Research Department
Federal Reserve
Bank of
San Francisco

August 14, 1981

FRBSF Weekly Letter

Summer of '41

Here we have an economy that, while confronting problems of unemployment and inflation, suddenly is forced to deal with the sharpest peacetime increase in defense spending in the nation's history. The summer of 1981? No, this all happened in the summer of 1941.

There are striking parallels between today's events and the events of 40 years ago. But there are also striking dissimilarities—such as differences in the levels of prices and wages. However, we might find it useful to review those earlier events, to see how the nation dealt with rather similar problems in that long-ago period—a period that only one-third of today's population is old enough to remember.

Low living costs . . .
The cost of living was quite different then, as can be seen from checking price lists for various items in the San Francisco Bay Area in the summer of 1941. The typical supermarket customer could buy milk for 12 cents a quart and bread for 8 cents a loaf, while fruits and vegetables generally cost 5 cents a pound. The shopper could find ground beef at 17 cents a pound, pork shoulder at 19 cents a pound, and chicken at a relatively expensive 30 cents a pound. For the discriminating palate, Napa Valley Chablis or Burgundy cost 95 cents a fifth.

A couple stepping out in style could do so in a $28 suit for him, and a $15 dress for her. They could find a six-course dinner at any number of good Italian restaurants for 65 to 75 cents each. Drinks were 15 cents at most neighborhood bars, but up to 30 cents in the more exclusive downtown hotels. The cost of a hotel room ranged between $3.50 and $6.50. For those who could not afford a new $745 Nash Sedan (25.8 miles to the gallon), the public-transit fare was 5 cents, and taxi fare was about 35 cents for the first mile.

For those prepared to miss "One Man's Family" and "I Love A Mystery" on their $18.98 Emerson table-radio (or on their $390 Stromberg-Carlson console), Katherine Cornell could be seen on stage for $2.00 in George Bernard Shaw's "The Doctor's Dilemma". And there was always a movie for 25 to 35 cents, including such 1941 hits as *The Maltese Falcon, The Wagons Roll At Night,* and also *International Squadron* ("Starring in His Most Important Role by Far—Ronald Reagan").

For the 1½ million inhabitants of the Bay Area—less than one-third as many as today—apartments in good residential areas could be rented for between $30 and $60 a month. New homes could be purchased for $5,500, including $550 down and monthly payments of $36. Property taxes were less than $100 a year on most homes, but irate taxpayers still could be shocked by a city budget of $69 million (compared with $1,200 million today).

. . . and wages
While living costs were relatively low in 1941, so were wages and salaries. Nationwide, the hourly pay in durable-goods manufacturing averaged about 80 cents—and with a 41-hour average workweek, weekly pay averaged $33.56. In retail trade, earnings averaged $22.17 a week, or about $1,050 a year. (Incidentally, Federal Reserve employees averaged $1,600 in 1941.) And in professional categories, doctors averaged $5,100, dentists $3,800, and lawyers $4,800 that year.

Nonetheless, costs and prices both rose substantially in 1941 in the wake of sharp increases in defense spending. The consumer price index increased 5 percent, compared with a one-percent increase in 1940. Factory hourly wages increased about 10 percent for the year—and weekly wages jumped 18 percent on the heels of a strong increase in the average workweek.

The unemployment rate meanwhile declined, from 14½ percent of the labor force in 1940 to below 10 percent in 1941. A major contributing factor was the Selective Service Act, which Congress passed in 1940 but renewed by only a one-vote margin in the House of Representatives in August 1941. Draft calls, plus voluntary enlistments, more than doubled the size of the armed forces, to about 1.6 million in late 1941. (But 45 percent of the 2 million initial registrants were rejected as physically or mentally unfit.) Civilian employment increased 6 percent during 1941, with 2.6 million added to defense-industry payrolls and another 400,000 added to civilian-government payrolls. Meanwhile, agricultural employment dropped by over 400,000 as farm workers left their fields and orchards to join Rosie the Riveter in defense plants and shipyards.

Size of stimulus

Heavy defense spending provided the stimulus for the sharp increase in economic activity, with a new appropriation bill responding to each advance of the German forces in Europe. Already, in May 1940, President Roosevelt obtained a $900-million appropriation from Congress to modernize the armed forces. In July of that year, Congress passed an additional $5-billion defense appropriation, largely to finance a 70-percent increase in naval tonnage. And in March 1941, when U-boats were sinking Allied shipping at a rate three times faster than the rate of ship building, the President signed HR 1776, the "Lend Lease" bill. The measure authorized the President to sell, lease, exchange, or transfer "any defense article to any country whose defense was deemed vital to the U.S." With an initial appropriation of $7 billion, and final spending of $50 billion, the U.S. shipped overseas not only tanks, guns, ships, and planes, but in addition, millions of cans of Spam, boxes of cornflakes, and other attributes of the American Way of Life.

Thus by the summer of 1941, the defense program was well under way. Within roughly a year's time, appropriations and contract authorizations in support of the defense effort aggregated almost $60 billion, while actual defense expenditures jumped from $2 billion in 1940 to $14 billion in 1941. Defense spending in 1941 reached 11 percent of GNP —compared with 5 percent in 1981—and the increase in that category accounted for more than one-half of the total increase in GNP for that year.

Paying the cost

To cover the cost of the expanded defense program, President Roosevelt in mid-1940 called for an increase in personal-income taxes and the imposition of a steep excess-profits tax, "so the few don't gain at the expense of the many . . . and so no one will be enriched by the national rearmament effort." The excess profits tax involved graduated tax rates of 25 to 50 percent on profits in excess of a "normal" defined as 95 percent of 1935-39 average profits. Meanwhile, Congress reduced income-tax exemptions for taxpayers, and increased the income-tax rate from 4 to 10 percent on the first bracket ($2,000) of taxable income. As a result, the number of individual returns jumped from less than 8 million in 1939 to 26 million in 1941. But social-security taxes remained at one percent ($30) for both employees and employers on the first $3,000 of wages.

The increase in taxes raised Federal revenues substantially, to $3.5 billion in 1941. Still, the increase failed to cover the rise in defense outlays, and the Federal debt thus jumped from $50 billion in mid-1940 to about $68 billion in late 1941. The nation's banks acquired some $4 billion of that increase, while the general public financed about $6 billion through purchases of savings (defense) stamps and bonds. Defense bonds carried an annual yield of about 3⅓ percent when held to maturity—substantially more than what savers could earn on long-term governments (about 2 percent), Treasury bills (one-tenth of one percent), or savings deposits (subject to a 2½-percent ceiling). In another step to reduce spending pressures, the Federal Reserve imposed consumer-credit controls in late 1941, with a minimum payment of one-third down and a maximum maturity of 18 months on big-ticket purchases. Incidentally, consumer credit outstanding then totalled $10 billion, compared with more than $300 billion today.

On the monetary side, the Federal Reserve announced a policy of "standing ready to advance funds on U.S. Government securities at par to all banks . . . that is, to maintain conditions in the U.S. Government security market that are satisfactory from the standpoint of the Government's financing requirements". This policy of monetizing the deficit, a feature of wartime finance, meant a sharp increase in the money supply throughout the World War II period. Although the 1941 *Annual Report* of the Federal Reserve Board of Governors never mentioned the term "money supply," various monetary aggregates increased between 13 and 17 percent during 1941, and at a similar fast pace in later years. Not surprisingly, then, the era of the $5,500 single-family home and 17-cent-a-pound hamburger rapidly came to an end with the summer of 1941.

Verle Johnston

Publication—Monetary Policy Objectives

Copies are now available of the publication, *Monetary Policy Objectives for 1981 —Midyear Review*. This is a summary of the report made by Federal Reserve Chairman Volcker to Congress on July 21, 1981. Free copies of this publication can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 7/29/81	Change from 7/22/81	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	150,072	− 198	12,372	9.0
Loans (gross, adjusted) — total#	128,887	− 279	12,963	11.2
Commercial and industrial	38,745	− 203	5,365	16.1
Real estate	53,394	130	6,182	13.1
Loans to individuals	23,103	155	− 768	− 3.2
Securities loans	1,370	− 21	486	55.0
U.S. Treasury securities*	6,226	18	− 97	− 1.5
Other securities*	14,959	63	− 490	− 3.2
Demand deposits — total#	39,158	103	− 3,936	− 9.1
Demand deposits — adjusted	27,474	− 288	− 3,900	−12.4
Savings deposits — total	29,896	− 362	803	2.8
Time deposits — total#	83,689	721	21,680	35.0
Individuals, part. & corp.	75,552	839	21,807	40.6
(Large negotiable CD's)	34,007	526	11,594	51.7

Weekly Averages of Daily Figures	Week ended 7/29/81	Week ended 7/22/81	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (−)	75	13	− 93
Borrowings	105	72	4
Net free reserves (+)/Net borrowed(−)	− 31	− 59	− 97

* Excludes trading account securities.
\# Includes items not shown separately.

Editorial comments may be addressed to the editor (William Burke) or to the author . . . . Free copies of this and other Federal Reserve publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.