

# AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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

March 15  
1943

54 Dunster Street, Harvard Square - Cambridge, Mass.

## R E S E A R C H R E P O R T S

### COMING EFFECTS OF CURRENT EVENTS

#### *New Deal Consolidated*

Until the complete texts of the two voluminous reports of the National Resources Planning Board are available for study, we cannot offer subscribers a considered opinion of their value. However, our familiarity with preceding recommendations from this source, together with newspaper summaries of the current reports, leads us to believe that they embody a consolidated statement of the New Deal's philosophy developed during the prewar period. In essence, this philosophy implies detailed management of all aspects of the Nation's economy by the Federal Executive, thereby creating the millennium through a system of benign paternalism.

The first document entitled "Security, Work and Relief Policies" envisages a considerable enlargement of the social security system already established here. The summary indicates that the report out-Beveridges the British plan without including an elucidation of financial aspects that are apparently considered minor matters that would be brought up only by pettifoggers. About the only observation concerning this report that can be made with assurance at the present time is that its influence is directed toward the elimination of social responsibilities from the local authorities and their concentration in the hands of the Federal Government.

The second report, "National Resources Development — Report for 1943," has been summarized in the press and apparently contains recommendations of a constructive nature. Nevertheless, it clearly foreshadows the retention of many wartime restrictions on industry, such as were abandoned after the first World War. The Board evidently believes that the Government should maintain control over a considerable sector of private industry after the war. It points to the examples of mixed corporations in Great Britain, having both private and Government representation on the board of directors. The extent of this Government participation in private industry can be judged from the following excerpt from the report:

"In the post-war period, the mixed corporation might be an effective form of organization for certain plants in those industries of crucial importance in war time and in which Government has made great war time investments. In this category are aluminum, magnesium, other basic metals, synthetic rubber, some chemicals, shipbuilding, and aircraft."

In transmitting the two plans to Congress, the

President stated: "Because of their basic importance to our national welfare during the war and after the war, it is my earnest hope that the Congress will give these matters full consideration during this session."

The insistence of the President on Congressional action on these programs during the present session may have political significance. Congress has expressed its opposition to the National Resources Planning Board by refusing the President's request for an appropriation to extend its life during the next fiscal year. This suggests that Congress will not be inclined to take action on the Board's recommendations. In the event that the President's request is ignored, he will be in a position to go before the voters in his campaign for a fourth term with the charge that Republican opposition has prevented the enactment of legislation vital to the people during a period of crisis.

#### *The Income-Tax Dilemma*

The usually influential House Ways and Means Committee clearly does not know what to do about income taxes this year. Its action last week indicated an inclination to ignore the popular demand for establishing assessments on a current basis, but nevertheless it recommended inauguration of collections at source on the old basis of taxing the preceding year's income. The responsibility for the present confusion in Congress regarding the Nation's fiscal policy can be laid at the door of the Treasury. This Department has temporarily at least succeeded in derailing the Ruml movement without providing a sensible solution to the extraordinary tax problem created by the war-spending program.

The peculiar attitude of the Treasury in assuming that it has contractual rights to taxes on 1942 income because of the terms of the Revenue Act of 1942 does not appear tenable. Like any other piece of legislation, this fiscal measure can be modified by Congress. Taxes are not an irrevocable gift from Congress to the Treasury, and, until they are collected, assessments can be altered. In fact, even after collections are made, it is within the power of Congress to order refunds.

The Treasury has persuaded some Congressmen that it would be unethical to adopt the Ruml plan on the tenuous assumption that the officers having charge of tax collecting have authorities superior to the mandate of the people. In no other way could tax liabilities

Note: The first article in the Institute's series of studies entitled "The Background of Investment" will appear in the next bulletin dated March 22, 1943.

be construed as assets of the Treasury rather than of the public. More practical concepts regarding fiscal relationships between the Treasury and the public may be brought forth by debate in both Houses of Congress before the Revenue Act of 1943 becomes law.

It is to be hoped that the Government's financing program will be considered as a whole embracing the two methods, taxation and borrowing, for obtaining the necessary funds to meet expenditures. If it is not already obvious, it will be made clear during the remainder of the year that the assessment of taxes has an important influence on the Government's borrowing operations. It can be taken as axiomatic that whatever expenditures are necessary to win the war will be made regardless of how the funds are obtained. At the same time, it is important for the welfare of the people and ultimately for the success of the war effort itself that financial policies of the Government are adapted as far as possible to avoid inflation with its accompanying inequities and economic disruptions. This can be done only by eliminating considerations of political expediency and by adopting measures that can be recognized as equitable by the public as a whole.

Mr. Doughton, Chairman of the House Ways and Means Committee, has assumed that the people accustomed to paying income taxes have saved the funds to meet this year's payments out of last year's incomes. Before considering the newcomers to the income-tax list, it seems desirable to examine this assumption in respect to the portion of the public inured to the income-tax system. Although Mr. Doughton has not referred to this aspect of the matter, the form in which savings for taxes exist is important in determining the effect that they will have on the fiscal program. If the prospective taxpayers have accumulated Treasury tax-anticipation notes and use these to meet tax payments due this year (as they will if they feel that future taxes are to be collected at source), this will not bring in new funds to the Treasury nor will it reduce the purchasing media available to the public. Similarly, if these funds are accumulated as deposits in savings banks and are withdrawn to meet the March and June installments of the income tax, the banks that are currently investing their funds in Government bonds will be forced to stop such a program or even to sell some Treasury issues that they now hold. Only if these funds are held in the form of hoarded currency or demand deposits will they draw off purchasing media from the inflationary potential when they are employed to meet income-tax payments.

Some of the newcomers to the income-tax liability group have no doubt saved for the prospective taxes, realizing how large they will be, and others have savings set aside for other purposes that can be used. The remainder in many instances will be faced with the necessity of borrowing. (The many loan companies that are advertising assistance in income-tax payments are apparently expecting a considerable increase in their business.) If taxation at source is enforced before these loans are liquidated, a drastic reduction in living standards by those in debt will be necessary. Of course, the Government may consider this desirable, but it is obvious that there will be less demand for War Bonds under these circumstances.

As a matter of fact, the present tax uncertainties are already having an adverse effect on the sales of Government Savings Bonds, and an increasing amount of those previously purchased are being turned in. The extent

of the damage that has been done by the controversy over the Federal income tax will not be known until late this month. There are now so many returns being made that much time must be consumed in analyzing the reports.

As far as so-called "forgiveness" of 1942 taxes is concerned, it is difficult to see why the Administration should offer opposition to the program. Adoption of the Ruml plan (with safeguards against windfalls that have been suggested) would make the public feel better about the whole tax situation without costing the Treasury any loss in revenue. The placing of taxation on a current basis is a rational fiscal policy, and, whatever the Treasury may say, it should not be accomplished by imposing double taxes on the people in order to effect the transition. If the Treasury feels that more taxes can be extracted from the people, this should be accomplished by a frank raising of the income-tax rates or, preferably, through the adoption of other types of taxation.

A sound fiscal program must be so constituted as to interfere least with the sale of War Bonds to individuals and savings institutions. To effect this, it would seem more advisable to consider the adoption of a general sales tax. Such a tax would tend to check the war-time-spending orgy and would seek out some of the excess purchasing media that have been injected into the money-credit system.

## BUSINESS

### *The Trend of Commercial Failures*

The record of commercial failures continued its favorable trend last month, and both the number and liabilities involved in insolvencies were reduced from the January totals. Since the national defense program began to interfere seriously with the normal flow of materials and finished goods and especially since our entrance into the war, many industrial and commercial enterprises have had to limit activities for one reason or another. No evidence of these difficulties has appeared in the record of commercial failures during the past two years. With the exception of the report for December 1941, which showed a substantial but temporary increase in the liabilities of commercial failures, the seriousness of losses of this nature has persistently decreased.

The number and liabilities of commercial failures during each month of the past two years and during January and February 1943 are shown in the accompanying table. The monthly series is compiled by Dun & Bradstreet. The data include in addition to volun-

COMMERCIAL FAILURES, NUMBER AND LIABILITY

	<i>Number of Failures</i>			<i>Liabilities of Failures</i> (000 Omitted)		
	1941	1942	1943	1941	1942	1943
January	1,124	962	458	\$11,888	\$9,916	\$5,515
February	1,129	916	422	13,483	9,631	4,163
March	1,211	1,048		13,444	12,011	
April	1,149	938		13,827	9,232	
May	1,119	955		10,065	9,839	
June	970	804		9,449	9,906	
July	908	764		13,422	8,598	
August	954	698		11,134	6,736	
September	735	556		9,393	5,473	
October	809	673		7,333	7,181	
November	842	585		9,197	5,245	
December	898	506		13,469	6,950	
	11,848	9,405	880	\$136,104	\$100,818	\$9,678

tary and involuntary bankruptcies other losses to creditors through concerns forced out of business by foreclosure or attachment with insufficient assets to cover all claims.

## THE FUNDAMENTALS

### Supply

The steel-ingot production rate last week remained at 100 per cent of theoretical capacity for the third successive time. During February, the industry's production of ingots and steel castings was only 6,811,882 net tons, compared with output of 7,408,744 net tons in January. The decrease was primarily caused by fewer working days in February, but adverse weather was also a factor. With new facilities in operation, a new high production record will be established for March this year if the current production rate is sustained. *The Iron Age* reported that, as an example of improved efficiency in the steel industry, better inventory controls, pooling of orders, adequate stocking, and the elimination of red tape have effected an acceleration of two months in the time required from the start of raw materials until the finished production of airplanes.

	1929	1932	1937	1938	1942	1943
Per Cent of Capacity	94.0	26.5	86.0	30.0	95.5	100.0

(Latest 1943 weekly data; corresponding week earlier years)

There was a substantial increase in electric-power production last week. The gain in comparison with output in the corresponding week of 1942 improved from 14.0 to 16.3 per cent.

	1929	1932	1937	1938	1942	1943
Billion Kilowatt-Hours	1.69	1.54	2.21	2.02	3.39	3.95

Lumber production increased slightly more than seasonally last week, and the adjusted index advanced from 110.9 in the preceding week to 111.3. Shipments also increased, while the volume of orders remained about unchanged.

	1929	1932	1937	1938	1942	1943
<i>New York Times</i> Index	124.6	40.0	81.5	63.2	129.8	111.3

### Demand

The managers of retail grocery establishments reported that housewives are avoiding making purchases involving the use of ration coupons. There is apparently a tendency to seek nonrationed items and supplement them by resort to accumulated home stocks of canned goods. Presumably, active demand for rationed goods will come later in the month before the value of the coupons expires. The rush to buy clothing is now abating. Apparently, the public is becoming convinced that the Government does not contemplate the imposition of clothing rationing in the immediate future. Last week, the dollar volume of department-store sales was only 14 per cent greater than it was during the corresponding week of 1942. This compared with a gain of 26 per cent for the first week in March and an average gain for the four weeks in February from sales in February 1942 of 31 per cent.

### Prices

The upward trend in the sensitive wholesale commodity price indexes that continued without interrup-

tion from the middle of February through the first week in March failed to make further progress last week. Moody's Spot Commodity Price Index was 248.9 on March 4 and 247.3 on March 11. The Dow-Jones Index of Commodity Futures closed at 91.60 on March 4 and 91.71 on March 11.

The cost of living increased during January 1943 and was about seven per cent higher than it was in January 1942. It has now advanced 21 per cent from the prewar level existing in August 1939. The composite index prepared by the National Industrial Conference Board and separate items for earlier significant periods are shown in the accompanying table.

	July 1914	June 1920	Aug. 1939	Dec. 1942	Jan. 1943
All Items Combined	61.3	192.6	84.0	101.0	101.4
Food	66.1	147.2	75.3	103.3	109.1
Housing	57.7	91.2	86.3	90.8	90.8
Clothing	58.8	149.9	71.9	88.6	88.6
Fuel and Light	63.3	98.6	84.0	90.6	91.7
Sundries	59.0	107.3	96.9	106.4	106.7

Higher food costs have been the most important factor in causing the wartime rise in the combined cost-of-living index, but clothing prices have also advanced substantially. Although the cost of housing has increased only moderately since August 1939, the average is now close to that reached in June 1920. The index for sundries is also approximately the same as it was in June 1920. Items included in this group are physicians' fees, reading material, housefurnishings, and candy and tobacco.

## FINANCE

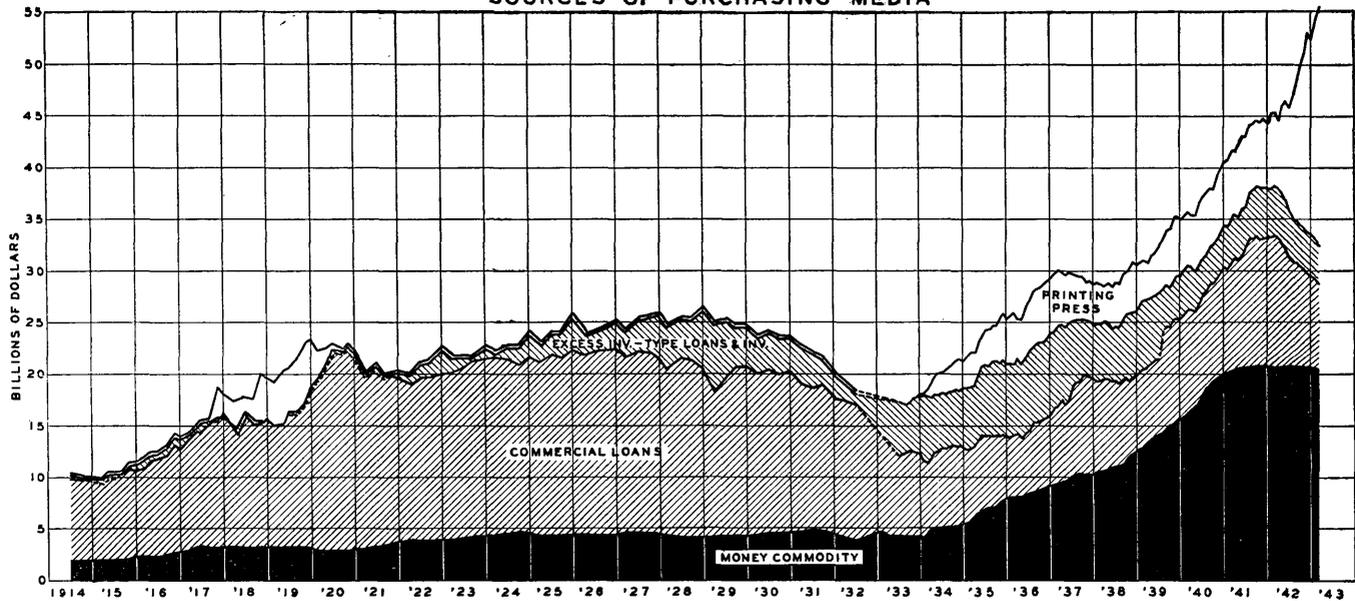
### Sources of Purchasing Media

Purchasing media include all forms of money and credit that are usually accepted by sellers in exchange for their goods or by creditors who finally complete the transaction and do not leave either the buyer or seller directly or contingently obligated in any way. Under our present money-credit system, purchasing media available to the public consist of currency in circulation plus demand deposits (checking accounts). All purchasing media in use or which someone holds available for use have come from one of the sources shown in the chart at the top of page 44.

The first and basic source of purchasing media is the money commodity represented by the solid black section of the chart. Although gold is no longer permitted by the Government to circulate in the form of coins, gold certificates representing the Government's monetary gold stocks have been delivered to the Federal Reserve Banks and form the basis for most of the Federal Reserve notes that now constitute eighty per cent of the total currency in circulation.

The chart shows that the great increase in the Nation's gold stock that began with devaluation of the dollar in January 1934 was accelerated when war was brewing in Europe in 1938 and in the first three quarters of 1939. The movement continued uninterrupted during the first year of the war and was halted only after Lend-Lease arrangements were made with Great Britain in 1941. Thereafter, the Nation's monetary gold stocks, and consequently the purchasing media

## SOURCES OF PURCHASING MEDIA



derived from them, remained virtually unchanged. Only during the past few months has there been an observable change in the situation. It is now evident that we are employing gold for war purposes, and a net reduction of about \$100,000,000 has been made in the gold held in the Treasury's reserve fund during the past three months. This of course represents a minor change in so large a total.

The second source of purchasing media, indicated in the chart as derived from commercial loans, is created in connection with the extension of credit by the commercial banks to finance the production and movement of agricultural and industrial products by private industry. The purchasing media created in this fashion are not inflationary, when the credit is used to bring goods to the civilian markets. There has been a substantial contraction in commercial loans since the United States entered the war, and this trend continued during February, when there was a reduction of about 3½ per cent from the aggregate reported at the end of January.

The third source of purchasing media involves the extension of bank credit on goods, real estate, or securities that have tangible value but which are not offered on the market during the period of the loan. The private speculative orgy of the 1920's was made possible by the purchasing media created by the banking system in this manner. Since we entered the war, the banks have decreased their holdings of non-Government securities and also their credit extended on corporate security collateral, and purchasing media from the third source have steadily decreased.

The fourth source of purchasing media arises from the Government's power to create promises to pay that are accepted at face value, primarily because of the implied promise to tax. A considerable proportion of the Government's wartime deficit financing has involved the creation of new "printing-press" purchasing media, shown as the fourth source in the chart. The commercial banks throughout the country have subscribed to new Treasury issues, in payment for which special Government accounts have been set up without necessitating

debts to any other accounts in the banking system. When the Government draws on these accounts to meet war costs, the newly created purchasing media are thereby distributed to the public. These are inflationary because they are not offset by a corresponding volume of goods appearing in the market. The recipients of the purchasing media are in a position to use them to bid for the restricted quantities of goods that remain available. There is thus a strong force exerted to raise prices, a force that can only temporarily be checked by Government edict.

During February, there was no essential change in the volume of investment-type assets held by the commercial banking system. This would ordinarily indicate that there would be no increase in purchasing media during the month (in the absence of an increase in the Treasury's gold holdings). However, during the month, the Treasury reduced its bank balances with the Federal Reserve Banks and with other depositories from approximately \$7,000,000,000 to about \$4,500,000,000. This reflected the distribution of funds acquired by the Government through tax receipts and through earlier borrowings. In effect, it represented the acquisition by the public of purchasing media, a portion of which had previously been created by inflationary means.

There will presumably be a considerable reduction in purchasing media available to the public this month as a result of the payment of the March income-tax installment. Expenditures for war activities have now attained a rate of about \$6,000,000,000 a month, and even such heavy withdrawals from the public as are involved in current tax collections will replenish the Treasury's accounts for only a brief period.

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