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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Federal Budget

On January 9, 1950, President Truman sent his recommended Budget for the fiscal year beginning next July to Congress. Although the Budget proposed is described as a "sound" and "prudent" financial program, it is expected to result in a $5,100,000,000 deficit. Furthermore, except for the expenditures of the current fiscal year, the proposed outlays totaling $42,439,000,000 are the largest for any previous peacetime year.

Receipts, on the other hand, are estimated at $37,250,000,000, the least since 1943. Direct taxes on individuals under existing legislation are expected to contribute $18,940,000,000, slightly more than is expected from this source for the fiscal year ending next June. Corporation taxes are expected to net $10,520,000,000 in the 1951 fiscal year, $650,000,000 less than such taxes during the current fiscal year. However, this estimate appears to be somewhat optimistic in view of a 21-percent decrease in corporation profits during 1949. (This percentage decrease was indicated by the President in his Annual Economic Report released last week.) For this reason alone the deficit during the fiscal year 1951 may be as much as $500,000,000 more than that estimated.

Excise taxes are expected to yield about the same revenue as that estimated from this source for the current fiscal year. However, the President has clearly indicated that some change in these taxes will be recommended. Employment taxes under existing legislation may increase more than $300,000,000 in the forthcoming fiscal year. Mr. Truman announced that he will propose new legislation intended to increase revenues from this source nearly $1,500,000,000. (The accompanying tables do not reflect the effect of proposed tax legislation.) Receipts from customs probably will be about the same as those received in recent years, but miscellaneous receipts are expected to decrease.

Of the $42,440,000,00 expenditures for the 1951 fiscal year, including those that would result from proposed legislation, $13,540,000,000 (32 percent) is for national defense. National-defense expenditures have increased each successive year since 1947 and are nearly 10 times the amount spent for the same purpose in 1940. Furthermore, Mr. Truman stated that the national-defense expenditures are "expected to approximate the 1951 level in the next few years."

In view of the large number of times that current expenditures for national defense exceed the amount spent in 1940, when the United States was threatened by two potential enemies apparently more powerful than the one threatening this country today, one might assume that war is imminent. However, we believe that war is not imminent but that it is much further in the future than it was in 1940. In a recent bulletin[1] we concluded that "men and materials used in the normal course of industrial progress and production will contribute more, in the long run, to the national defense than would use of the same men and materials for the maintenance of a large standing Army, Air Force, and Navy."

Next in order of importance, insofar as the proportion of total expenditures is concerned, are veterans' pensions and benefits. The expected cost of such benefits in the fiscal year 1951 is $6,080,000,000, about $80,000,000 less than estimated expenditures during the current fiscal year. Since the high reached in 1947, the annual cost of veterans' programs has decreased nearly $1,300,000,000.

The interest on the public debt is expected to decrease about $100,000,000 during the next fiscal year, but the President states that the decrease in this expenditure is attributable to a "shift in reporting methods." In reality, interest costs apparently will continue to increase. (The President admits that "the Budget deficits this year and next will add to the total volume of interest-bearing debt.") Unfortunately, in order to keep this cost to a minimum, the Government has persisted in continuing its easy-money policy and either has overlooked or has purposely disregarded the higher cost of Government operations that are attributable to the continued inflation resulting from the easy-money policy.

The cost of the foreign-aid program is expected to be $4,710,000,000 in the fiscal year beginning next July, about $250,000,000 less than the estimate for the current year. The decrease is attributable to an expected cutback in the ECA program and aid to occupied areas. However, the $1,300,000,000 to be saved will be largely counterbalanced by a substantial increase in commitments for foreign military assistance.

Next in importance are general public works, including housing projects, and conservation and development of land, mineral, and water resources. Although the terminology used to describe the projects is deceptive, total public-works expenditures distributed through vari-

[1] "Economic Aspects of National Defense," *Research Reports*, December 12, 1949.

ous sections of the Budget are estimated at $3,550,000,000, almost $700,000,000 more than is estimated for such purposes during the current fiscal year. Nevertheless, the President said, "The major question in my mind is not whether we are doing too much, but whether the budgetary requirements of the major national security and war-connected programs have constrained us to undertake too little toward supporting and stimulating the realization of our country's great potential development." Evidently the Administration will attempt to offset any further decreases in the cost of foreign-aid programs by recommending domestic public-works projects calculated to maintain the size of future budgets.

In a separate section of the Budget, Mr. Truman listed several public-works projects as long-term investments. This new procedure is an attempt to separate so-called recoverable, long-term assets from current costs of Government operation. Fortunately, the President has not excluded such "long-term investments" from his usual Budget computations, as was originally recommended by an advisory group.

Other features of the President's Budget were the $500,000,000 increase in the Social Security program, the $20,000,000 decrease in the cost of general government, and the $500,000,000 decrease in aid to agriculture. In referring to this last expenditure, Mr. Truman stated that the decrease would result "from smaller outlays on price supports as acreage allotments and marketing quotas serve to reduce production of some 1950 crops." In view of the continued high level of price supports on most crops, there is little doubt that farmers will produce as much as is allowable and probably will shift some land to other crops not restricted by acreage allotments. Therefore, the assumption that funds required for the price-support program can be reduced seems to be unrealistic.

Although the 1951 Budget is the largest ever submitted in peacetime, its size is overshadowed by a more significant development. In his Budget Message, Mr. Truman argued: "The soundness of a fiscal program cannot properly be judged simply by the year-to-year change in the expected margin between receipts and expenditures. A prudent program must meet much broader tests, if it is to serve the long-range interests of our people." This statement reflects a marked reversal of policy from the stand taken only a year ago, when Mr. Truman said: "In a period of high prosperity it is not sound public policy for a Government to operate at a deficit. A Government surplus at this time is vitally important to provide a margin for contingencies, to permit reduction of the public debt, to provide an adequate base for the future financing of our present commitments, and to reduce inflationary pressures."

In view of this newly adopted policy, the President's concluding statement is far from reassuring: "Our strength is not being impaired by our present great responsibilities and the temporary deficits required to meet them. Given wise policies, which meet the broadest tests of national welfare, we can look forward to the future with confidence." Can the citizens of this country "look forward to the future with confidence" when they are faced with indefinitely continuing Budget deficits and the inevitable accompaniments, inflation, depreciation of the dollar, and the concealed dissipation of the buying power of all life-insurance, pension, and savings funds?

SUMMARY OF THE NATIONAL BUDGET
(Billions of Dollars)

Accounts	*Fiscal Year 1940*	*Fiscal Year 1949*	*Fiscal Year 1950 (Est.)*	*Fiscal Year 1951 (Est.)*
Receipts:				
Direct Taxes on Individuals	$ 1.34	$18.73	$18.67	$18.94
Direct Taxes on Corporations	1.27	11.55	11.17	10.53
Excise Taxes	1.88	7.55	7.63	7.64
Employment Taxes	.84	2.49	3.05	3.34
Customs	.35	.38	.37	.38
Miscellaneous Receipts	.27	2.07	1.29	1.10
Deduct: Refunds and Trust Fund Receipts	.09	4.53	4.42	4.67
Total Receipts	$ 5.86	$38.24	$37.76	$37.25
Expenditures:				
National Defense	$ 1.50	$11.91	$13.15	$13.54
Interest on Public Debt	1.04	5.35	5.73	5.62
Other Activities:				
General Government	.34	1.17	1.22	1.28
Transportation and Communication	.53	1.62	1.89	1.68
General Public Works	.63	1.79	2.85	3.55
Veterans' Pensions and Benefits	.55	6.67	6.91	6.08
Aid to Agriculture	1.57	2.51	2.67	2.21
Social-Security Program	3.15	1.91	2.28	2.71
Labor	.01	.19	.22	.24
International Finance	.05	6.46	5.96	4.71
Miscellaneous	.08	.19	.36	.64
Reserve for Contingencies	..	..	.05	.18
Total Expenditures	$ 9.45	$39.77	$43.29	$42.44
Surplus (+), or Deficit (—)	(—)3.59	(—)1.53	(—)5.53	(—)5.19

SUPPLY

Industrial Production

Steel-ingot production, scheduled at 97.2 percent of capacity for the week ended January 14, 1950, was 1 percent more than production in the preceding week but was 2 percent less than that in the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Percent of Capacity	84	25	78	30	99	97p
Weekly Cap. (Million Tons)	1.38	1.52	1.51	1.54	1.84	1.84
Production (Million Tons)	1.16	.38	1.18	.46	1.82	1.78

Automobile and truck production during the holiday week ended January 7, 1950, in the United States and Canada was estimated at 118,588 vehicles, compared with a revised total of 113,062 vehicles for the previous week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Vehicles (000 omitted)†	96	31	96	54	98	119*p

Electric-power production in the holiday week ended January 7, 1950, increased to 5,695,372,000 kilowatt-hours from 5,492,674,000 kilowatt-hours in the previous week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Billion Kilowatt-Hours†	1.73	1.62	2.24	2.14	5.74	5.70*

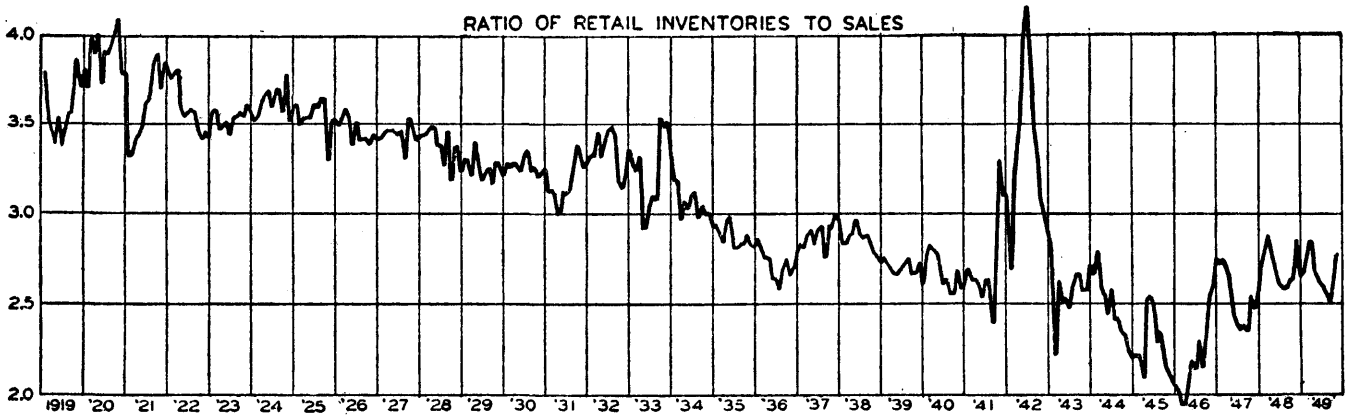
Lumber production in the holiday week ended December 31, 1949, decreased. *The New York Times* seasonally adjusted index was 16 points below that for the previous week but was 13 points above that for the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1948*	*1949*
The New York Times Index†	115*	39*	72*	105*	86*	99*

†Latest weekly data; corresponding weeks of earlier years
p=preliminary; *holiday

Ratio of Retail Inventories to Sales

The ratio of retail inventories to sales rose more than 1 percent during November to within 3 percent of the



1949 peak. However, preliminary data indicate that a substantial increase in the volume of sales during December was accompanied by some decrease in inventories. Consequently, a fall in the ratio comparable to that during December 1948 may have occurred last month.

The November increase in the ratio was attributable to a 1-percent enlargement of inventories. Sales were unchanged during the month.

At the end of November, inventories were 2.8 times the dollar value of sales during that month. Although this ratio has been exceeded only 4 times since the end of World War II, the ratio was not high compared with those of the prewar period. For 17 years the ratio remained greater than 3.0 and fell below that figure for the first time in 1936. The ratio rose to 3.0 by the end of 1937, but the downward trend was resumed until the end of 1941. The unusual increase during 1941-42 apparently was attributable to retailers' attempts to accumulate inventories before industry converted to wartime production. After receding rapidly in late 1942 and early 1943, the ratio decreased irregularly until February 1946. The subsequent upward trend, which was made possible by the resumption of peacetime production, reached a postwar peak of 2.9 in March 1948.

Although the upward trend of the ratio since last August has been marked, it apparently has been reversed; and the November figure was below the level reached last March, when retailers initiated an intensive program of inventory reductions. News reports indicate that retailers are optimistic about 1950 sales prospects. The results of a recent Dun & Bradstreet survey provide further evidence that no sharp reduction of inventories is considered necessary by business executives. On the contrary, more than half of those interviewed expected inventories at the end of the first quarter of 1950 to be equal to or greater than those at the end of the same period of 1949. (Inventories at the end of March 1949 were 4 percent greater than those at the end of November 1949.)

On the basis of preliminary sales and new-orders data. we have estimated that the ratio of retail inventories to sales may have decreased as much as 10 percent during December, primarily as a result of a large increase in sales. If retailers, encouraged by the holiday buying and optimism about the prospects for 1950, placed unusually large new orders during December, our estimate may be inaccurate; but a substantial decrease in the ratio probably occurred.

Inventories apparently were so low at the end of December that retailers will attempt to restock during the next few months. Moreover, the high probability of further inflation during 1950 (see the articles "The Federal Budget" and "Purchasing Media" in this bulletin) suggests that demand for consumers' goods will remain at a high level or perhaps increase during the next several months. If such proves to be the case, the ratio of inventories to sales may not reach the levels that have induced more or less extensive liquidation of inventories by department stores in the spring months of each of the last 3 years.

DEMAND

Purchasing Media

The amount of purchasing media in circulation increased $1,330,000,000 during December to a new high for the year. At $97,667,000,000, the total was $612,000,000 more than that reported at the end of December 1948 and only $750,00,000 less than the all-time high reached in December 1947.

The Money Commodity

Purchasing media derived from the money commodity, gold, decreased for the fourth consecutive month during December. The amount of monetized gold held at the end of December was $23,374,000,000, which was $56,000,000 less than that held at the end of November and was $186,000,000 less than the all-time high reached last August.

Devaluation throughout much of the world no doubt was partly responsible for the exports of gold in recent months. However, some relatively large sales of gold were made that may not have occurred as a result of the devaluations.

The Second Source

Purchasing media derived from the second source, commercial and agricultural loans, increased $188,000,000 during December thus raising the total to $20,300,000,000. Although the purchasing media derived from this second source have increased more than $1,500,000,000 since the low reached last July, the total is still $1,500,000,000 less than the high reached in December 1948.

In the first half of 1948 and of course in 1949, when a business recession occurred, commercial and agricultural loans decreased. During the first 5 months of 1948 such loans decreased less than $1,000,000,000, but during the first 7 months of 1949 the decrease was nearly $3,000,000,000. Much of the curtailment of borrowing by commercial, industrial, and agricultural interests in those years was directly attributable to the efforts to reduce burdensome inventories at the retail

level. In view of the relatively better retail-inventory situation this year than that existing in either 1948 or 1949, we should expect during the first half of 1950 no greater curtailment of the credit extended to business than the decrease early in 1948.

Inflationary Sources

For the third consecutive month the purchasing media derived from inflationary sources increased. The gain during December was $1,200,000,000 and since September has been nearly $3,000,000,000. The increase during December was primarily attributable to an increase in purchasing media derived from the fourth source, the printing press.

Purchase of about $1,600,000,000 Government securities by the commercial and Federal Reserve banks, particularly the latter, was primarily responsible for the increase in the inflationary-type purchasing media during December. The Treasury refunded more than $10,000,000,000 worth of maturing securities with short-term notes and certificates, most of which carried a slightly lower interest rate than the maturing issues during December. Apparently, the Federal Reserve banks were forced to underwrite a substantial portion of this refunding program. Presumably the portion of the maturing issues held by the commercial banking system was converted to the shorter-term issues, and in addition the banking system absorbed a substantial portion of the refunding issues that individuals and others did not want.

To date the Treasury has financed approximately $4,000,000,000 of the Budget deficit of more than $5,500,000,000 expected for the current fiscal year. Presumably the difference will be financed by sale of Government securities in the next several months. In view of the fact that the commercial banking system apparently acquires a large proportion of such new issues, we should expect much of the deficit to be financed by borrowing from the commercial and Federal Reserve banks.

Whether this development will be reflected in a corresponding increase in the inflationary purchasing media in circulation depends to a large extent on what the holders of tax-savings notes choose to do during the first quarter. As we have mentioned previously, nearly $8,000,000,000 of Treasury Savings notes are outstanding. If these notes are turned in to the Treasury for the payment of taxes in lieu of cash payments, the Government will be forced to borrow still more from the commercial banking system, with resulting additions to the inflationary purchasing media in circulation.

Conclusions

1. We do not expect any marked change in the amount of noninflationary purchasing media available during the next few months.

2. Any decrease in the amount of inflationary purchasing media in circulation during the first quarter of this year probably will be much less than the decreases of more than $5,000,000,000 *in the first quarters of 1948 and 1949; furthermore, some increase is possible if tax-savings notes are used to pay corporate and other taxes.*

3. During the second quarter the amount of inflationary purchasing media in circulation apparently will be increased as it was last year.

4. In view of the $5,000,000,000 *Budget deficit expected for the fiscal year 1951, the amount of inflationary purchasing media added during the last half of 1950 probably will approximate that provided during the last half of 1949.*

5. The total purchasing media in circulation may decrease slightly during the first quarter of this year, but a marked increase, perhaps to a level exceeding $100,000,000,000, *now seems probable by the end of 1950.*

Department-Store Sales

Department-store sales for the holiday week ended January 7, 1950, were slightly more than sales for the previous week but were 25 percent less than sales in the corresponding week last year.

PRICES

Commodities at Wholesale

(August 1939=100)	*1949 Jan. 12*	*1950 Jan. 5*	*1950 Jan. 12*
Spot-Market Prices (28 basic raw materials)	292	250	250
Commodity Futures Prices (Dow-Jones Daily Index)	290	279	282