponding period shown. The data for investment-trust issues are excluded to avoid duplication.