

AMERICAN INSTITUTE for ECONOMIC RESEARCH

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Economic Aspects of Intervention

During the past several days, the crescendo clamor of the interventionists has reached startling proportions. Full-page advertisements have urged "Stop Hitler Now"; the President, in a recent address, has made evident his willingness to lead the new crusade; in any event, he is reported to have expressed approval of the newspaper advertisements just mentioned. Although that type of appeal seems more appropriate on the football field than in connection with the grim business of war, it is impossible not to share the apprehension with which all the good people concerned view Hitler's progress in Europe; nevertheless, we believe that the extreme interventionists have either overlooked or have failed to give sufficient consideration to one possibility that must not be forgotten.

Regardless of anything we may or may not do, it is possible that Hitler will soon be the master of Europe. France may be defeated and England may be rendered virtually impotent long before any intervention on our part could be effective. (It is generally conceded by our military men that this country could not possibly send an armed force to Europe before the spring of 1941, probably not until the fall of that year.) In view of this possibility, and recent events suggest that it is not a remote one, should not we give first consideration to preparations for hemisphere defense? Would it not be sheer recklessness to adopt any other course? Have we the right to gamble with the future of this country by ignoring the worst possibility merely because we hope for the best, merely because we hope that Hitler *can* be stopped in Europe?

Many people seem to have forgotten that both France and England have ample funds with which to buy equipment and supplies from the United States. The Allies could greatly increase their recent rate of buying and still continue the war for three years at least. Therefore, in permitting the Allies' needs to have priority over our own requirements we shall do all that can be done in any event to aid them in the near future. Furthermore, their purchases will finance the plant expansion here that we shall need for hemisphere defense. (Hitler cannot possibly attack the United States for a few years, even if he does become the master of Europe. When and if that attack comes, we shall want the most recent models of planes then available; the planes that we may sell to the Allies this year and next will by that time be obsolete.) There is no reason why our prepara-

tions for hemisphere defense should delay the shipment of planes to England and France.

There is another possibility that also should not be overlooked. Both England and France had departed farther than we have from a truly-competitive, enterprise economy. Some shrewd observers have even argued that the social systems of both those nations were decaying, largely as a result of failure to correct the abuses of the competitive enterprise system. These abuses have been charged with responsibility for the mass unemployment, low standard of living, the increasing power of vested interests, and the other evidences of a decadent and divided economy.

If there is truth in these assertions, and the internal weaknesses of England and France have prevented their developing the strength now needed, we must ask ourselves other important questions. Have we the ability to prop up decadent (if they are decadent) nations of Europe? Even if we have the ability dare we turn our attention and strength in that direction when there is so much that needs to be corrected here at home? Is it not an obvious fact that we have great, unsolved economic problems that will certainly be gravely complicated by our participation in Europe's war?

In asking these questions, we do not, of course, imply that the dictatorship economies are the strong and virile ones; on the contrary, we believe that the resort to dictatorship is evidence of serious weakness rather than strength. We believe that the competitive enterprise system, when uncorrupted by the abuses responsible for the evils found in our economic system today, is not merely the best, it is the only economic system that can long endure.

We believe that the wisest course for the immediate future is to prepare for hemisphere defense and at the same time remove the abuses of the competitive system here in the United States. Unless we correct these internal weaknesses that are sapping the nation's economic strength, we may find the efforts to defend our way of life frustrated. If there is to be a test of military strength between those who accept an all-powerful state and our American system, let us begin by resolving to follow the great economic and social prin-

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ciples embodied in our Constitution to their logical conclusions; at least, let us not ask our youth to pour out their life blood in defense of those principles if we lack the energy, intelligence, and will to apply them.

Why is Money Idle?

Important facts that explain, at least in part, why much money is idle today are available in the latest Federal Reserve Bulletin. In our special study of this subject a year ago, we based our findings on what we believed were representative samples and concluded that most of the idle deposits were held by individuals. The complete data, presented in the table below, fully confirm this conclusion.

ESTIMATED CHANGE IN DEMAND DEPOSIT HOLDINGS BY CLASSES OF DEPOSITORS, DECEMBER 31, 1933, TO DECEMBER 31, 1937
(Billions of Dollars)

	Dec. 31 1933	Dec. 31 1935	Dec. 31 1936	Dec. 31 1937
Total demand deposits adjusted for transit items	15.07	21.86	24.77	23.37
Business — total	6.12	7.64	8.48	7.74
Finance — total	2.39	4.96	5.37	5.11
Corporations engaged in:				
Insurance	0.56	0.92	0.95	0.89
Other finance	0.82	1.74	1.57	1.50
Domestic noncorporate and foreign:				
Security brokers	0.20	0.20	0.30	0.28
Banks' trust departments	0.44	1.06	1.24	1.03
Foreigners	0.37	1.04	1.31	1.41
Public bodies — total	2.69	4.13	4.16	3.64
Unclassified—balances of individuals, nonprofit organizations, etc.	3.87	5.13	6.76	6.88

Referring now to the table, the reader will observe that business cannot be accused of having hoarded its cash by accumulating idle deposits. In the same period that the cash balances (checking accounts) of businesses increased 26 per cent, prices rose 18 per cent and industrial production increased 15 per cent. The combination of these two factors presumably increased by 35 per cent the amounts to be paid by checks in settlement of business accounts. In view of this greater need of cash balances, the modest 26 per cent gain actually recorded seems to leave little or no room for idle funds.

On the other hand, the large increase in cash balances reported under the general heading "Finance" unquestionably does reflect the accumulation of idle funds. The dollar amount of the increase reported by insurance companies was relatively small, only \$330,000,000; and this represented a return to more normal conditions after the heavy drain on life insurance cash surrender and loan values. (Our earlier study showed that neither the life insurance companies nor the savings banks had accumulated abnormally large cash balances in relation to those usually held.) The security brokers' 1937 deposits were only \$80,000,000 greater than the 1933 total, and their business had increased substantially; therefore, they were probably not guilty of hoarding. However, the other agencies shown under the heading, "Finance," apparently have accumulated idle cash balances.

The increase in cash balances held by banks' trust departments was great, 134 per cent, and totaled \$590,000,000. From our contacts with such agencies, we are convinced that the primary reason for this hesitation to invest funds was the same as that apparently responsible for the similar attitude of individual investors, which is discussed in the next paragraph. It is

hardly surprising that foreigners accumulated idle balances here, and such accounts are presumably much larger today than the December, 1937, totals.

It was in the cash balances of individuals, however, that a most important increase occurred. The gain from \$3,870,000,000 in 1933 to \$6,880,000,000 in 1937 was highly significant. If the life insurance companies and savings banks had accumulated idle funds, it might reasonably be supposed that no opportunity for profitable investment, even at very low rates of interest, could be found. Similarly, if corporations had accumulated large idle checking-account balances, it would be logical to assume that they were having difficulty in finding investment possibilities that seemed more attractive than hoarded funds. Obviously, if savings institutions and corporations in general can find uses for funds that would otherwise be idle, individuals can likewise do so unless they choose not to for reasons that are peculiarly their own.

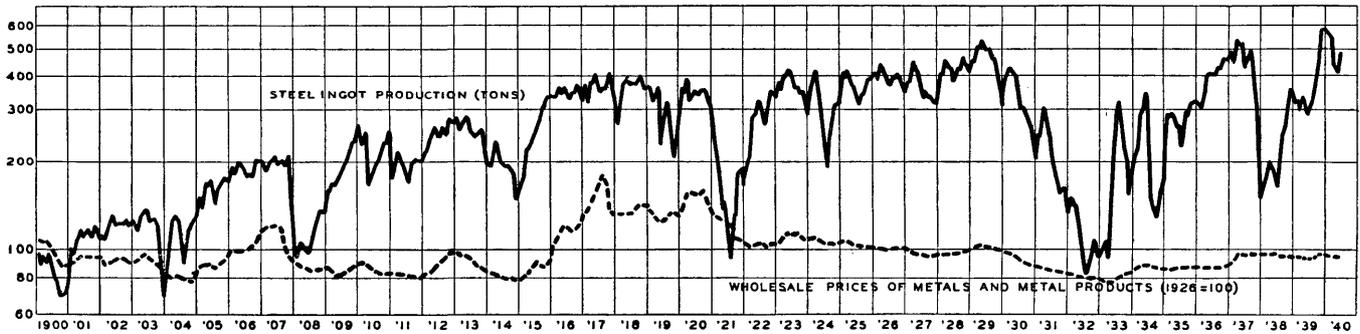
This invites the question, What reasons would induce many individuals to accumulate idle funds without having a similar effect on corporations in general and savings institutions in particular? The answer seems to be obvious. Life insurance companies and savings banks are obligated to return to depositors, insured individuals, and their beneficiaries specific amounts in dollars. These institutions can meet their obligations by fifty-nine-cent dollars, forty-cent dollars, or even worthless paper dollars. It follows that they can afford to run the risk of a depreciated currency and that they therefore unhesitatingly purchase Government bonds, corporate bonds, mortgages, and make various other investments that call for an interest return in fixed-dollar amounts and that specify a principal sum in dollars. It is little or no concern of theirs that the dollars which they will eventually return to depositors may never provide the protection against those hazards for which the funds were originally accumulated.

The status of an individual is vastly different, however. He is vitally concerned about the future value of the dollar, because he is relying on his capital or the income from it for living expenses, the protection of his family and other future needs. The fate of depreciated currency has become a matter of common knowledge during the past twenty years. Certainly, most men of substantial means are well informed as to the possibilities involved. Consequently, it is not surprising to find that many of them insist on maintaining far larger than normal checking-account balances while they watch the course of events and plan such steps as may be necessary in the future to protect at least a portion of their capital. This attitude probably will continue to influence individuals and trustees until the New Deal's reckless monetary experiments are brought to an end.

Steel-Ingot Production and Metal Prices

Steel-ingot production, shown by the solid line in the accompanying chart, is unusually significant at present, because semifinished steel products are the prime essentials in modern warfare. Reference to earlier years shown on the chart indicates that there is a tendency for the steel industry to follow a cyclical movement that usually lasts about three years. The most recent complete cycle included the years 1935-1937. After the sharp decline in steel production during the final quarter of

STEEL INGOT PRODUCTION AND PRICES OF METALS AND METAL PRODUCTS



1937, recovery began in 1938, and an average cycle would be completed late in 1940. However, in the past, steel production has been sustained at high levels for a more protracted period than three years when there were unusual circumstances, such as existed during the World War period and again during the period of inflation during the 1920's.

The upturn in steel production during May was probably a normal development, but the movement may be carried to extremes because of abnormal demand created by war preparations. If the rate of gain made during the first half of June continues, steel-ingot production will soon be at a record high volume. Steel-production capacity has increased substantially during the past decade.

The index of wholesale prices of metals and metal products (plotted in the dotted line on the chart) declined moderately during May; but, at 94.8 per cent of the 1926 monthly average, the index was only about a point below the highest levels reached during the European war boom last fall. The technological progress made by the metal-producing industries has tended to maintain metal prices at a reasonable level, compared with prices during the forty-year period shown on the chart. However, as in the past, a substantial increase in the index may be expected if the inflation that usually accompanies a world war develops in the United States.

BUSINESS

Exports in April

Although there have no doubt been more drastic changes in our export trade to separate destinations than was revealed by reports of foreign trade for April significant changes are observable in the April data. During the first seven months of the war, exports to the Scandinavian countries increased greatly, but were virtually cut off in April, when Germany invaded Norway and Denmark. Exports to Belgium and the Netherlands during the early months of the war increased, but not so much as did exports to the Scandinavian countries. These declined substantially in April, apparently as a result of the growing apprehension that Germany would invade the low countries.

In the June 3 bulletin (page 95) we published a table showing the losses to our export trade that would result from the enlargement of areas under Nazi domination. The loss of export trade to Mediterranean destinations resulting from Italy's entrance into the war will increase the total loss to 15 per cent. In view of the avowed attitude of the Administration, it appears inevitable that losses of trade to the Nazi-dominated areas will be

more than offset by increased shipments of war materials to the Allies.

UNITED STATES FOREIGN TRADE

Destination	April		Per Cent Increase
	1939	1940	
	Exports (In millions of dollars)		
Canada	34.5	54.4	57.7
Mexico	6.3	6.6	4.8
South and Central America	35.6	47.0	32.0
Belgium	5.2	4.2	19.2*
France	12.5	46.0	168.0
Germany	6.5
Italy	4.1	9.2	124.4
Netherlands	5.9	4.7	20.3*
Norway	2.1
Sweden	6.6	2.1	68.2*
United Kingdom	34.3	53.3	55.4
U. S. S. R.	3.6	6.1	69.4
Other Countries	73.8	90.4	22.5
Total	231.0	324.0	40.3

* Decrease

THE FUNDAMENTALS

Supply

The steel-ingot production rate advanced from 80½ to 85½ per cent of theoretical capacity last week. The *Iron Age* summarized the present situation as follows: "Consumers of steel are swayed between the desire to build up inventories that will afford reasonable protection against delayed deliveries, Government priorities, and higher prices and the caution engendered by the unpredictable outcome of the war. Most of them are pursuing a middle course, and hence inventories are not being unduly enlarged. In addition to the munitions orders to be placed by the United States Government and the Allies, new steel business in the near future will include substantial purchases by the automobile industry for 1941 models, and there are indications that the railroads may soon be forced into equipment building and repair programs."

	1929	1932	1937	1938	1939	1940
Per Cent of Capacity	96.0	22.0	76.0	26.5	52.5	85.5

There was a decrease in electric power generated last week in comparison with output in the corresponding week of 1939. The increase from output in the corresponding week last year was 8.7 per cent compared with an increase of 10.3 per cent in the preceding week. The unfavorable implication is modified by the fact that electric-power output was increasing substantially during June 1939.

	1929	1932	1937	1938	1939	1940
Billion Kilowatt Hours	1.70	1.44	2.21	1.99	2.26	2.45

Last week, the automobile industry produced 95,560 units compared with output of 65,265 cars in the corresponding week of 1939. Production schedules are being maintained at a higher rate than was recently considered probable, based on reports from the industry, and dealer stocks are increasing. If a portion of the productive capacity of the automobile industry is to be devoted to munitions, airplane, or military truck production, existing passenger-car stocks will later be absorbed. The revival of passenger-car sales in the latter part of May substantiates the theory that the defense program will accelerate sales, because of increased pay rolls.

	1929	1932	1937	1938	1939	1940
Units (000 omitted)	126	44	119	40	65	96

Cotton-mill activity was unchanged last week, when the normal seasonal trend was downward, and the adjusted index advanced from 119.6 in the preceding week to 122.7. Orders placed by the Government initiated its army-supply program. This may hasten the placing of private orders for fall requirements.

	1929	1932	1937	1938	1939	1940
New York Times Index	115.1	67.0	141.9	92.1	120.9	122.7

Lumber production increased last week and the adjusted index advanced from 75.7 to 79.0.

	1929	1932	1937	1938	1939	1940
New York Times Index	122.5	39.9	95.9	62.1	78.9	79.0

Demand

Reports of retail merchants throughout the country vary widely according to location. Adverse weather conditions are apparently exerting an important influence on consumer demand, and unfavorable war news is also viewed with varying degrees of apprehension in different sections. Statistical evidence of expanding demand for products of the heavy industries is beginning to appear in an increasing number of reports. The most recent factual information of importance records a substantial increase in sales of copper after a period of lagging demand for the metal.

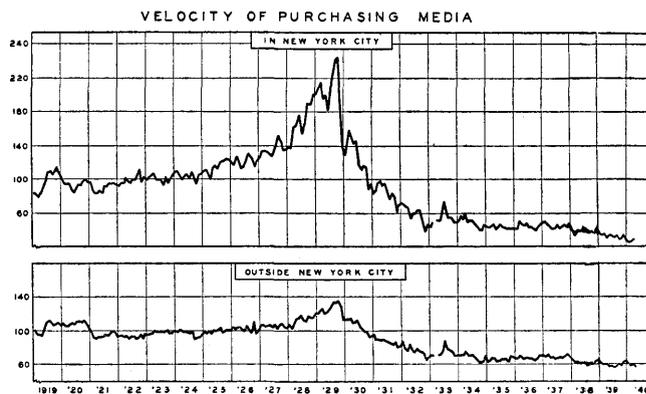
Prices

The sensitive wholesale commodity price indexes advanced substantially last week. Moody's Spot Commodity Price Index was 152.9 on June 6 and 155.3 on June 13. The Dow-Jones Index of Commodity Futures closed at 51.90 on June 6 and at 52.62 on June 13. The composite steel-scrap price, compiled by the *Iron Age*, rose to \$19.17 last week, 59 cents higher than it was in the preceding week. Increasing domestic demand is apparently more than offsetting the loss of the important Italian market for iron and steel scrap.

FINANCE

Velocity of Purchasing Media

The accompanying chart shows the velocity of purchasing media for New York City, where there is a concentration of speculative transactions, and separately for the remainder of the country. The indexes, based on ratios of bank debits divided by checking-account deposits, are computed by the Federal Reserve Bank of New York.



Since the middle of 1933, when there was a short-lived inflationary boom, both the New York City and outside of New York City series have fluctuated within a narrow range. There was a barely perceptible upward trend in the recovery period from the end of 1934 to the end of 1937. During 1938, 1939, and the early months of 1940, the general trend has been towards moderately lower levels.

The dollar volume of checking-account transactions has increased during recent years, although this is not discernible in the indexes of velocity, because checking-account deposits have increased greatly during the period. Substantial increases in the velocity of purchasing media usually accompany activity in the construction industry and other capital goods' industries. These industries have been less active than the consumer goods' industries during the post-depression recovery period.

The Federal Reserve indexes shown in the chart are available only through April 1940. Estimates based on bank-debit data indicate that velocity of purchasing media both in and outside of New York City has since remained about unchanged.

New Capital Issues

An expanding trend in the volume of new capital issues of corporate securities that was discernible in the report for April was not evident in the summary for May. The par value of new capital issues decreased from \$54,000,000 in April to \$29,000,000 last month.

SECURITIES

Bonds

Irregular recovery in bond prices last week resulted in the average reaching a level of more than one point above the lowest level reached in the May decline. The Dow-Jones Average of Forty Bonds advanced from 82.62 on June 6 to 84.89 on June 13.

Stocks

The advance in stock prices last week was apparently based on the realization that the United States has embarked on a great program of production of war materials for the Allies and materials for our national defense. Although the story may be different after the presidential election, there is now no indication that Congress will levy taxes commensurate with Government spending. The implication of inflation to come is unmistakable.

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