Published Weekly by
AMERICAN INSTITUTE
for ECONOMIC RESEARCH
Great Barrington, Massachusetts

RESEARCH
REPORTS

January 21, 1963

State of the Union

President Kennedy's State of the Union message, delivered before Congress on January 14, contained no surprises. Although his proposal of a permanent reduction in Federal tax rates was paramount, he also discussed various aspects of the Nation's foreign relations and offered a program of "imperative" new measures for improving "the quality of American life."

The possiblity that the President would propose an income-tax reduction plan now has been realized and the broad structure of the plan has been outlined officially, although its details remain to be presented. The tax reduction, which would be achieved over a period of 3 years beginning in 1963, would result in an estimated total reduction in tax payments of $13.5 billion, but $3.5 billion of that amount would be offset by closing various tax loopholes and broadening the tax base. For the first year of the program a reduction of $6 billion in tax payments is proposed, but according to the plan this would be partly offset through a gain of $1.5 billion in tax receipts "by gradually shifting the tax payments of large corporations to a more current time schedule."

Of the proposed $13.5 billion reduction in annual tax liabilities, $11 billion would result from a lowering of the individual income tax rates from their present range of 20 to 91 percent to a range of 14 to 65 percent, and $2.5 billion would result from a reduction in the maximum corporation income tax rate from 52 percent to 47 percent.

Perhaps the most significant and encouraging aspect of the President's decison to advocate tax reduction is its indication of his recognition that the prevailing tax system has been destructive of incentives to work, produce, and invest; that it has hampered the Nation's economic growth; and that in the upper brackets of the individual income tax it is largely punitive, inducing tax avoidance procedures and consequent economic distortions while producing comparatively little revenue. The tax system that would remain would still be an inhibitor of incentives and an impediment to rapid economic growth. However, the proposed reduction of rates in the lower brackets of the individual income tax would lighten somewhat the heavy burden imposed on incomes that permit only a bare subsistence.

An unfavorable aspect of the tax-cut proposal is that it comes at a time when the Federal Government's budget shows a large deficit. In his message, the President spoke of "the need to control expenditures" and said that the tax reduction program would require "the reduction or postponement of many desirable programs." But he then went on to say, "by holding down the budgetary cost of existing programs * * * it is both possible and imperative to adopt other new measures that we cannot afford to postpone." These include "investing in our youth," safeguarding health, protecting the basic rights of individuals, and making the best use of the Nation's resources and facilities.

Evidently the President does not contemplate the reduction of deficits or the achievement of a balanced budget through a reduction in expenditures. Instead, he looks to the tax reduction program to increase the national income and thereby enlarge the Federal revenues. He said in this connection, "It is a fiscally responsible program—the surest and soundest way of achieving in time a balanced budget in a balanced full employment economy." Whether the proposed tax reduction will ultimately result in a balanced budget remains to be seen, but in the meantime, almost certainly, large deficits will accumulate.

It is this prospect of large continuing deficits that has caused concern among many thoughtful people who have experienced in the not far distant past the adverse effect of such deficits on the buying power of the dollar. Some of them wonder whether the President and his economic advisers care particularly when or whether the Government's budget is brought into balance. Perhaps the Administration at last has recognized that except during wartime the massive deficit spending of the past three decades (in which the Government's debt rose from about $18 billion to $305 billion) failed to achieve continuing full employment and to stimulate economic growth, and so it wants to experiment with a new "pump priming" method, namely, that of revenue reduction.

Many who view the tax-cut proposal in this way expect a new and perhaps marked upsurge of inflation, possibly very soon. Some think of inflation as being simply a rise in prices, not realizing that a sustained rise in the price level will not occur unless an excessive (inflationary) amount of purchasing media (currency and checking deposits) is created and put into active use. Thus, it is especially important at the present time to examine carefully not only the probable extent and timing of the tax cuts, but also other fiscal developments that will accompany them, and still other influences within the economy that can either augment or abate their inflationary potential.

Because the proposal will be subject to usual congressional procedure it is not likely to be enacted into law before the present fiscal year ends on June 30. Whether the tax reductions would apply retroactively to all of the calendar year 1963 or only the latter half of the year cannot yet be known, but a direct and immediate effect on the budget seems improbable. Meanwhile, the January 1st increase in the Social Security tax rate will yield

an estimated $1 billion additional revenue during the first 6 months of 1963 and another $1 billion in the second 6 months. Moreover, most of the anticipated deficit for the period July 1, 1962, to June 30, 1963, has already been incurred and financed by the Treasury. Thus very little deficit financing is to be expected before June 30. Possibly before the end of December a substantial part of the $1.5 billion extra revenue anticipated from readjustment of corporation income last payment dates also will have been collected by the Treasury. Thus a substantial part of the reduction of taxes proposed for the first year of the program (whether that year begins on January 1 or July 1, 1963,) could be offset by additional receipts of $3 billion or $3.5 billion. If the initial annual tax cut of $6 billion were not made effective until fiscal 1964, little or no addition to the budgetary deficit from this source could be expected throughout the present calendar year, and it seems improbable that it would add greatly to whatever deficit there were in the first half of calendar year 1964.

Although a careful appraisal of the facts indicates that further monetization of Government deficits on a large scale is not imminent, even if the President's program were fully adopted by the Congress, the general impression throughout the country seems to be otherwise. This expectation of substantially more inflation in the near future may lead to some anticipatory speculative activity, accompanied by some inflationary monetization of private debt by the banking system and possibly some increase in prices sensitive to such developments. However, when it becomes apparent that little or no further monetization of Government debt is taking place, such speculation in all likelihood will be discouraged.

Whatever may be the long-run implications of the tax reduction proposed in the President's State of the Union message, whether for the general improvement of the U.S. economy or the future buying power of the dollar, any substantial inflationary effect of tax reduction appears destined for the distant, not immediate, future.

What the Indicators Say

Among the leading indicators, the employment accession rate decreased and the inverted layoff rate remained unchanged in November. Failure liabilities, inverted, increased in December.

Among the roughly coincident indicators, four of the eight series were reported as increasing in December: the inverted unemployment rate, industrial production, personal income, and retail sales. Also, the gross national product increased during the fourth quarter.

The leading indicators are still forecasting recession.

SUPPLY

Industrial Production

Production of steel, automobiles, electric power, and lumber (1) in the 1- and 4-week periods ended on the indicated dates in the current year and (2) in the corresponding periods of earlier years was as follows:

Steel	*1929*	*1932*	*1956*	*1960*	*1962*	*1963*
Ingots—million tons						
1 week: January 12	1.16	0.38	2.43	2.72	2.30	1.91
4 weeks: January 12	3.58	1.17	9.56	10.89	8.92	7.38
Automobiles						
Vehicles—thousands*						
1 week: January 12	96	31	182	201	175	202*p*
4 weeks: January 12	278	124	630	643	644	690*p*
Electric Power						
Kilowatt-hours—billions						
1 week: January 12	1.7	1.6	11.6	14.3	17.0	17.5
4 weeks: January 12	7.7	7.5	45.0	55.4	65.4	68.3
Lumber						
New York Times Index						
1 week: January 5	132	42	128	123	104	n.a.
4 weeks: January 5	138	44	124	136	105	n.a.

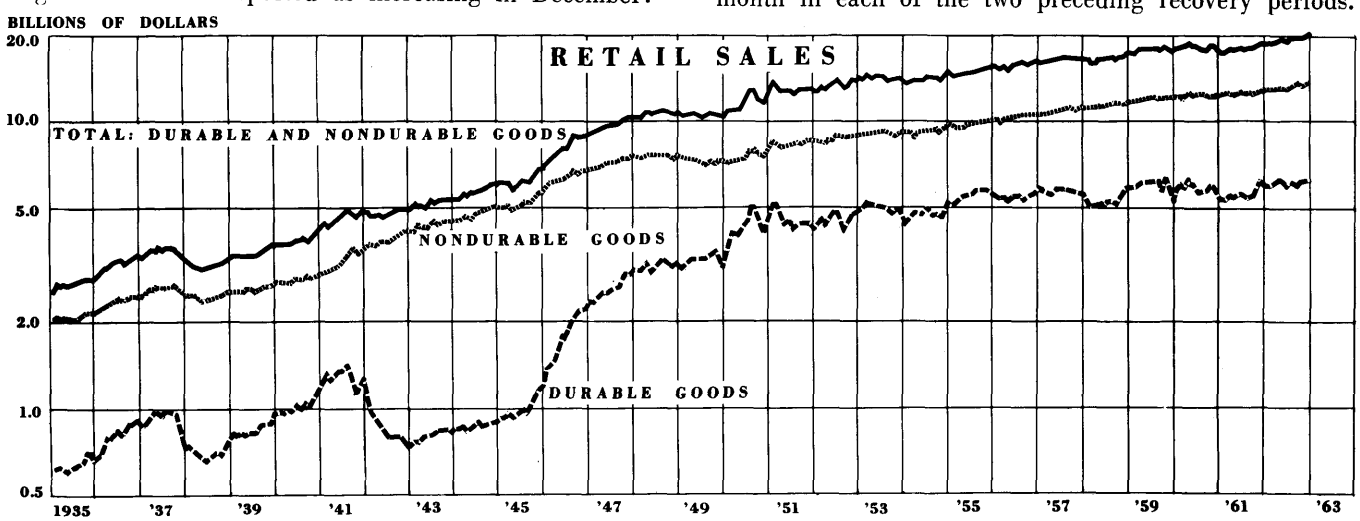
* Cars and trucks in the United States and Canada.
p Preliminary.
n.a. Not available.

DEMAND

Retail Sales

Retail sales seasonally adjusted increased in each month after August to a record amount in December preliminarily reported as 7½ percent more than those of December 1961. Sales for the year totaled nearly $235 billion, about 7 percent more than those for 1961. Aided by near-record sales of automobiles, sales of durable goods, which account for most of the fluctuations in retail sales, increased about 6 percent from September to December, compared with less than 2 percent for nondurable goods. Sales of durable goods in December were nearly 10 percent more than those in December 1961; sales of nondurable goods, which account for about two-thirds of all retail sales, were only about 6 percent more in December 1962 than in December 1961.

The rate of gain in retail sales in December measured from the most recent cyclical trough (February 1961) 22 months earlier exceeded that of the corresponding month in each of the two preceding recovery periods.



RETAIL SALES IN RECENT BUSINESS-CYCLE RECOVERIES

Kinds of Goods	*Percent Increase in Monthly Sales in 22nd Month After Cyclical Trough**		
	1954	*1958*	*1961*
All	12.7	10.9	13.1
Durable	13.9	16.9	20.5
Nondurable	11.9	8.1	9.9

* Increases are measured from 3-month averages centered at the trough months, which were August, April, and February in 1954, 1958, and 1961, respectively.

The accompanying table, Retail Sales in Recent Business-Cycle Recoveries, reveals that this was true for durable goods with reference to both the preceding recovery periods but only with reference to one of them for nondurable goods. This table compares the percentage increase in retail sales in the twenty-second months following the trough months from which the three most recent periods of business expansion have been measured. It reveals that in December 1962 all retail sales had increased 13.1 percent from their level at the latest business-cycle trough. The percentage increases for the corresponding months of the two preceding periods of expansion were 10.9 and 12.7, respectively. Data are shown similarily for sales of both durable and nondurable goods.

Because many people borrow to buy durable goods, changes in the rate of increase in consumer-installment debt tend to reflect changes in consumer confidence and dispositon to buy. For this reason, the continued expansion of consumer-installment debt augurs well for continued growth of consumer durable goods sales.

According to findings of the University of Michigan Survey Research Center released this month, consumer confidence improved during the fourth quarter of 1962 with favorable implications for retail sales during the early months of 1963. The Center's Index of Consumer Sentiment increased from 95.0 for September to 98.9 for December. The December index, however, still was not above that for early 1962. (The index is based on a rating of consumer attitudes in the fall of 1956 as being equal to 100.)

Latest weekly data for retail sales continue to show moderate increases from those of a year earlier.

Doubts concerning the business outlook that have been raised by the leading indicators of business-cycle changes are not yet reflected in retail sales, which is a roughly coincident indicator of such changes.

Department-Store Sales

The seasonally adjusted index of sales of department stores reporting to the Federal Reserve banks was 161 in December, compared with 164 in November, as revised, and with 156 in December 1961. Although sales during the early part of the Christmas shopping season were disappointing, primarily attributable to unfavorably warm weather, heavy final volume and an extra pre-Christmas shopping day brought December sales almost up to the stores' early expectations. However, sales in New York City and Cleveland were adversely affected by the newspaper strikes.

Prices of goods sold in department stores decreased 0.4 percent from October to November, when their average was 0.9 percent higher than it was in November 1961. Except for temporary reductions accompanying January clearance sales, merchants anticipated little change in store prices in early 1963.

Our index of the physical quantity of goods sold in department stores (derived by dividing the dollar sales index by the index of prices) was 8 percent more in November than it was in October and 6 percent more than it was in November 1961. The December index is estimated to have increased about 2 percent from that for December 1961.

The potential quantity of department-store sales, as measured by the production of goods commonly sold in these stores, increased 1.2 percent from November to December, and was 4.1 percent more than it was a year ago. The late December increase in sales and relatively favorable sales in the first half of January may encourage further increases in such production during January and February.

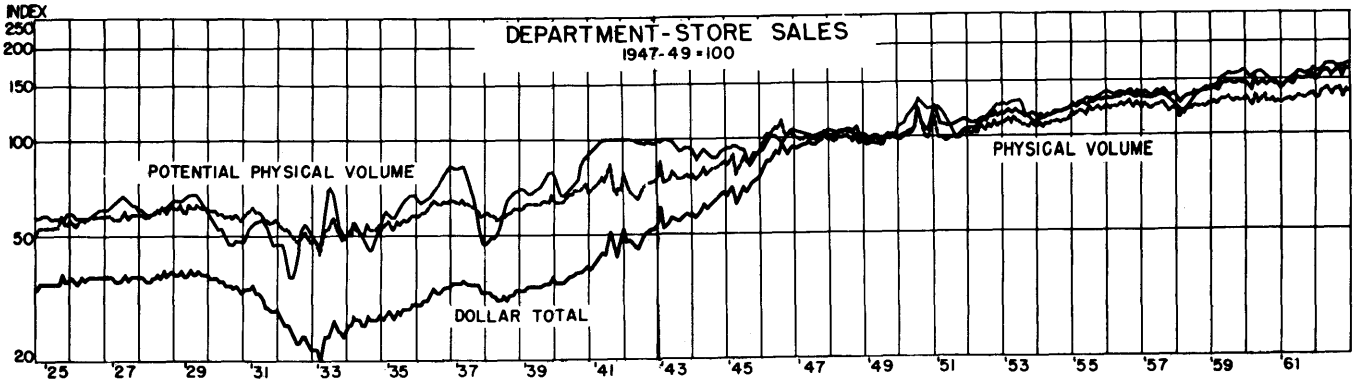
During the first 11 months of 1962, department-store sales for the country as a whole increased 5 percent more than those in the comparable 1961 period. Best regional records were attained in the South and West, with 7-percent relative gains in the Dallas, Atlanta, and San Francisco districts and a 6-percent gain in the Richmond area. Results were perceptibly poorer in the Midwest and Eastern regions, with a 2-percent gain for the Boston area and 3-percent gains in the Cleveland, St. Louis, and Kansas City districts. Stores in "downtown" metropolitan areas practically all reported relative sales decreases.

The favorable level and trend of department-store sales at the yearend and in early January suggest that department-store sales will continue their long-term upward trend for the next several months.

Latest Weekly Data

Sales of department stores reporting to the Federal Reserve banks compare with those of corresponding periods a year earlier as follows:

Period	*Percent Change*
Week ended January 12	+ 9
Four weeks ended January 12	+11



PRICES

Commodity Prices

Index	*1962* *Jan. 14*	*1963* *Jan. 7*	*Jan. 14*
Spot-market, 22 commodities	263	247	n.a.
Commodity-futures	311	302	303
Steel-scrap	$37.50	$26.50	$27.17

n.a. Not available.

Note: The indexes are respectively those of the U.S. Bureau of Labor Statistics, Dow-Jones, and *Iron Age*. The spot-market and futures indexes are converted so that their August 1939 daily averages equal 100. The steel-scrap index is a composite price for No. 1 heavy melting scrap.

BUSINESS

Ratio of Retail Inventories to Sales

Note: Data for inventories and sales are seasonally adjusted; data for orders are not so adjusted.

The ratio of inventories to sales in November for the department stores reporting to the Federal Reserve banks was 7.3 percent less than the ratio in October but unchanged from that of a year earlier.

Inventories of reporting stores at the end of November were 1.0 percent less than those of a month earlier but 5.6 percent more than inventories of a year earlier.

Sales in November were 6.7 percent more than those of a month earlier and 4.8 percent more than those of a year earlier. Indexes of inventories and sales of department stores for November and the ratio of these inventories to sales compare with those of the preceding month and a year earlier as follows:

	1961 *Nov.*	*1962* *Oct.*	*Nov.*
Inventories (1947-49=100)	180	192	190
Sales (1947-49=100)	166	163	174
Ratio: inventories to sales	2.90	3.13	2.90

New orders placed by the stores during November were 3.9 percent less than those placed during the corresponding month last year. Orders placed by the stores and unfilled at the end of November were 1.4 percent less than those at the end of November 1961.

Present indications are that store inventories are sufficiently large so that purchases by the stores during the next 2 or 3 months will be only of seasonal proportions.

BOOK REVIEW

Essays on the Soviet Economy by Naum Jasny
Frederick A. Praeger, Inc., Publisher, 64 University Place, New York 3, New York

The four essays that comprise this book are the product of nearly two decades of study of the Soviet economy. Three of the essays were completed several years or more prior to the last one and have been subject to more or less reworking on the basis of further experience and facts.

All four are sequels to three others published by the Food Research Institute at Stanford University in 1951-52.

The author not only warns of the difficulties facing the student of the Soviet economy as a result of falsified and manipulated statistics but he also seeks to give the benefit of his experience with such data by describing means he used in discovering the facts presented in his essays. The work is a valuable guide for both beginners in the field and experienced research workers.

BUSINESS EXPENDITURES FOR NEW PLANT AND EQUIPMENT
AS A PERCENT OF GROSS NATIONAL PRODUCT

Year	*1st Quar.*	*2nd Quar.*	*3rd Quar.*	*4th Quar*	*Full Year*
1954	7.6	7.5	7.4	7.2	7.4
1955	6.7	6.9	7.4	7.7	7.2
1956	8.0	8.3	8.5	8.5	8.4
1957	8.4	8.4	8.4	8.2	8.3
1958	7.5	6.9	6.6	6.5	6.9
1959	6.5	6.7	6.9	6.9	6.7
1960	7.0	7.1	7.1	7.1	7.1
1961	6.8	6.5	6.6	6.6	6.6
1962	6.6	6.7	6.9	6.8*e*	6.8*e*
1963	6.7*e*				

e Estimate.

PURCHASING MEDIA
(In millions of dollars as at month ends)

	1961 *Dec.*	*1962* *Nov.*	*Dec.*
Private noncommercial debt monetized as F.R. notes and checking accounts	42,736	43,597	48,618
U.S. debt monetized as F.R. notes and checking accounts (inc. inactive p.m.)	34,443	29,157	29,157
Silver and U.S. debt monetized as Treasury currency by U.S. fiat	3,927	3,888	3,888
Total inflationary purchasing media	*81,106*	*76,642*	*81,663*
Private commercial debt monetized as F.R. notes and checking accounts	51,345	55,121	56,008
Gold	16,889	15,978*	15,978*
Total noninflationary purchasing media	*68,234*	*71,099*	*71,986*
TOTAL PURCHASING MEDIA	149,340	147,741	153,649
Less inactive purchasing media	11,858	11,858	11,858
Total active purchasing media	*137,482*	*135,883*	*141,791*

*Net foreign short-term claims as of October (latest figure available) exceeded U.S. gold stock as at end of both November and December by $4,313 million.