

AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Income-Tax Complications

The tax measure passed by Congress last week represents an unnecessarily modified and complicated form of the relatively simple Ruml plan. The mutilation of the original proposal is primarily attributable to the opposition of Treasury officials, but considerations of political expediency played an active part throughout the course of the bill's progress through the congressional mill. With all its faults as an unsatisfactory compromise measure that imposes higher taxes by indirection, it is a forward step in the establishment of a current basis for income taxpayers.

Under the new law, only individuals having a tax liability of less than \$50 applying to the larger of 1942 or 1943 incomes will have last year's assessment abated. There is a flat \$50 abatement for each person whose abatement year (1942 or 1943) tax is between \$50 and \$66.67. Others to whom the income-tax law applies must in addition to assessments made under the terms of the Revenue Act of 1942 pay one-eighth of the 1942 or 1943 liability on March 15, 1944 and another eighth on March 15, 1945. It will therefore be nearly two years before these individuals will reach a current basis, unless they elect to make advance payments.

Beginning July 1, 1943, employers are required to deduct 20 per cent of the excess of their employees' pay over family-status exemptions (17 per cent income tax and three per cent Victory tax). After this year, persons receiving income from business, professions, rents and royalties, interest and dividends, and persons with wages and salaries in excess of \$2700 if single and \$3500 if married will be required to estimate their liability above withholding level and make payments quarterly. In 1943, such taxpayers are required to file declarations of their estimated tax on September 15, and the payments made in March and June of this year will be treated as payments of their estimated 1943 tax. A new declaration can be filed on December 15, amending this estimate.

Members of the armed forces, beginning with 1943, are allowed an exemption on base service pay of \$1500 in addition to regular exemptions for civilians. Income taxes owed by any person dying while a member of the armed services in war time are completely cancelled.

Persons required to make declarations of estimated taxes from sources not withheld by employers must observe care in including income from all such sources, because a six per cent interest penalty applies if any

taxpayer's estimate is more than 20 per cent ($33\frac{1}{3}$ per cent in the case of farmers) below the actual income.

It is obvious that the new forms, when they are prepared, will be more distressing than before to taxpayers unaccustomed to dealing with accounting problems. At least, this may create a strong popular sentiment to force Congress to simplify income-tax procedure after the war is over.

Labor and Politics

As long as Samuel Gompers lived, he successfully withstood powerful pressure to force him to take sides in national party politics. He believed that any temporary advantages that organized labor might win through the power of its collective vote would be at the cost of imperiling the whole labor movement.

The prolonged coal miners' dispute has jeopardized the Nation's morale as well as its war-production program. It is alienating the public's sympathy with labor organizations. It is unquestionably the fruit of seed sown when John L. Lewis cast off the Gompers' tradition and grew to power by uniting labor politics with national politics. That combination is a union easier to create than to dissolve and bids fair to cost the Nation and the labor movement further embarrassment.

THE BACKGROUND OF INVESTMENT

The Individual's Program

The average person's savings are of vital importance for carrying him and his family through the emergencies of his productive years and are essential to safeguard his later years of retirement. Yet many, probably a majority of individuals, have no established program suitable to their special circumstances. Investments are frequently made on casual advices of friends and on "tips" of dubious origin. The investment experience of such a haphazard procedure inevitably leads to the dissipation of hard-won surplus earnings.

An investment program that will successfully meet the inevitable hazards encountered during an investor's lifetime must be based on tested principles and must also be flexible. The individual's special circumstances change from time to time, and the investment program must conform to the new conditions. It must also be

—
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adapted to the economic changes that are constantly occurring.

During the earlier portion of a man's earning lifetime, he has youth, adaptability, and surplus energy. These qualities enable him to surmount difficulties, deal with changed conditions, and, most important of all, take a severe beating in the business world and still achieve success in the future. During this period of his life, a man is justified in risking much or all of his capital in some venture that may not be successful, because he can count on both the time and the strength to recover from any setbacks that may occur.

At the ages of forty to fifty, most men lose some of the energy and vitality that have been such valuable attributes of youth. Probably their judgment is improving, but, if they are wise, they will realize that another fifteen or twenty years will find them no longer able to carry the burdens that they now shoulder with ease. Therefore, during the period of middle age, most men should adopt a more conservative course, knowing that they may not have sufficient time to counterbalance the effects of serious mistakes. Obviously, highly speculative ventures should be avoided (unless of course there is ample surplus capital in excess over probable future needs).

After the ages of fifty-five to sixty-five, most men find that their powers are somewhat lessening. They may be so fortunate as to retain the best of health, but they begin to realize that time is urgently pressing on and that, if they do not soon seize the opportunity, they may never do the many postponed things that they hoped some day would be possible. It should also be remembered that the probability of some impairment of health is greatly increased in the later years of a man's lifetime. Therefore, worry should be avoided as much as possible. Because the man who has reached this age no longer can count on the opportunity to make up speculative losses in his investments, he must invest wisely either in retirement annuities or securities that will assure him the income needed for independence during his declining years.

In view of these circumstances, we have prepared three programs that should be generally applicable to nearly all individuals who have funds for investment. Modifications can be readily made to meet differences in circumstances from those indicated.

We have designated the programs as the Speculative Plan, the Speculative-Investment Plan, and the Investment Plan. The personal circumstances to which these plans apply, together with an outline of the recommendations, are presented in the following discussion:

Speculative Plan

The plan described here, the Speculative Plan, is intended to meet the needs of the speculator who desires to augment his capital in spite of the fact that speculation necessarily involves the risk of losses as great as the anticipated gains. The individual for whom this plan has been prepared is assumed to have adequate and certain income, which is largely independent of the state of business activity and his own business capacity. Employees of Federal, State, and Municipal Governments and various others whose incomes are almost equally well assured would be included in this group. Of course, other individuals who might not have such a definitely assured income but who have a large capital

might well use a portion of it in accordance with this plan. It is assumed that the speculator for whom this plan is prepared has ample life insurance, accident and health insurance, or the equivalent in cash reserves; that he has provided for his retirement, or that such provision is made for him by the agency for which he works; and that he has adequate cash reserves to carry him through any period when his securities could perhaps be liquidated only at great loss.

The plan is applicable to funds ranging from approximately \$8,000 up. Individuals who have a smaller capital to use for this purpose are advised to purchase the stocks of a few leading investment trusts.

The following table indicates the approximate percentage distribution of total speculative funds that, in our opinion, should be allocated to the various groups at this time. No provision is made in this plan for cash reserves that should be available for emergencies; because, as previously explained, it is assumed that the speculator already has such reserves.

Lower-Grade Bonds	30 %	
Speculative Bonds and Preferred Stocks	<u>20</u>	
Total		50%
Common Stocks:		
Railroads	5	
Natural Resource Industries	25	
Special Industries	<u>20</u>	
Total		50%
Total		<u>100%</u>

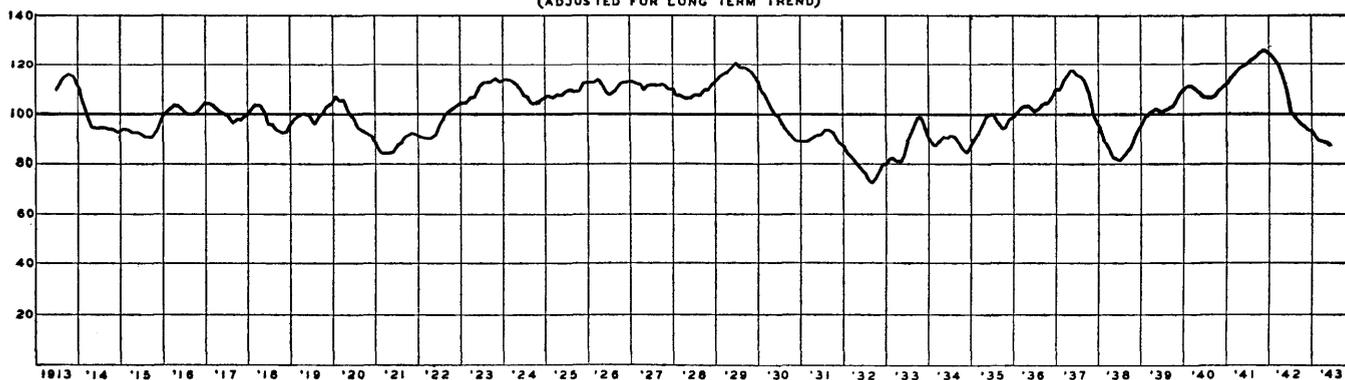
Speculative-Investment Plan

The plan described here, the Speculative-Investment Plan, is intended to meet the needs of the individual who has a reasonably certain and adequate business or other income and who desires to augment that income and increase his capital as much as possible from his investments. It is assumed that the individual following this plan has ample life insurance protection to cover the possible needs of his dependents, and that his position is such that his income will continue in spite of temporary illnesses, or that he has adequate accident and health insurance. It is also assumed that he has adequate cash reserves or the equivalent, such as the accumulated cash surrender value of life insurance policies, which could be used in the event of a serious illness or other emergency requiring unusual expenditures.

Anyone charged with the care of assets that are to be used to meet future liabilities must keep firmly in mind the purpose for which the funds are to be used. It is safe to say that much of the trouble that arises in connection with the handling of funds is directly attributable to a failure to appreciate and keep everlastingly in mind the obligations that the fund must meet. In this instance, the vital point is that the fund must be increased through the income from securities and some appreciation. A moderate degree of risk may be assumed in attempting to accumulate the funds that will later provide an income when the investor has retired from active business. Because this investor has other regular income, he is warranted in following a less conservative course than the individual who must depend on the income from his investments.

The following table indicates the approximate per-

INDEX OF LIVING STANDARDS
(ADJUSTED FOR LONG TERM TREND)



centage of total speculative-investment funds that, in our opinion, should be allocated to the various groups at this time. No provision is made in this plan for cash reserves that should be available for emergencies, because it is assumed that the speculative investor already has such reserves.

Bonds and Preferred Stocks:	
Medium-Grade Bonds	30 %
Lower-Grade Bonds and Preferred Stocks	<u>30</u>
Total	60%
Common Stocks:	
Railroads	5%
Natural Resource Industries	20
Special Industries	<u>15</u>
Total	40%
Total	100%

Investment Plan

The plan described here, the Investment Plan, is intended to meet the needs of the investor dependent on the income from his security holdings. The individual for whom this plan has been prepared is assumed to have an income from investments of from \$500 to \$10,000 per annum and to be entirely dependent on this income for his living expenses and other needs.

Anyone charged with the care of assets that must be used to meet future liabilities should keep firmly in mind the purpose for which the funds are to be used. In the Investment Plan, the vital point is that a regular and assured income must be obtained or the handling of the fund cannot be considered successful. In normal times, when not faced with the danger of inflation and a higher cost of living, the fund should not have substantial holdings of common stocks. The existence of devaluation and the probability of further inflation make it necessary for even the investor under this plan to accept risks that would be inadvisable during periods of monetary stability.

The following table indicates the approximate percentages of total investment funds that, in our opinion, should be allocated to the various groups at this time.

Cash or Equivalent	5 %
Bonds:	
High-Grade Bonds	20 %
Medium-Grade Bonds	<u>35</u>
Total	55%

Common Stocks:	
Railroads	5%
Natural Resource Industries	20
Special Industries	<u>15</u>
Total	40%
Total	100%

BUSINESS

Index of Living Standards

The index shown in the chart at the top of this page reflects the physical volume of consumer goods produced and distributed per capita in the United States. It is adjusted for long-term trend by adapting "weights" given to the component series of the index each year, so that each item will have an influence proportional to the year's production. The normal time required for consumer goods to reach the hands of the public is about six months.

It is not possible to utilize the Nation's productive capacity to the full at any time, but, when this condition is approximated in peace time, as it was during much of the decade of the 1920's, the country's living standards reach a high average level. There was much unused plant capacity during the severe depression of the early 1930's, and, even after recovery later in that decade, there were unemployed men and machines. It was therefore possible to increase the volume of consumer goods production greatly during 1941 at the same time that defense production was also being expanded. The last month before we entered the war marked the crest of the prosperity boom in the United States that was pushed to new heights, first, by demand from abroad that resulted in increased pay rolls here and, then, by our own rearmament program that gave full employment to virtually all skilled workers in the metal industries.

Production for civilian consumption reached a peak about two years ago. Large supplies of durable and nondurable consumer goods were available for distribution after the Nation's production capacity was being transferred to war work. The accumulated stocks of consumer goods have until recently cushioned the effects of the drastic decrease in production of goods to meet civilian demand. Nevertheless, the decline in living standards since we entered the war has been serious. Month-to-month declines in the index were most substantial during the first half of 1942 and thereafter became more moderate. However, the latest index for May 1943 indicates a decline of more than a point

(from 88.9 per cent of estimated normal in April to 87.6 per cent in May). Last month's decline was caused by a moderate decrease in the production of consumer goods that has previously been well sustained and a more substantial decrease in the production of consumer durable goods than any that has occurred since the middle of 1942.

It is apparent that the diversion of labor to war activities has reached a point where the civilian supply is seriously endangered. Arthur D. Whiteside, who is in charge of the Office of Civilian Requirements, has announced that steps are already being undertaken by the Government to protect home-front needs. He apparently does not consider that the civilian economy has yet reached an irreducible minimum, below which we cannot survive, because he recently stated: "We do not expect to approach [that level] until every means to prevent it is explored to the limit."

An adequate food supply is of the first importance to the maintenance of the Nation's living standards. Presumably, the Government's statistical organizations are best qualified to estimate the Nation's food-supply situation, and the following summary of the prospects for the remainder of this year, prepared by the Department of Commerce on the basis of forecasts made by the Department of Agriculture should be significant:

"Civilians apparently will have an adequate diet in 1943 when compared with earlier years, yet there is no doubt that they will not have all they may wish and can purchase. Present estimates indicate that the civilian demand for meat during the entire year 1943 may be as high as 160 pounds per capita, whereas not more than 128 pounds will be available for distribution. Similarly, there will be only about 46 pounds of fats and oils (including butter) to meet an expected demand of 55 pounds per person.

"In addition, it is anticipated that scarcity of one commodity will result in increased demand for substitutes. For example, with an adequate supply of meat, the demand for cheese would probably be around seven pounds per person, and for chickens around 26 pounds. Inability to obtain meat, however, will expand the demand for these meat substitutes. As a result, civilian demand for cheese may reach 10 pounds per person, in contrast with an estimated supply of only 5.7 pounds.

"It has been clear for some time that the diet of the civilian population must be adjusted to the available supplies of foods. Grains are in plentiful supply; there will be more wheat, rye, oats, and barley than in either 1942 or the prewar period, 1935-39. The same is true of poultry products, lard, and margarine. These products must substitute for meats, butter, fresh fruits and vegetables, and other scarce commodities. Under existing rationing regulations, there will also be a more nearly equal distribution of the commodities that are scarce.

"Farmers, of course, granted favorable weather, have still to meet the problems of scarce labor and farm machinery. The labor situation has been eased somewhat both by the recent selective-service regulation regarding the deferment of farm workers of military age and by the measures taken to induce men over 38 engaged in less essential occupations to shift to more essential jobs. Shortages of machinery are still acute, however, particularly in those areas where rapid expan-

sion in the production of certain crops, such as soybeans, has taken place in the last few years."

THE FUNDAMENTALS

Supply

The steel-ingot production rate decreased last week from 98 to 97 per cent of theoretical capacity. *The Iron Age* reported that a severe drop in steel output would result if the coal strike is prolonged for as much as a week, and stated: "Even if it ends within a few hours, the position of the steel industry from the standpoint of its coke stocks will be further impaired." This authority further expressed the opinion that "if steel tonnage is lost, it will be irretrievable." According to executives in the steel industry, the contemplated imposition of war manpower regulations for a forty-eight-hour work week in the steel plants would reduce production. Their position was expressed as follows by the steel industry's advisory committee: "In order to keep mills operating at capacity levels, the steel industry must hire about 20,000 new workers monthly to provide for the turnover, which is averaging about four per cent monthly. This turnover is expected to increase sharply with greater inroads of the draft. Already the industry is having difficulty in finding the thousands of new workers it must have monthly. That difficulty will be multiplied if, indeed, the task is not made impossible by the delays and restrictions that will result from the War Manpower Commission's instructions."

	1929	1932	1937	1938	1942	1943
Per Cent of Capacity	96.5	22.0	75.0	26.0	98.0	97.0

The increase of 20 per cent in electric-power output last week, compared with production in the corresponding week of 1942, was more favorable than any previous weekly record established this year. The industry is now generating 80 per cent more power than it was prior to the outbreak of war in 1939.

	1929	1932	1937	1938	1942	1943
Billion Kilowatt-Hours	1.69	1.31	2.13	1.88	3.32	3.99

Lumber production increased contraseasonally last week, and the adjusted index advanced from 110.4 to 111.7.

	1929	1932	1937	1938	1942	1943
New York Times Index	122.5	39.9	95.9	62.1	119.9	111.7

Demand

The public's ability to exert pressure on merchants' supplies will presumably be somewhat curtailed when the withholding tax on incomes is in force next month. However, the effect on retail sales will probably not be serious, because consumers already cannot utilize their incomes advantageously in markets where the supply of many varieties of desired goods is inadequate.

Prices

The sensitive wholesale commodity price indexes failed to exhibit decisive trends last week. Moody's Spot Commodity Price Index was 245.6 on May 27 and 245.7 on June 3. The Dow-Jones Index of Commodity Futures closed at 91.77 on May 27 and at 92.01 on June 3.

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