

# AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

54 Dunster Street, Harvard Square - Cambridge, Mass.

W E E K L Y  
B U L L E T I N

March 16  
1942

## RESEARCH REPORTS

### COMING EFFECTS OF CURRENT EVENTS

#### *Tension*

Since the attack on Pearl Harbor, the fact that we are at war has naturally been more clearly realized on the West Coast than in other parts of the country. Civilian defense efforts have been taken more seriously where danger seemed more imminent.

Submarine activities along the Atlantic Coast have been slow in arousing public apprehension in the eastern section of the country. Recent German naval activity and Hitler's probable acquisition of much of the French fleet loom as more ominous developments. Germany appears to be acquiring a sufficiently formidable naval strength to challenge the mastery of the Atlantic sea lanes now held by the United Nations. The winter respite in Europe is approaching its close. Hitler with his central position and still retaining the offensive can choose his lines of attack. His present strength may soon be tested.

The tension that characterizes a period of defensive waiting may well be the prelude to the thorough-going war effort in this country that will prove the power of the Nation. The spring war crisis, if it comes according to schedule, should create the essential unity of endeavor between our economic and fighting fronts. If we have not gone too far down the dead-end road that France followed to defeat, the war may prove the occasion for the rebirth of our nation rather than its untimely demise. The temper of the public is changing, and it is possible that the people will develop real resistance to domination by politically powerful minority groups. If this can be accomplished, the Constitution may be saved from its internal as well as its external enemies.

### WHERE ARE WE GOING?

#### *The Background for Inflation*

Last week we described the sources from which purchasing media (currency in circulation plus checking accounts) originate and showed in the chart the abnormally large volume that is now available to the public. Although statistical evidence indicates that there will be no further appreciable expansion during the war period in the amount of purchasing media derived from either the money commodity, commercial loans, or bank credit extended on private investment-type

assets, there will certainly be a great increase in purchasing media via the "printing press."

The necessities of large-scale war have always caused a considerable expansion in the volume of purchasing media through the monetization of Government credit. In this issue we shall discuss the factors in the present situation tending to increase the volume of inflationary purchasing media available as demand in the markets, and in a subsequent bulletin we shall appraise the natural influences and the planned controls that may limit the inflationary expansion and its effects.

#### *Forcing Factors*

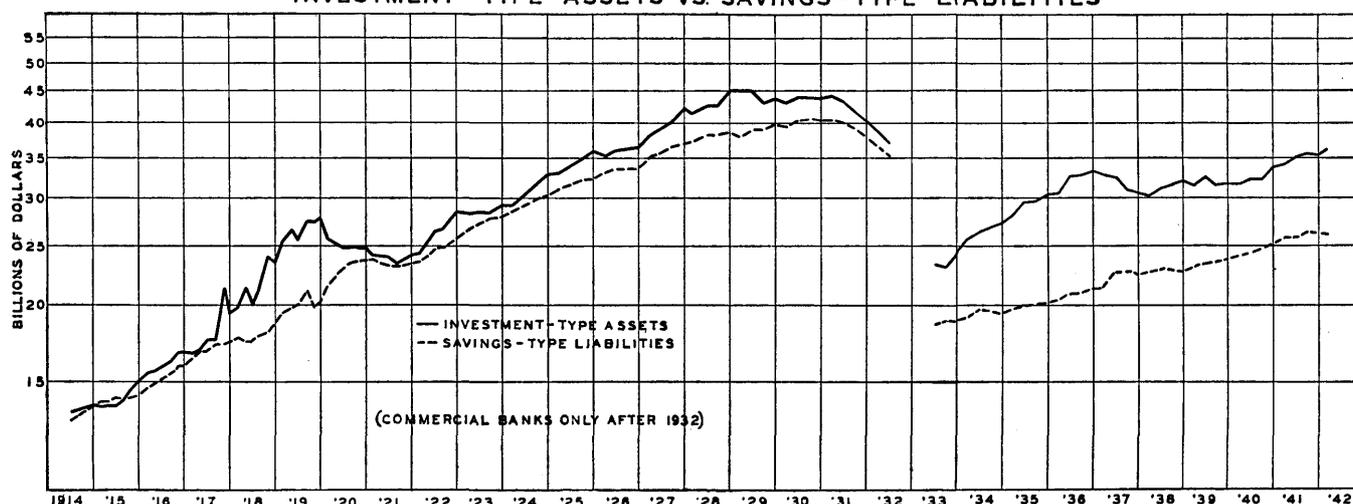
Extraordinary expenditures for national defense did not become important until after the middle of 1940. However, they began to increase substantially during the final months of that year, and, primarily because of this, the average monthly expenditures of the Federal Government increased from \$788,000,000 in the calendar year 1939 to \$805,000,000 in the calendar year 1940. The war effort really got under way during 1941, and the following table of monthly Government expenditures shows that the spending rate more than doubled during the year.

AVERAGE MONTHLY FEDERAL EXPENDITURES  
(Millions of Dollars)

	1940	1941	1942
January	712	1,111	2,628
February	668	1,075	2,630
March	822	1,399	
April	783	1,315	
May	647	1,141	
June	887	1,528	
July	818	1,598	
August	706	1,529	
September	759	1,874	
October	869	2,083	
November	817	1,858	
December	1,172	2,542	

Average monthly expenditures for the calendar year 1941 were almost double those for 1940. Tax levies were increased in order to defray part of the cost of the national defense program. Treasury receipts for 1941 exceeded those for 1940 by fifty per cent. The circumstances attending Government financial operations create an irregular flow of expenditures and receipts. For example, more than half of the Government's income is received during the four months of the year (March, June, September, and December) when the income-tax installments are paid. Treasury receipts are therefore shown quarterly in the table on page 42.

## INVESTMENT-TYPE ASSETS VS. SAVINGS-TYPE LIABILITIES



### TREASURY RECEIPTS

(Millions of Dollars)

	1940	1941
First Quarter	1,693	2,613
Second Quarter	1,488	2,420
Third Quarter	1,644	2,146
Fourth Quarter	1,591	2,483

The increase of only fifty per cent in Treasury receipts when there was an increase of 100 per cent in expenditures widened the disparity between income and outgo that has characterized Treasury operations since 1931. Budgetary deficits necessitate the creation of new public debt, and the Federal debt increased \$13,408,000,000 during the calendar year 1941, compared with an increase of \$3,293,000,000 during the calendar year 1940. If the Nation's savings are large enough to absorb the new public debt and are invested in Government issues, there will be no inflationary increase in available purchasing media resulting directly from the new debt.

During 1940, \$1,828,000,000 worth of the total new Government debt of \$3,293,000,000 was purchased by savings banks, insurance companies, Federal agencies, and individuals. The commercial banks purchased the remainder of \$1,465,000,000 of Government securities. In 1941 the Treasury and other Government officials made extraordinary efforts to finance the budgetary deficit from savings. The total new Government debt was \$13,408,000,000, and \$9,342,000,000 of the issues was purchased by individuals and by savings institutions. The remainder, \$4,066,000,000, was sold to the commercial banking system.

Congress is now expected to grant the Treasury's request to increase the Federal statutory debt limit from \$65,000,000,000 to \$125,000,000,000. The Government expenditures are mounting so rapidly that even the increased Federal tax levies will not suffice to prevent a budgetary deficit for the 1942 calendar year of about \$30,000,000,000. Even if the Treasury is as successful this year as it was in 1941 in financing its deficits through savings, the commercial banking system and the Federal Reserve System will have to absorb between \$9,000,000,000 and \$10,000,000,000 of new Government debt.

The accompanying chart shows the trend of the investment-type assets and the savings-type liabilities

of the banking system. (Data for the commercial banks only are shown after 1932.) The trend of the savings-type liabilities is relatively steady; but there are wider fluctuations in the curve showing investment-type assets. A steeper upward trend in the curve of investment-type assets indicates that these assets of the banking system are increasing at a faster rate than savings are accumulating; conversely, a more rapid downward trend usually indicates that part of the new savings at the time in question are being used to liquidate past excess originations of credit.

During our participation in the World War, the much greater increase in investment-type assets than in savings-type liabilities reflects the inflationary trend during that period. There was a similar experience during the inflation of the 1920's and again in the inflationary progression from 1933 to 1937. During the latest period shown in the chart, investment-type assets of the commercial banks have been increasing; although savings-type liabilities have increased only moderately and during the past few months have tended to decline. Even if the savings that are available to the commercial banks do not continue to decrease but become stabilized, all of the new debt that the Treasury cannot dispose of to savings institutions and individuals must be disposed of to the commercial banks and will result in the creation of an equivalent amount of new inflationary purchasing media when the banks credit the Treasury's checking accounts in payment for the bonds. It seems probable therefore that the approximately \$8,000,000,000 of inflationary purchasing media now existing will be doubled during 1942.

### *Dwindling Consumer Goods Supplies*

Although there are at present fairly adequate supplies of nondurable consumer goods in the hands of manufacturers, wholesalers, and retail merchants, there are no longer supplies of many of the most important durable consumer goods, and these may virtually disappear from the markets before 1943. The exigencies of the war will also cut deeply into our supplies of many nondurable commodities.

The Nation can no longer depend on obtaining supplies of goods that we normally import either from belligerent or nonbelligerent countries. The transport requirements of the United Nations will need nearly

all of our available ocean-going shipping during the remainder of the war. Thus, the country must prepare itself to do without many import commodities.

There will also probably be scarcities of consumer goods products, for which we have the domestic supplies of raw materials. The fabrication of these products will be curtailed by the transfer of labor and machinery to the production of war materials. As the number of our armed forces increases, the proportion of producers to nonproducers in the Nation's economy will shrink, and the supply of consumer goods for the civilian population will become less adequate.

#### *Purchasing Media, Production, and Prices*

In an economy that is functioning fairly normally, there is a definite relationship between the supply of purchasing media that represent active demand, the supply of goods, and commodity prices. This relationship can be conveniently expressed by the following formula:

$$\frac{\text{Purchasing Media}}{\text{Production}} = \text{Prices}$$

It is obvious that, when purchasing media are increasing and the production of goods offered on the market is decreasing, there will be an especially great influence tending to force prices higher. Although purchasing media normally function at a relatively uniform efficiency rate (velocity of turnover), there are occasions when there are an abnormal number of speculative exchanges, and conversely there are circumstances that discourage even the normal number of business exchanges. The factors during the present period that may limit the operation of the normal purchasing media-production-price relationship will be discussed subsequently. However, it should be emphasized that the basic economic forces are now potentially inflationary.

#### *The Line of Least Resistance*

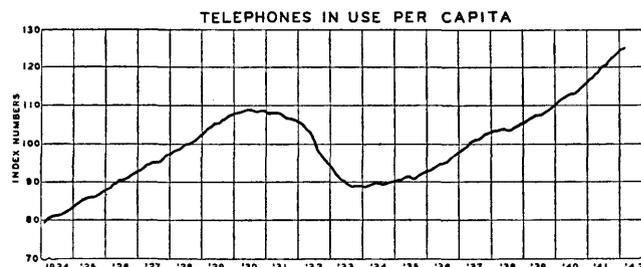
When considering the factors that probably will contribute to an inflationary progression, it would be unwise to ignore the human element, inasmuch as the money-credit mechanism is operated by human beings. The great inflationary progressions of history have developed or have been allowed to develop either because of the desire for speculative profits or because of unwillingness to do the inexpedient thing. The checks that may be effective in stemming inflation always involve immediate sacrifices in order to ward off greater sacrifices in the more distant future.

Just as in the decade of the 1920's, political pressure was exerted to prevent the Federal Reserve authorities from taking action that might have deflationary results, political pressure is now being exerted to prevent the most effective steps to check the inflationary progression accompanying the financing of extraordinary war-time expenditures. The line of least resistance dictates the rejection of any program for limiting either the inflation or the effects of inflation. It is easier for politicians to allow real wages and real returns from farm marketings to be pared by the subtle process of inflation than to attempt to discourage the activities of the organized labor leaders or the "friends of the farmer" who insist that their adherents can obtain special privileges without having to pay for them.

## BUSINESS

### *Telephones in Use*

There was an increase of approximately 120,000 telephones in service during February 1942. This compared with an increase of about the same number in the preceding month and an increase of 143,000 in February 1941. The Institute's index of the number of telephone stations in service per capita advanced from 124.9 in January to 125.4 in February. The index, expressed as a per cent of the 1935-1939 monthly average, is adjusted for population growth but not for seasonal factors. The following chart shows the trend of the index.



During the 18-year period shown, the number of telephones in service has increased from 11,500,000 to 21,440,000, a gain of 86 per cent. The population of the continental United States has increased less than 20 per cent during this period. The rate of growth for telephone service has therefore been substantially greater than the growth rate of the population.

The index reflects commercial activity to a greater extent than it does industrial activity. Although the index usually lags cyclical trends in business, it is valuable in showing the breadth of commercial activity, for which there are few comprehensive statistical indicators available.

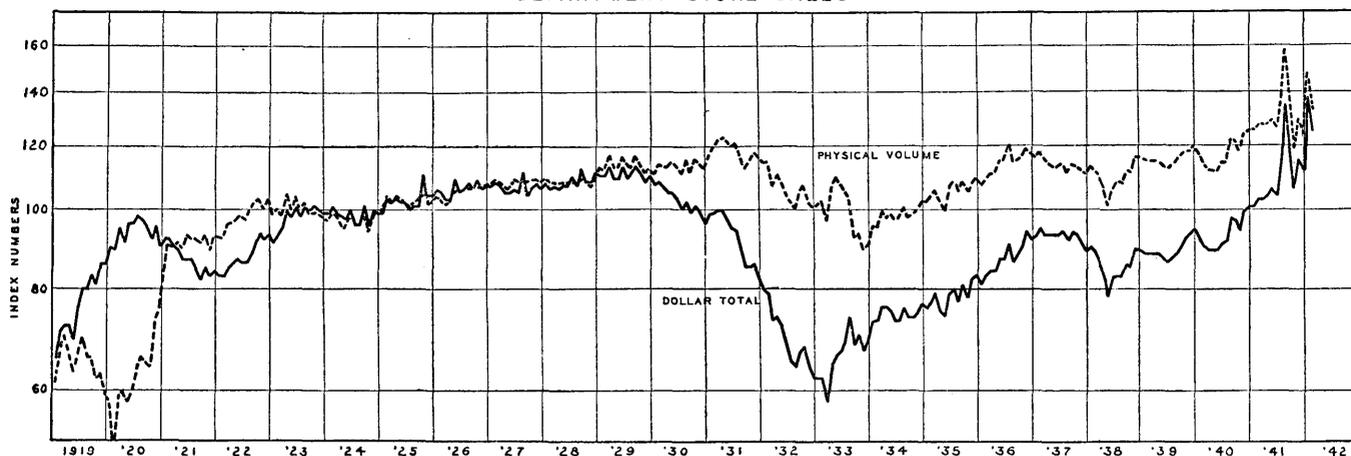
Although the index continued to advance since we entered the war, the rate of advance has diminished somewhat, especially during the first two months of 1942. If this trend continues, there will be little or no increase during the late spring and summer when the season is normally quiet for the telephone business.

### *Department-Store Sales*

The Federal Reserve's seasonally adjusted index of department-store sales is presented in the chart at the top of page 44, 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 = 100) has been divided by a retail-price index based on the same period. By this method the trend 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 trends of these 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 that a great shrinkage in physical volume occurred late in 1919 and early in 1920, when commod-

DEPARTMENT-STORE SALES



ity prices were soaring. The decreased volume of department-store sales, which reached a low point in February 1920, reflected the "buyers' strike" that occurred at that time. There was a rapid decline in prices from the summer of 1920 to the summer of 1921. This was accompanied and followed by a substantial increase in the physical volume of department-store sales, although the dollar volume was decreasing.

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 were postponed during the buyers' strike of 1919-1920. From 1922 to 1930 commodity prices were stable, and the indexes of physical volume and dollar sales followed a substantially identical trend. During this seven-year period, the trend of both indexes was gradually upward, and month-to-month fluctuations were more moderate than they were during less normal periods.

After the stock-market break of 1929, when retail prices began to decrease, the physical volume was well sustained, and in 1931 it reached the high for the entire movement. Consumers were taking advantage of the apparent bargains that were being offered by department stores; and, until the continuing depression 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 in the trend of the two curves in 1932 and early 1933 reflected the sale of goods at distress prices.

From the end of 1933 to the beginning of the present World War, changes in the two curves were generally parallel. Although the average price of department-store merchandise increased during the first year and a half of the war, the change was not great, and the trends of the dollar-total curve and the physical-volume curve were similar. It was not until late last summer 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 frightened the public into endeavoring to protect itself by rushing to anticipate future needs.

During the past six months, the month-to-month fluctuations in both curves have been wide, but the general level has been high in relation to the levels existing in the earlier periods shown by the chart. Prices have advanced substantially during this half-year period, and the index of physical volume has been reduced more nearly to the level of the index of dollar totals. Although the dollar-total index reached a new high level in January 1942, the physical-volume index for that month was lower than its best record made in August 1941.

THE FUNDAMENTALS

Supply

The steel-ingot production rate last week declined from 96½ to 95½ per cent of theoretical capacity. The decrease in operations was attributed partly to plant shut-downs for repairs and equipment installation. *The Iron Age* expressed confidence that "Obstacles to the speeding of America's arms program are unlikely to last very long in the face of a general demand for production on a war-winning scale."

	1929	1932	1937	1938	1941	1942
Per Cent of Capacity	94.0	26.5	86.0	30.0	99.0	95.5

(Latest 1942 weekly data; corresponding week earlier years)

There was a somewhat greater-than-seasonal decrease in electric-power production last week. Output was 3,392,000,000 kilowatt-hours, compared with 3,409,970,000 in the preceding week and 3,004,639,000 in the corresponding week of 1941.

	1929	1932	1937	1938	1941	1942
Billion Kilowatt-Hours	1.69	1.54	2.21	2.02	3.04	3.39

Lumber production increased less than seasonally last week, and the adjusted index declined from 132.0 in the preceding week to 129.8.

	1929	1932	1937	1938	1941	1942
New York Times Index	131.9	38.2	80.4	64.6	132.0	129.8

Demand

Last week the dollar volume of department-store sales was 28 per cent greater than it was during the corresponding week of 1941.

Prices

The sensitive wholesale commodity price indexes last week remained within the narrow range in which they have held since early in February. Moody's Spot Commodity Price Index was 228.9 on March 5 and 230.2 on March 12. The Dow-Jones Index of Commodity Futures closed at 87.19 on March 5 and at 87.41 on March 12.