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RESEARCH REPORTS

Summary

Production, purchasing power, and prices during February, as indicated by the Institute's basic indexes, showed few marked changes. The Index of Industrial Production showed a further decline. The Index of Inflation again advanced over a point. The Commodity Price Index was unchanged.

The usual discussion of the Institute's Basic Indexes and Supply, Demand, and Prices will appear in the next weekly bulletin. A tendency toward rapid recovery in industrial operations where interruptions have been caused by floods offers evidence that executives look for a strong demand during the spring season.

An examination of the Federal budget is presented in this bulletin. The chief items of receipts and expenditures are discussed with a view to estimating the probable deficit to be looked for during the fiscal year beginning July 1 of this year.

The Federal Budget

The manner in which the Federal budget for the fiscal year 1937, beginning July 1, 1936, has been presented to the nation has led to much confusion concerning the state of Government finances. Estimates of receipts and expenditures and recommendations as to means for raising needed revenue are embodied in three separate messages from the President to Congress — the regular budget message, the message on new taxes, and the relief message.

A number of factors intervened to prevent complete preparation of a budget for the guidance of Congress in making appropriations and determining tax policies when Congress first convened. The President postponed estimates of relief appropriations pending more accurate information. The AAA processing taxes were declared invalid by the Supreme Court. A measure for immediate payment of the soldiers' bonus was passed by Congress over a presidential veto.

Only an approximate appraisal of the 1937 national budget can be made at this time. The effects of continued Treasury deficits upon the nation's economy, however, are so serious that a general estimate should be attempted in order to know what further Treasury deficit to expect.

The largest item which is left in an uncertain position in the national budget is the amount needed for relief. The President has stated, "Only if industry fails to reduce substantially the number of those now

out of work, will another appropriation and further plans and policies be necessary." In view of the difficulties the Government has placed in the way of the expansion of private industry, the possibility of such additional appropriations being called for is by no means a remote one.

Receipts

In the President's original budget message, dated January 3, a table of actual and estimated receipts over a period of four fiscal years was presented. In view of certain changes which have since been made, it is probable that receipts will fall below those theoretically expected for the coming fiscal year.

The following table was presented in the President's budget message:

(In Millions of Dollars)	Actual		Estimated	
	1934	1935	1936	1937
RECEIPTS				
Income taxes	818	1,099	1,434	1,943
Miscellaneous internal revenue	1,470	1,657	1,873	2,103
Processing taxes	353	521	529	547
Customs	313	343	353	354
Miscellaneous	162	180	183	160
Taxes under the Social Security Act, etc.	39	547
Total Receipts	3,116	3,800	4,411	5,654

Under "Income taxes" it will be seen that a large increase is expected in the fiscal year 1937 over 1936 receipts. The estimate of larger income tax receipts is based upon the expectation of greater revenue due to higher corporate and individual profits. It is in this class of taxation that the additional revenue for which the President has asked, to compensate for bonus payments and loss of processing taxes, will fall. If a rearrangement of corporate and individual tax levies is to provide an additional \$600,000,000 of revenue, it will be seen that this class of receipts must be in excess of \$2,500,000,000, or over three times the amount of 1934 receipts from such sources.

In previous bulletins we have discussed recommendations made by the President for a revision of corporate and individual income tax policies. Disregarding at this time the advisability of heavy taxes on corporate surpluses, there is another feature of such a policy which is unsatisfactory. It is practically impossible to estimate the amount of revenue which will be added by taxes on future undistributed corporate earnings. The amount of revenue which may actually

accrue from the additional taxes to be imposed by Congress may be only a fraction of the \$620,000,000 which is supposed to be provided for.

The President's message on new taxes also calls for an assessment on "windfalls," resulting from the non-payment or refund of AAA processing taxes. This is intended to provide the Treasury with over \$100,000,000 additional funds. There is some doubt as to whether this proposal will be acted upon by the present Congress. In any case, the tax would have a highly doubtful status under the Constitution, and even if imposed by Congress, could not be relied upon to provide additional revenue.

Miscellaneous internal revenue taxes may be expected to yield approximately the sums indicated in the budget estimate for 1937. The items of customs and miscellaneous taxes are relatively stable. Taxes under the Social Security Act, the railroad pension act, and the coal conservation act, included in the final item under "Receipts," are all dependent upon Supreme Court decisions.

A revised estimate of the national budget for the fiscal year 1937 may be summarized about as follows:

<i>(In Millions of Dollars)</i>	
Income taxes (as of original budget)	\$1,943
Additional income taxes	620
Miscellaneous internal revenue	2,103
"Windfall" taxes	100
Customs	354
Miscellaneous	160
Taxes under Social Security Act, etc.	547
Total Receipts	\$5,827

From the above discussion, it will be seen that this summary represents the approximate maximum which can be expected for Federal receipts during the coming fiscal year. To be sure, it is possible that business recovery will provide a greater revenue than expected because of larger incomes and profits. On the other hand, it is probable that taxes received through alterations in corporate and individual income tax schedules will not result in bringing in the full amount of additional revenue asked for by the President.

Expenditures

Since the Administration has resorted to the device of dividing Federal expenditures into "Regular" and "Recovery and Relief" classifications, the regular expenditures have amounted approximately to the total receipts. Although the budget for the fiscal year 1937 calls for regular expenditures in approximately the same amount as total receipts, there is some doubt as to whether even this fictitious appearance of a balanced budget will be realized.

Expenditures for recovery and relief, according to the budget, will be substantially reduced during the coming fiscal year. However, this proposed reduction is dependent upon a substantial increase in private employment, and cannot be definitely counted upon. Actual and estimated total expenditures for the fiscal years 1934-37 inclusive are presented in tabular form in the President's budget message, as shown in the next table.

It will be seen that the cost of regular departments has increased very rapidly during the past four years, and, even excluding the cost of activities such as are provided for under the Social Security Act, has doubled in this time. The payment of the Veterans' Bonus will,

<i>(In Millions of Dollars)</i>	<i>Actual</i>		<i>Estimated</i>	
	1934	1935	1936	1937
EXPENDITURES				
1. Regular:				
Operation and maintenance of departments	\$1,086	\$1,083	\$1,568	\$2,586
Veterans' pensions and benefits	556	605	718	790
Interest on national debt	757	821	742	805
Tax refunds (excluding processing taxes)	63	45	47	49
Agricultural Adjustment Act	290	743	621	619
Civilian Conservation Corps	332	436	528	220
Statutory debt retirements	360	573	552	580
Total regular	\$3,444	\$4,306	\$4,776	\$5,649
2. Recovery and relief	3,661	3,069	2,869	*1,103
Total 1, and 2	\$7,105	\$7,375	\$7,645	\$6,752

* Estimated expenditures from unexpended balances of previous appropriations.

of course, substantially increase the item of veterans' pensions and benefits. That interest on the national debt has been maintained at a relatively stable level during the four-year period indicated, in spite of the large increase in the gross debt, can of course be attributed to the unusually favorable market for Government securities. If private capital is later able to make use of more funds at higher interest rates than the Government is now paying, or if Federal credit becomes at all impaired in the public estimation, the national debt service charges may mount rapidly, due to the large proportion outstanding in short-term issues.

In estimating the amount needed for recovery and relief, we may first assume as correct the more optimistic figure referred to in the President's relief message. This will consist of \$1,100,000,000 of funds previously appropriated, together with \$1,500,000,000 which the President has asked Congress to appropriate. (From Treasury reports of relief expenditures to date and assuming the same rate of spending for the remainder of the current fiscal year, unexpended appropriations will be in excess of the President's estimate. This will merely have the effect of postponing relief expenditures, since sums already appropriated will probably be spent during the next fiscal year.)

According to the changes which have been made in the original budget appearing in the table above, an estimate of the Federal expenditures for the fiscal year 1937 will be approximately as follows:

<i>(In Millions of Dollars)</i>	
1. Regular	
Departments	\$2,586
Veterans' pensions and benefits	1,870
Interest on national debt	805
Tax refunds	49
Soil Conservation Act	500
CCC	220
Debt retirements	580
Total Regular	\$6,610
2. Recovery and Relief	2,600
Total Expenditures	\$9,210

In estimating expenditures under the item "Veterans' pensions and benefits," we have arbitrarily added \$1,080,000,000 as the probable amount (based on the President's estimate) for which the veterans will apply in the form of cash payments. This may turn out to be a conservative figure. The fact that the President dis-

tributes this outlay over a period of nine years as a budget item does not alter the fact that the Treasury will be required to raise the entire amount immediately and thus increase to that extent the National Debt.

In case the Social Security Act and the railroad pension and coal conservation acts are declared unconstitutional, the saving in expenditures will be balanced by the loss of receipts of taxes collected under these acts, and will not affect the budget either way. It is highly doubtful if the CCC expenditures will be cut down materially from those of the 1936 fiscal year, as proposed curtailments have met with such serious objection from Congress that orders for abandoning a portion of the camps have been rescinded.

In every case we have attempted to present figures from the most favorable aspect, from the point of view of achieving a balanced budget. Changes which are likely to occur in these comparisons of revised receipts and expenditures may be expected to take the form of decreased revenue and higher expenditures. When actual expenditures are balanced with receipts for the fiscal year 1937, it is quite possible that the deficit for that year will be over \$1,000,000,000 in excess of that estimated by the President. If this is the case, little or no progress will have been made toward effecting a balanced budget.

Significant Features of the Budget

There are two features of the national budget of ominous significance to the nation's future economy. First, it becomes clear in analyzing the revised budget for the fiscal year 1937 that no appreciable progress has been made toward a reduction of Treasury deficits. Receipts, because of recovery and increased tax levies, are steadily mounting, but expenditures appear to be mounting fully as rapidly.

The following comparison of receipts and expenditures, including the revised estimates for the fiscal year 1937, indicates no encouraging trend:

	<i>Actual</i>		<i>Estimated</i>	
	<i>1934</i>	<i>1935</i>	<i>1936</i>	<i>1937</i>
<i>(In Millions of Dollars)</i>				
Receipts.....	\$3,116	\$3,800	\$4,411	\$5,827
Expenditures.....	7,105	7,375	7,645	9,210
Deficit.....	\$3,989	\$3,575	\$3,234	\$3,383

The estimate of expenditures for the fiscal year 1937 includes the non-recurring item of bonus payments. On the other hand, as we have already stated, estimates may be overfavorable to the extent of \$1,000,000,000, in which case no progress toward a reduction in the deficits, which have been running at the rate of over \$3,000,000,000, has been achieved.

Of equally serious import is the second notable feature of the Federal budget; namely, the transfer of many recovery and relief expenditures to the regular, from the recovery and relief classification. It will be seen by referring to the tables above that regular expenditures have mounted as rapidly as receipts have increased during the four-year period for which data are presented. Even ignoring expenditures under the Social Security Act, the item under "Operation and maintenance of departments" has increased to an alarming extent. This is chiefly due to record peacetime defense appropriations and also to record regular Federal bureau expenses.

In spite of the vagueness of the various budget estimates presented by the Executive Department of the Government, the information available is sufficiently clear to show that no near-term reversal can be expected in the proportion of Federal income to Federal expenditures. As long as this situation exists, Treasury deficits, financed in the only way possible, through credit extensions from the commercial banks, must continue to swell the amount of inflationary purchasing power, which in time will inevitably lead to a depreciation of the monetary unit.

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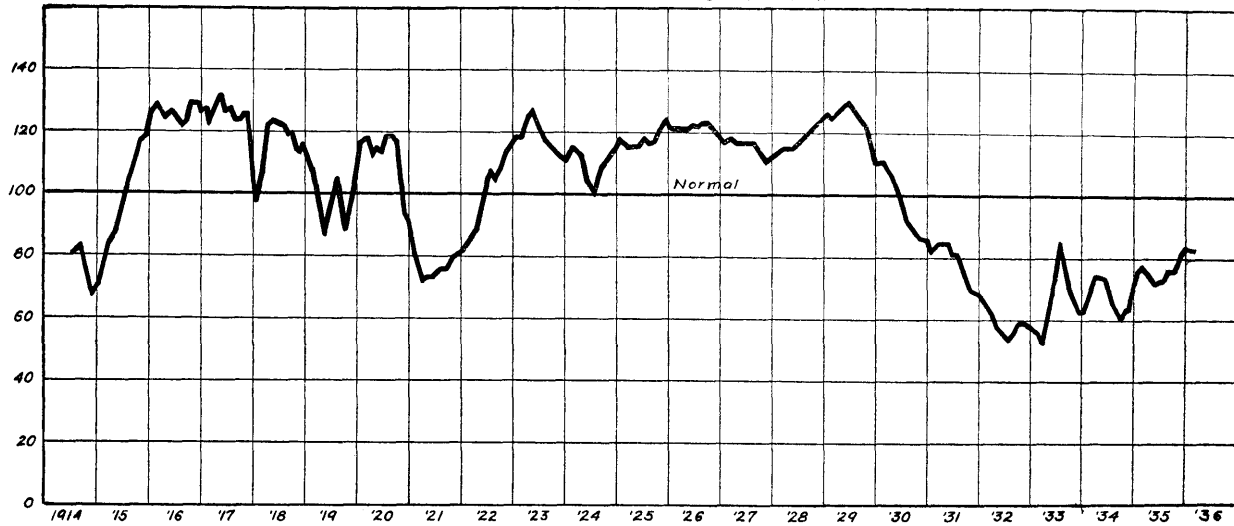
Statistical Summary

For the convenience of clients who wish a more detailed statement of the three basic indexes presented than may be obtained from the charts we make the following tabulation showing the data for the past twelve months.

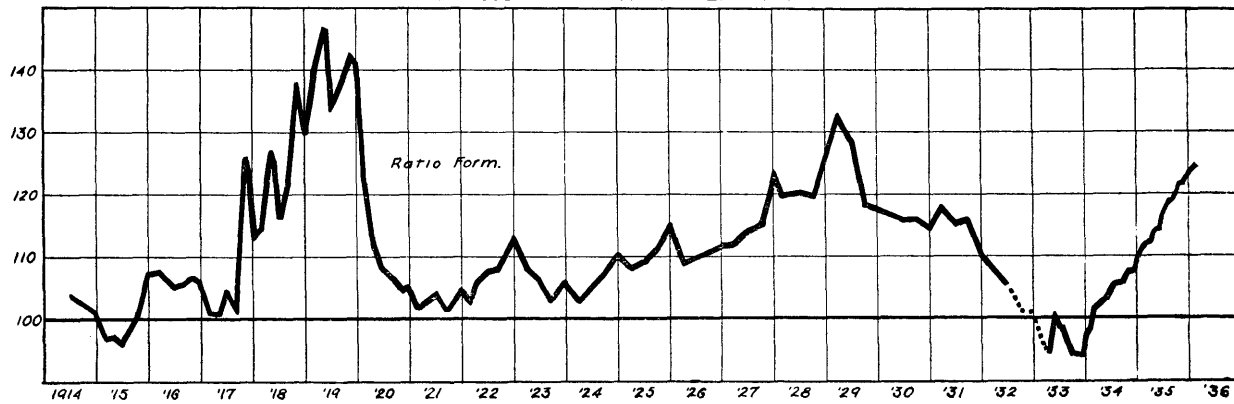
Production, Purchasing Power and Prices

	1935										1936	
	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
Index of Industrial Production . . .	75.8	73.9	71.7	73.4	73.5	76.4	76.3	78.1	81.3	83.3	82.8	81.6
Index of Inflation (ratio form) . . .	113.5	114.4	114.5	117.3	119.0	119.3	120.3	121.7	121.3	123.1	124.4	125.6
Commodity Price Index	140.5	141.0	141.0	139.8	139.6	141.5	144.0	143.2	144.0	144.8	144.4	144.4
Commodity Price Index (In terms of old gold dollar)	84.5	84.5	84.5	83.8	83.7	84.6	85.2	84.8	85.2	85.7	85.4	85.4

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COMMODITY PRICES.

