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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

We Begin to Pay

The outstanding feature of the new Federal tax measure is the drastic broadening of the base to include the lower income groups. If this had been done at the beginning of the New Deal's spending orgy, the resulting brake on expenditures might have prevented, at least in part, the Federal extravagance that has increased the national debt so greatly. (Of course, a program of broad general taxation would have been contrary to the theories of pump priming and redistributing income that were such an essential part of the New Deal's recovery and reform program.) Strong objection to Federal extravagance apparently becomes sufficiently widespread as to influence the Nation's vote only when the costs of the program are brought home to a large segment of the people. Because of the cost of collection, the small payments assessed against the lower income groups may not result in substantial net profit to the Government, but practical demonstration of the fact that the cost of Government must be borne by the people and not by some magic power of the Federal Treasury will insure more effective protest against a reckless fiscal policy.

If the emergency tax burden that has now been imposed is not to become permanent after the present crisis has passed, the voters must learn certain fundamentals. It is most important that they see the direct connection between tax payments (including hidden tax levies) and the cost of Government. The money juggling that has been going on since the depression has so obscured this connection in the public mind as to encourage the idea that the Government is in the happy position of being able to spend regardless of current income.

If the new army of taxpayers learns to scrutinize Federal expenditures more carefully, they may come to realize that the result of Government extravagance cannot be passed on to a future generation. Great as the Nation's tax bill is, it will still not be sufficient to meet more than 60 per cent of present Government outlays. Of course, the notion that private debt is bad and that public debt is good has been fostered by many New Deal adherents. They have maintained that the Government debt could be indefinitely increased and at times should deliberately be increased as a social welfare measure. Continuation of such a policy will mean disaster, and one virtue of the new tax bill lies in the fact that it may help us to stop short of an irretrievable disaster such as the uncontrolled inflation of the German mark in 1923.

BUSINESS

Department-Store Sales

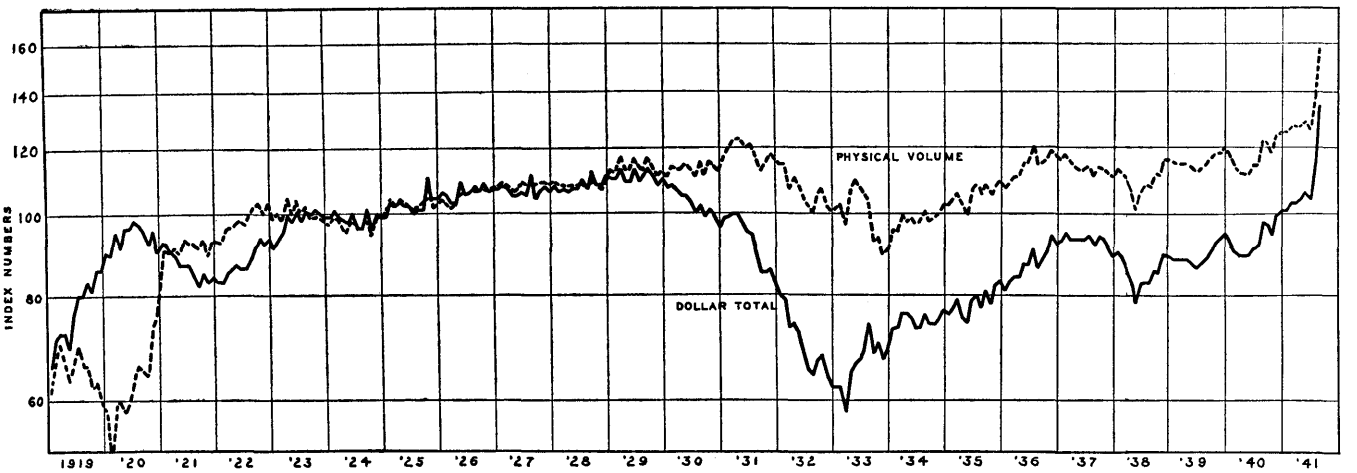
The Federal Reserve's seasonally adjusted index of department-store sales is reproduced at the top of page 152, together with an index of the physical volume of sales. In order to compute the index of physical volume, the Federal Reserve index of department-store sales, which has as its base the 1923–25 average equal 100, has been divided by a retail-price index based on the same period. By this method, the trends of department-store sales, measured both by dollars and by physical volume, can be observed. A ratio scale was used in order to facilitate comparisons between the trend of the two indexes. The behavior of these indexes is especially significant at times such as the present, when abnormal economic developments cause unusual changes in the consumer goods demand-supply relationship.

The most significant feature in the relationship of the two curves during the earlier years shown is the evidence of a great shrinkage in physical volume that occurred late in 1919 and early 1920, when commodity prices were soaring. The decreased physical volume of department-store sales, which reached a low point in February 1920, reflected the "buyers' " strike that was given prominent newspaper publicity at that time. There was a rapid decline in prices from the summer of 1920 to the summer of 1921, and this was accompanied and followed by a prompt and substantial rise in the physical volume of department-store sales, although the dollar volume was declining.

The index of physical volume remained at a higher level than the index of dollar sales during 1921 and 1922, when consumers were making purchases that had been postponed during the buyers' strike of 1919–1920. In the period from 1922 to 1930 commodity prices were stable, and the indexes of physical volume and dollar sales followed a substantially identical trend.

After the stock-market break of 1929, when retail prices began to decrease, the physical volume was well sustained and in 1931 reached its high for the entire movement. Consumers were taking advantage of the apparent bargains that were offered by department stores, and, until the continuing depression seriously

DEPARTMENT-STORE SALES



curtailed the public's ability to buy, they were able to continue making substantial purchases, measured by physical volume. During the period from 1929 to 1933 the slope of the dollar-total curve, when compared with the slope of the index of physical volume, shows that the decline in prices was more rapid than the contraction in physical volume. The extreme divergence from the trend in 1932 and early 1933 reflected the sale of goods at distress prices.

It is interesting to note that the physical volume, which had increased sharply in the summer of 1936 when the soldiers' bonus was paid, turned downward early in 1937, although the dollar total of sales was maintained throughout the greater part of 1937. Rising retail prices met consumer resistance and, on a much smaller scale, the diverging trends of 1919 were repeated.

The comparative movement of the two indexes shows that substantial and rapid general price increases soon meet consumer resistance. An upward trend of prices that is gradual and moderate does not appear to have a visible effect on the physical volume. On the other hand, lower prices help to sustain a substantial volume of sales even during a period of declining business activity. This behavior is a practical illustration of the phenomenon that economists call "elastic demand."

Although the average price of department-store merchandise increased during the first year and a half of the present war, the change was not great during this period, and the trends of the dollar-total curve and the physical-volume curve were similar. The trends of both curves were upward. It was not until July this year that the buying wave produced by the national defense industrial boom reached panic proportions. Rising wage scales, wider employment opportunities, and expansion in other income payments provided the wherewithal for a great expansion in consumer goods purchases. Increased talk of shortages in many types of consumer goods this summer frightened the public into endeavoring to protect itself by rushing in to anticipate future needs. This resulted in spectacular advances in the two indexes during July and August 1941, as the chart shows. The Federal Reserve index of department-store sales, based on dollar totals, advanced from 104 in June to 115 in July and to 135 in August.

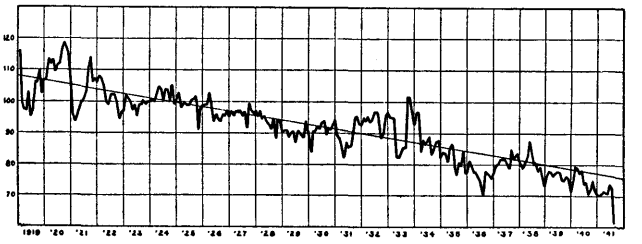
Although the index of physical volume also rose substantially, the average price of department-store merchandise increased more rapidly than it had during the earlier part of the war period, and, although there was an increase of nearly 30 per cent in the dollar-total index from the June to the August level, the index of physical volume increased less than 26 per cent.

If, as now appears probable, prices of department-store merchandise continue to rise, but income payments remain stabilized at about the present level, the trend of the physical-volume index will probably show an increasingly adverse trend in comparison with the index of dollar totals. Furthermore, it would not be surprising if there were temporary reactions from the buying panic that may have reached a peak, for the time being at least, in August. Early reports from the Federal Reserve districts for September show smaller increases in the level of sales compared with those in the corresponding weeks of 1940 than were reported in July and August.

Ratio of Retail Inventories to Sales

The accompanying chart shows the ratio derived by dividing the Federal Reserve index of department-store stocks each month by the Federal Reserve index of department-store sales. Although the indexes are based on data that include only one-third of the total department-store trade, the ratio shows the approximate level of inventories in relation to consumer demand throughout the country.

RATIO OF RETAIL INVENTORIES TO SALES



A marked feature of the curve shown is its long-term downward trend. The ratio of stocks to turnover has been steadily decreasing during the period covered by the indexes. The approximate long-term trend obviously cannot continue in a straight line indefinitely. However, there is as yet no indication of a change in the tendency to limit stocks of merchandise.

Department-store stocks were small in relation to sales when the 1936 business boom began, but were gradually built up and were apparently excessive for a brief time in 1938 after the boom had collapsed. Since then the ratio has in general remained below the long-term trend line, and we believe that last month it not only reached a new low level for the period shown, but also was farther below the long-term trend line than at any other time. The data for department-store stocks, on which the ratios for July and August are based, are preliminary. The Federal Reserve indexes of department-store stocks for these months have not yet been published, and our estimates are based on incomplete reports. Apparently, there was a substantial increase in department-store stocks during July, but it was presumably less than the increase in the volume of sales. Although department stores bought more heavily at wholesale in August, it is obvious that only part of these purchases could have been added to their stocks of goods in view of the great volume of sales reported during that month.

The Trend of Commercial Failures

Although the number of business insolvencies increased slightly in August from the July level, they remained well below the monthly average for this year. The liabilities of commercial failures, which are the more significant figures, decreased in August to the lowest total in the monthly series compiled by Dun and Bradstreet. The revised series include, in addition to voluntary and involuntary bankruptcies, long-term discontinuances with a loss to creditors and statistics of concerns forced out of business through such action as foreclosure, attachment, or execution with insufficient assets to cover all claims. The new series is carried back to January 1939, and the trend of both the number and liabilities of failures has been irregularly downward during the period covered. The number and liabilities of commercial failures during each month of the past two years and during the first eight months of 1941 are shown in the accompanying table.

COMMERCIAL FAILURES, NUMBER AND LIABILITY

	Number of Failures			*Liabilities of Failures (In Millions of Dollars)*		
	1939	*1940*	*1941*	*1939*	*1940*	*1941*
January	1,567	1,237	1,124	20,790	15,279	11,888
February	1,202	1,042	1,129	13,582	13,472	13,483
March	1,332	1,197	1,211	19,002	11,681	13,444
April	1,331	1,291	1,149	18,579	16,247	13,827
May	1,334	1,238	1,119	15,897	13,068	10,065
June	1,119	1,114	970	12,581	13,734	9,449
July	1,153	1,175	908	14,999	16,213	13,422
August	1,126	1,128	954	12,637	12,997	11,134
September	1,043	976		10,545	11,397	
October	1,234	1,111		17,464	12,715	
November	1,184	1,024		13,201	16,572	
December	1,153	1,086		13,243	13,309	
Total	14,768	13,619		182,520	166,684	

"Protective" Inventories

An article in the current issue of the Cleveland Trust Company's *Business Bulletin* brings out an aspect of the manufacturers' inventory situation that is not revealed in the data published by the United States Department of Commerce. In discussing the substantial increase that has occurred during the past year in manufacturers' inventories, the *Bulletin* states:

"The sharpest rise has occurred in goods in process of manufacture. They are now about 50 per cent above the level of a year ago, while raw materials owned by manufacturers are only 20 per cent higher. Finished goods in the hands of manufacturers are actually five per cent smaller than they were a year ago. The form which the increased inventories have taken suggests that a considerable quantity of raw materials may have been put through one or more stages of manufacture and then accumulated as protection against a possible forced redistribution of raw materials."

THE FUNDAMENTALS

Supply

The steel-ingot production rate decreased from 97½ to 95½ per cent of theoretical capacity last week. The decrease was caused by strikes in scattered plants throughout the industry and to a lesser extent by pig-iron and steel-scrap deficiencies. The proportion of the industry's capacity that is being devoted to defense work is steadily increasing. The *Iron Age* stated: "While September steel shipments covering American and British defense needs are running more than 50 per cent of the total tonnage shipped, recent orders from Washington granting additional priority ratings are likely to push the total of defense rated business in October shipments to from 70 to 75 per cent."

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Per Cent of Capacity	84.5	15.0	81.0	47.0	93.0	95.5

(Latest 1941 weekly data; corresponding week earlier years)

Electric-power companies generated 3,281,290,000 kilowatt hours last week, thus recording an all-time high in output. The Rocky Mountain region was the only geographic division of the country that has virtually failed to participate in the great increase in the distribution of electric power.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Billion Kilowatt Hours	1.81	1.48	2.28	2.21	2.77	3.28

Last week the automobile industry produced 53,165 cars and trucks, compared with output of 32,940 units in the preceding week, and 63,240 in the corresponding week of 1940. The production schedules of the automobile companies forecast increasing output of new models during the next few weeks.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Units (000 omitted)	95	23	30	16	63	53

Cotton-goods production decreased only slightly last week, when the normal seasonal trend is downward. The adjusted index advanced from 165.5 to 173.3 per cent of estimated normal.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	114.8	107.9	125.1	117.2	121.2	173.3

There was a greater than seasonal increase in lumber production last week and the adjusted index advanced from 118.9 to 125.9. A 30 per cent increase in new orders last week compared with the volume of the preceding week forecasts a further increase in production during the remaining days of September.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	129.1	34.8	86.1	76.7	116.2	125.9

Demand

The Federal Reserve index of department-store sales was eight per cent higher last week than it was in

the corresponding week of 1940. This was the smallest gain recorded since last spring; and, inasmuch as retail prices have risen seven per cent during the past year, it seems obvious that the reaction from the July-August buyer's panic has arrived.

The Government's priority system may affect the distribution of consumer goods more seriously at the present time than it would have done twenty years ago. For example, the increased demand for pleasure automobiles and for home appliances has been especially great, and steel and other metals, for which there are shortages, are essential for the manufacture of these products. If the public cannot obtain the quantity of these products that is desired, it may increase its expenditures for less durable consumer goods, or, as the Government hopes, increase its investments in Defense Savings issues.

Prices

The sensitive wholesale commodity price indexes were reactionary last week, after a rise of a month's duration. Moody's Spot Commodity Price Index was 219.3 on September 11 and 217.6 on September 18. The Dow-Jones Index of Commodity Futures closed at 83.58 on September 11 and at 82.83 on September 18.

The General Motors-Cornell Index of Wholesale Prices of 40 basic commodities for the United States has advanced 41 per cent since the war began. The index for England has risen 53 per cent. Most of the advance in prices in Great Britain (40 per cent) occurred during the first year of the war and was attributed primarily to increased costs of imported materials as a result of the depreciation of the pound. This factor has not been operative in the United States, but prices here have recently been increasing as rapidly as the British price index rose early in the war. If the present trends continue in Britain and in the United States, our living costs may rise as much as those in Great Britain have, even if our participation in the war remains limited.

FINANCE

The Harwood Index of Inflation

There was a fractional advance in the Index of Inflation (ratio form) from 106.2 for the week ending September 3 to 106.6 for the week ending September 10. Although there was a decrease of more than $100,000,000 in Government securities held by the commercial banks, this was more than offset by a decrease of $200,000,000 in the Treasury's bank deposits. The latter reflected the distribution to the public of funds previously hoarded by the Government. Apparently the Treasury refrained from borrowing to maintain its bank balances at a high level, because it expected that the receipts from the third installment of the income tax due September 15 would replenish its cash resources. The Treasury's expectations will probably be realized, because receipts from this installment are expected to be nearly $1,000,000,000. This sum, together with receipts from other sources will probably exceed expenditures for a few weeks even at the present high rate of spending. Therefore, the Index of Inflation will probably decline slightly during the next two or three weeks.

The Federal Debt

The Federal debt has more than doubled during the past eight years, and, at the present rate of increase, will have more than tripled during the decade beginning June 30, 1933. There is no question that the situation courts disaster, but, because public confidence is an important factor, it is impossible to determine precisely when and how the ill effects will appear. It is frequently contended that public debt does not have to be "paid off" and therefore that its magnitude is not especially important. However, there are other aspects of the situation that are frequently ignored.

One obvious effect of an increasing public debt is the growing interest charges that the Government must pay annually. Through its easy-money policy, the Government has been able to prevent as great a proportionate rise in the interest on the public debt as has occurred in the principal. The following summary indicates the extent to which the interest-bearing Federal debt and its service charges have increased since 1933.

Fiscal Year Ending June 30	*Interest-Bearing Debt* (*Millions of Dollars*)	*Per Cent of 1933*	*Interest on Debt* (*Millions of Dollars*)	*Per Cent of 1933*
1933	22,158	100.0	689	100.0
1934	26,480	119.5	757	109.9
1935	27,645	124.8	821	119.2
1936	32,989	148.9	749	108.7
1937	35,800	161.6	866	125.7
1938	36,576	165.1	926	134.4
1939	39,886	180.0	941	136.6
1940	42,376	191.2	1,041	151.1
1941	48,387	218.4	1,111	161.2

Although the debt increased 118 per cent during the period shown, interest charges increased only 61 per cent. Had charges increased proportionately to the increase in the debt since 1933, interest requirements for the fiscal year 1941 would have been $1,505,000,000. However, if interest rates on Treasury issues become stabilized, the debt service will increase in direct proportion to the increase in the public debt. The long period of downward trend in interest rates appears to have culminated, and, if this proves to be true, the service charge on the public debt will become a serious problem by the time the national defense borrowing program is completed.

SECURITIES

Bonds

Bond prices continued to decline last week, but the pace was less rapid than it was in the preceding week, and a firmer tendency developed during later sessions. The Dow-Jones Average of 40 bonds was 90.00 on September 11 and 89.96 on September 18.

Stocks

The stock market reflected more optimism last week than it has during the preceding two months. Although the volume of transactions on the New York Stock Exchange increased with rising prices, it remained smaller than the totals during the rise early in July.

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