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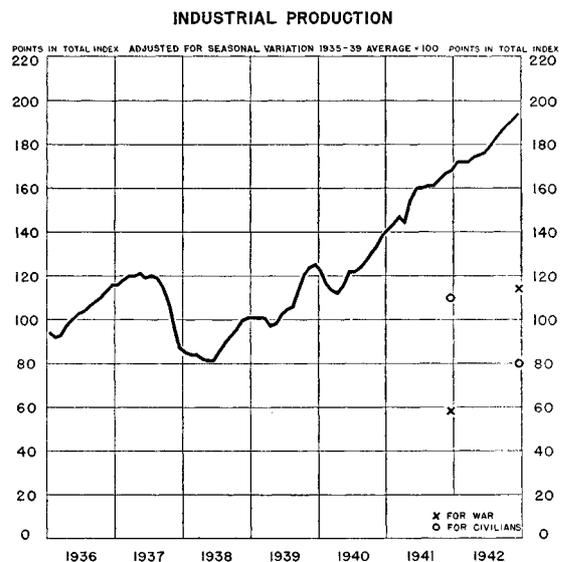
REVIEW OF 1942—TRANSITION TO WAR ECONOMY

In 1942 the economy of the United States was in transition from a peacetime to a wartime basis. According to official announcements, the armed forces, which had been about 2 million men when the United States entered the war in December 1941, were expected to exceed 6 million at the end of 1942. During the year about a million men were transported abroad in expeditionary forces; additional training facilities were provided for the armed forces in this country; and output of munitions increased fourfold. Merchant ship construction was greatly increased, in an effort not only to offset current shipping losses but also to provide additional cargo space. By the end of 1942 deliveries of completed ships were at a rate of about 12 million tons a year as compared with a rate of one million a year earlier, and a further increase was in prospect. Supplies of munitions and other items made available during the year were sufficient to permit substantial increases in lend-lease shipments.

CONVERSION OF INDUSTRY

Much industrial equipment, including a large part of that in the automobile industry, was converted to war production and many new plants were built and equipped. Furthermore, many additional projects were being completed, providing additional capacity for production of scarce

materials as well as for manufacture of finished war products. Industrial production as a whole, as is shown on the chart,



The figures on industrial production for war and civilian purposes are based primarily on estimates for individual industries and have been tested by other calculations, but at best are only rough approximations.

All December 1942 figures are estimates.

increased from 168 per cent of the 1935-1939 average in December 1941 to an estimated 194 in December 1942, notwithstanding curtailment of production for civilian use. In an effort to conserve scarce materials for war production, considerable essential information was gathered and systems of priorities improved and in some instances replaced by direct allocation and inventory control.

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In the conversion process many skilled workers were made available for war production and many new workers, chiefly women, were drawn into the labor force. Toward the year-end action was being taken by the manpower authorities to prevent undue shifting of workers from one job to another and to keep adequate numbers of trained workers in war industries and certain essential civilian lines.

MAINTENANCE OF CONSUMPTION

Curtailement of output of certain goods for civilian use, particularly metal products, was reflected to some extent in retail markets, but only slowly in most instances. Production of most consumer goods continued at a high level, and by the time output was curtailed in selected lines, producers and distributors generally had on hand large stocks of such items. Consequently, except for a few products, notably automobiles, tires, and petroleum products, consumer goods were freely available for purchase during most of the year; only at the year-end were scarcities appearing in retail markets for a substantial number of items, including various foods. Rationing programs were developed and adopted to ensure equitable distribution of a number of scarce essential commodities. A more detailed statement on the supply and price situation appears on pages 7-12 of this BULLETIN.

PRICE CONTROLS

On the financial as well as the physical side, the transition to a wartime basis was accelerated in 1942. Total war appropriations and contract authorizations rose from 64 billion dollars at the end of November 1941 to 206 billion in June 1942 and 238 billion in November 1942. War orders in-

creased sharply, and war expenditures expanded without a corresponding rise in taxes and savings. Thus, the upward pressure on prices was greatly increased. In the early part of the year prices at retail as well as at wholesale advanced rapidly, with some of the heavy buying at that time representing purchases in advance of needs, for protection against possible scarcities. To maintain orderly price conditions and thereby to promote the war effort, action was taken in May by the Office of Price Administration to stabilize prices of most goods at the highest levels reached in March. This action was taken under authority of the Emergency Price Control Act passed toward the end of January. Maximum rent ceilings were set up for an increasing number of localities as a part of the effort to stabilize the cost of living.

During the period from March to September most retail prices showed little change, but food prices, many of which were uncontrolled at existing levels, continued to advance, as shown on the chart. Wage-rate increases were also substantial in this period. In October, at the request of the President, Congress passed an amendment to the Price Control Act providing for stabilization of prices of commodities previously not under control and for stabilization of wage levels, both with certain qualifications. The same amendment provided authority for appointment of a Director of Economic Stabilization. In a tax measure adopted in October, the annual yield of Federal taxes was increased by about 7 billion dollars, with the bulk of the increased payments coming from individuals. In the calendar year 1942 net receipts from Federal taxes totaled over 16 billion dollars. Meanwhile, individuals were saving an increasing proportion of their in-

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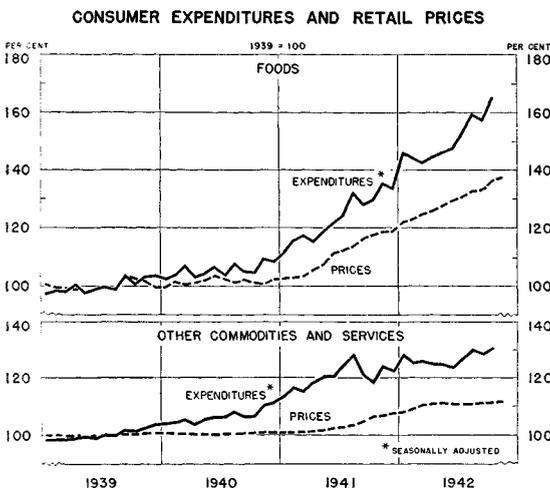
comes, chiefly by buying war bonds, paying off instalment and other debts, and accumulating currency and deposits.

Supply conditions for some commodities became more favorable than had been anticipated earlier in the year. Domestic production of many farm products reached record levels, and imports of some materials, notably wool, were larger than had been expected. As a result of all the diverse elements in the situation, including estab-

WAGE CONTROLS

Reflecting continued growth in demand for labor and the transfer of workers to the armed forces, there was a continued upward pressure on wage rates and salary levels. By order of the Director of Economic Stabilization, responsibility for salary level limitation was given to the Treasury and the War Labor Board, and the jurisdiction of the War Labor Board was extended to all wage-scale changes for workers not on farms, including changes mutually agreed upon by employees and employers. Acting under this wage control arrangement, the War Labor Board adopted a general policy of rejecting requests involving increases of more than the 15 per cent cost-of-living rise from January 1941 to May 1942. A considerable number of increases continued to be allowed, however, for industries in which previous raises had amounted to less than 15 per cent; for industries where wages were at substandard levels; and for industries where, in view of special circumstances, increases appeared essential to promote the war effort.

In manufacturing industries, average hourly earnings were about 90 cents in October, reflecting in part overtime payments in war industries, where the work week was typically 48 hours or more. In December 1941 the average had been 79 cents. Thus, the rise in this period was 11 cents, part of which was due to an increase in the proportion of workers employed in the war industries, where wage rates were relatively high and where the amount of work at overtime rates was unusually large.



Prices, food index of the Bureau of Labor Statistics and the Bureau's cost-of-living index with foods excluded converted to 1939 base. Expenditures, based on Department of Commerce seasonally adjusted data computed on 1939 base; sales of retail food stores and eating and drinking places totaled and subtracted from estimated total consumer expenditures providing an approximate breakdown of food and other expenditures. Latest figures shown for prices are for November 1942; October figures shown for expenditures are preliminary.

lished controls for most commodities, such price increases as occurred were small in most markets after March. Food prices, however, continued to advance, reflecting increases in prices of uncontrolled items and also in price ceilings of some controlled foods. The cost of living at the year-end was about 20 per cent higher than in the period of virtual stability from 1939 to early 1941, 5 per cent higher than in March 1942 and 2 per cent higher than in September 1942.

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FISCAL AND MONETARY DEVELOPMENTS

In fiscal affairs the period since Pearl Harbor has been one of rapidly increasing expenditures, and of sharply increased borrowing, with higher tax receipts offsetting only in part the rise in outlays. Expenditures for war purposes rose from about 2 billion dollars in December 1941 to 6 billion in December 1942. Further increases in expenditures, in tax receipts, and in borrowing were in prospect.

Bank purchases of United States Government securities continued in large volume. Nearly half of the increase in the public debt during 1942 was acquired by the banking system, including commercial banks and Federal Reserve Banks. As a consequence the proportion of commercial banks' loans and investments that was in United States Government securities increased from about two-fifths to over half during the year. Bank deposits rose accordingly, thus increasing required reserves and reducing excess reserves. Another drain on excess reserves came from an accelerated increase of money in circulation, which reflected chiefly the growth of payrolls, the rise in consumer expenditures and retail prices, the removal of many persons from their customary homes and bank connections, and increased holdings of idle currency.

As a result of these developments, member bank reserves in excess of requirements declined sharply during the year. Most of the decrease occurred at central reserve city banks in New York and Chicago, where Treasury receipts from taxes and security sales exceeded Treasury expenditures. In view of this situation, reserve requirements on demand deposits at member banks in central reserve cities were reduced by the Board of Governors of the Federal Reserve

System, in August, September, and October, by gradual steps from 26 to 20 per cent. Additional reserves were supplied to banks through purchases of Government securities by the Federal Reserve Banks. For the year as a whole the System's holdings showed an increase of 3.8 billion dollars.

FURTHER TRANSITION IN 1943

While the transition of the economy from a peacetime to a wartime basis had gone a long way by the end of 1942, it was not yet complete. In a great many ways the effects of war had only begun to be felt and the country was facing another year of profound readjustment in 1943.

On the physical side important shifts are to be expected in the use of manpower, in the production and distribution of goods, and in consumption. Under the program announced by the President, the armed forces are to be built up by an additional 4 million men during 1943. Also, working forces in war industries will be expanded by perhaps 3 million. About half these requirements will be met directly by drawing on students and women not ordinarily in the labor market, and the other half of the 7 million will be drawn from less essential jobs in industries producing or distributing goods for civilians or providing services for civilians. The workers withdrawn from civilian activities will be replaced in part by people not previously employed or seeking jobs; also there will be unusual incentives to increase output per employee. Already before the end of 1942, however, some civilian activities were being limited by manpower shortages and the prospect was for further reduction in output of civilian goods on this account as well as on account of material shortages. These curtailments and those that occurred

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in 1942, together with declines in stocks from earlier high levels, will be reflected to an increasing extent in reductions in the physical volume of retail sales. A growing number of items will be unavailable for purchase by consumers, at least in previous quantities, and consumers' use of durable goods on hand will be curtailed somewhat by shortages of gasoline, fuel oil, and the like. A growing number of problems relating to equitable distribution of scarce essential goods will have to be faced.

These physical readjustments, involving a general tightening of conditions in the civilian economy to meet the war program, will give rise to many problems of a price and financial nature for the people generally and for the regulatory authorities. Shortages of workers and materials are likely to be widespread, in industry and on farms, with consequent pressure on the authorities for price and wage advances. At the same time, producers and distributors, faced with declining business volumes, may regard higher prices as essential to maintain earnings.

Money incomes available for spending on goods and services or for savings, that is, incomes after payment of taxes now in effect, will be far in excess of those in 1942, while the supply of goods on which to spend them will be much smaller. As a result, there will be a strong upward pressure on retail prices, unless means are found, through additional taxes and savings, to channel more of the income into the war effort. It is not unlikely that saving—or nonspending—will be stimulated to some extent by the absence of some types of goods. There was evidence of that in 1942, and there is likely to be more. On the other hand, absorption of current income into repayment of debt, on instalment or

otherwise, has probably passed its peak. Also, the large and expanding volume of bank deposits and currency is available for increased spending.

That total physical production for war and civilian uses may continue to rise is indicated partly by current large additions to plant capacity, mainly for production of finished war products but to some extent for production of materials now scarce. War production will expand as additional plant capacity, materials, and labor are made available from one source or another. Expansion in the production of munitions, as distinguished from other war production, will be facilitated after a time by the tapering off of the large program for industrial and military construction, which will make available more materials and workers for munitions production. How far the expansion in war production as a whole may be offset by declines elsewhere in the economy will depend to a considerable degree on the availability of workers not previously in the labor market, and on output per worker, which will reflect a wide range of factors including the training and experience of employees, the hours of work, plant efficiency, and the over-all organization of production in the economy.

Production for war is largely in manufacturing and mining and consequently is reflected in a constant rise in industrial activity. The Board's index of industrial production, which had already advanced from 116 per cent of the 1935-1939 average in May 1940 to 168 in December 1941 and 194 in December 1942, is almost certain to rise further in 1943 by a substantial amount. Agricultural production was also larger in 1942 than ever before, as a result partly of planned increase but mainly because of exceptionally favorable weather condi-

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tions. In transportation, demands on available facilities will become even greater, since increases in military demands are likely to be offset only in part by reductions in the distribution of goods to retailers and consumers or additions to transportation facilities. By the end of 1942 distributors were already finding it increasingly difficult to obtain goods to sell or to hire people to sell them, and declining activity in the field of distribution seems indicated.

The exact nature and extent of the physical and financial readjustments in 1943 will depend in part on what further changes are made in the war program as new conditions develop. Recently the program has been reshaped somewhat to place added emphasis on requirements for such items as airplanes and ships, and less emphasis on certain munitions and new construction. Such changes, aimed to balance the program in the light of new developments and of an

improved situation with regard to military and industrial equipment, are of a different sort from the changes being made a year ago when the aim, under different circumstances, was to expand output and equipment in almost every direction. But, whatever the exact war measures taken, it appears that the present broad program is for a further transition to a war basis at a rapid rate and that many of the problems of 1942 in both physical and financial fields will be intensified in 1943. Experience already gained may be expected to assist in dealing with these problems and in making the maximum use of the nation's resources in a balanced and orderly fashion, so far as that is possible in a war economy. Policies in relation to price stabilization will not only promote full utilization of the nation's resources during the war but will also help to facilitate postwar readjustment.