AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Costs of War

Discussion of a five per cent tax on wages and salaries to meet the costs of aid to Britain emphasizes the magnitude of the task we have undertaken. It should be realized that even this large tax would meet less than half of the $7,000,000,000 initial expenditure. Our own defense spending plans totalled $32,000,000,000 several days ago and will soon exceed $35,000,000,000 without the cost of aid to Britain. Therefore, it is plain that even a 50 per cent tax on wages and salaries would not meet the costs of our "short-of-war" program.

If such an astronomical figure is the price of preparing to defend this hemisphere, what will it cost to restore peace, prosperity, freedom, and security "everywhere in the world"? It is too much to hope that the discussion of a five per cent payroll tax will restore reality to the dollar signs that stand at the left of these imposing rows of figures. The American people have been laboring under delusions of economic grandeur for more than two decades, and it will take more than one "trial balloon" to teach them the economic facts of life.

Of course, no informed person supposes that a five per cent payroll tax will be enacted. It would not be politically expedient, in the first place; and it is a waste of time to discuss other reasons pro and con under present circumstances. Therefore, the public will probably continue to believe that we can assume these enormous economic burdens without substantial cost to any individual, perhaps even with incidental benefits to most.

Such economic delusions of grandeur are a menace to the future of this country. There is real danger that we may be committed to a long and costly war. If Germany wins in Europe, we may be forced to fight whether we wish to or not; and if neither side wins in the near future we are still committed to a program the cost of which may far exceed any of the figures mentioned. Under such circumstances, the Nation would need every dollar of its borrowing capacity, and a few billions wasted now might make the difference between success and disaster. In fact, there is some reason to wonder whether the most serious danger we are facing is not from within. Are we to bring ruin on ourselves by an hysterical flight from reality, by refusing to face the facts until it is too late?

Unfortunately, the answer to this question is at best a qualified "yes," qualified that is by the assertion that the disaster may not be irretrievable. But it is impossible to doubt that we shall see much more inflation. We had spent our way to a substantial degree of inflation late in 1936 and suffered the usual after-effects of our spree in late 1937 and 1938. Like any confirmed drunkard, we sought a "hair of the dog that bit" us by inaugurating a new spending program that now seems almost too small to mention; this time not a single hair but the whole hide is to be our potion, and, although it may be years from now, there will be a memorable "morning after."

Price Controls

Various plans to prevent soaring commodity prices have been proposed for Government adoption, and some method may ultimately be tried. It was recently reported that Bernard Baruch's plan for price control is being given serious consideration by the Administration.

According to this plan commodity prices, wages, and rents would be fixed for a limited period of time at the then existing level. Boards established by the Government would be empowered to grant exceptions in cases where the establishment of maximum prices tended to inhibit the production of essential materials. Collateral features of the plan envisage the establishment of priorities, accompanied by a conservation program to eliminate waste and to curtail the production of luxury products.

There are serious weaknesses in any methods intended to establish price controls by Government authority. Control programs usually provide penalties for raising prices above certain established maximum limits, but fail to ameliorate the basic influences that tend to cause advancing prices. The Government's New Deal experiments in economic management have created new difficulties to be overcome if price controls are to be even moderately effective.

For example, the Wage-Hour law is an especially important factor in creating higher prices in times such as these. The provisions limiting the hours of work are in reality provisions for raising wages. In normal times, it may be possible for manufacturers to produce the volume of goods for which there is demand and still keep the hours of work within the periods set by law. However, when industrial activity becomes abnormally great, as it is now because of the national defense pro-

duction, it becomes necessary for manufacturers to maintain longer hours for their employees with penalty wage rates for overtime.

Government price-fixing would necessitate the establishment of an intricate network of boards and committees similar to those established by the NRA and would probably result in as great confusion. It would soon be found that the demand for "exceptions" would endanger the whole plan, and, in order to save it, the general price ceiling would have to be raised from time to time.

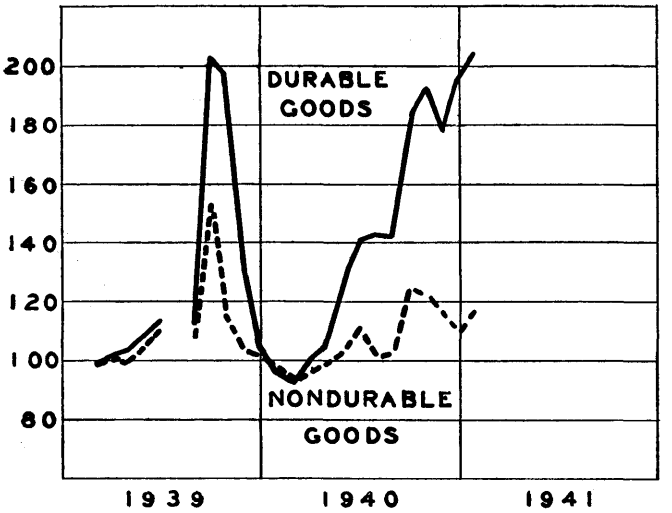
It is doubtful whether there is any method that would be successful in preventing a substantial rise in commodity prices now that we are committed to a major war effort. However, suspension of the Wage-Hour Act, retrenchment in Government-nondefense spending, and a more practical attitude toward the farm problem might help to retard the inevitable increase in living costs.

BUSINESS

Ratio of New Orders to Inventories

Our chart of the ratio of new orders to inventories has been made a regular feature of these bulletins since the United States Bureau of Foreign and Domestic Commerce developed the necessary statistical data last year. The chart shows the ratios derived by dividing the Bureau's index of new orders by the index of inventories for the durable and nondurable goods' industries, respectively.

RATIO OF NEW ORDERS TO INVENTORIES
(Manufacturers')



Note: Indexes for July 1939 are not yet available.

The ratios include the period of nine months preceding the outbreak of the European War. The great increase in manufacturing activity that was an immediate result of the war raised the new-orders index in September 1939 60 per cent from the August index. As the immediate fear of shortages was allayed, the flow of new orders began to decrease and by February 1940 had declined below the pre-War level. In the meantime, inventories increased nearly 15 per cent; consequently, the ratio of new orders to inventories declined below the base period level. Manufacturing activity decreased substantially during the first quarter of 1940, as reference to the Institute's Index of Industrial Production (February 24, 1941 monthly bulletin, page 33) shows. Although the index of inventories failed to decline appreciably when production slackened, inventories were no longer being accumulated by manufacturers, and, when an increased flow of new orders began to appear in March, the ratio of new orders to inventories started an upward trend that was followed with minor setbacks during the remainder of 1940 and January 1941.

The chart shows that the durable goods' industries have been the chief beneficiaries of the war boom, although the nondurable goods' industries have participated. The ratio of the durable goods' new-orders index to the durable goods' index of inventories in January 1941 reached a higher level than was attained at the crest of the initial war boom in 1939. Although the index of durable goods' inventories was slightly higher in January than it was in December 1939, the new-orders index increased more substantially.

The index of nondurable goods' inventories was higher in January than it has been in any preceding month during the past two years, and, although the nondurable goods' new-orders index was as high as it has been since September 1939, the ratio was only 17 points above the pre-war level of 100, as compared with a gain of 129 points in the new-orders index for durable goods.

Commercial Confidence

The upward trend of newspaper advertising that was revealed by the data for December 1940 became more pronounced in January 1941, and the lineage gain from that in the corresponding months of the preceding year increased from 4.0 to 5.9 per cent. The largest increase was reported in classified advertising. The retail stores increased their physical volume of sales seven per cent with an increase of about six per cent in newspaper-advertising lineage.

Newspaper-advertising lineage in the dailies of fifty-two cities during January 1940 and 1941 with the percentage increase of the latter in comparison with the record for the earlier period is shown below.

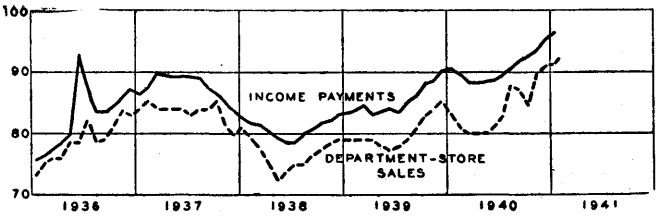
Newspaper Advertising Lineage	*January 1940*	*January 1941*	*Per Cent Increase January 1941 From January 1940*
	Millions of Lines		
Classified	19.1	21.4	12.0
Display			
Automotive	3.9	3.7	*5.1**
Financial	2.3	2.3	....
General	12.4	12.5	0.8
Retail	50.4	53.3	5.8
Total	88.0	93.2	5.9

*Decrease

Income Payments and Department-Store Sales

Our chart of income payments and department-store sales was first published in the February 10, 1941

INCOME PAYMENTS AND DEPARTMENT-STORE SALES



bulletin (page 22). It was accompanied by a description of the data used and by a discussion of the fluctuations of the two statistical series during the past five years. The chart is shown in this issue with income-payments data through January and department-store sales data through February 1941.

The income-payments index in January 1941 at 96.3 per cent of the 1929 monthly average was at the highest level since February 1930. The department-store-sales index reached the highest level since June 1931. Neither of these indexes is adjusted for population growth.

Exports in January

In last week's issue (page 40), we published a table showing the value of exports in January by principal commodities. Below, we present a brief summary of the value of exports by principal destinations. The total shown in this summary is slightly larger than that in the table of principal commodities, because reëxports are included in this summary but were omitted from the other.

UNITED STATES EXPORTS

	January 1941	
Destinations	*Value in Millions of Dollars*	*Per Cent of Total*
Canada	61.9	19.0
Mexico, South and Central America	51.6	15.9
West Indies	10.2	3.1
United Kingdom	116.6	35.8
South Africa	11.8	3.6
Russia	2.5	0.8
Far East*	51.1	15.7
Other Destinations	19.7	6.1
Total	325.4	100.0

* Includes Australia and New Zealand, British India, British Malaya, Hong Kong, China, Japan, The Netherlands Indies, and the Philippine Islands.

THE FUNDAMENTALS

Supply

The steel-ingot production rate advanced from 98 to 99 per cent of theoretical capacity last week. The *Iron Age* summarized the present situation as follows: "Steel production is being pushed upward close to its practical limit. The Cleveland-Lorain district has attained a rate of 100 per cent, making eight districts of thirteen operating at this rate or higher, while others, with one exception, are between 95 and 99 per cent. Enactment of the Lease-Lend Bill will immediately result in a speeding up of defense construction all along the line, particularly shipbuilding, in increased pressure from industry and from Congress upon the Administration to stiffen its attitude on strikes in defense plants, and in an expansion of the mandatory priorities system to include more products in which shortages loom."

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Per Cent of Capacity	94.0	26.5	86.0	30.0	63.5	99.0

(Latest 1941 weekly data; corresponding week earlier years)

An upward trend in the rate of miscellaneous manufacturing operations was indicated last week by the record of electric power consumed. The gain in output from that generated in the corresponding week of 1940 increased from 14.0 per cent in the preceding week to 15.1 per cent last week.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Billion Kilowatt Hours	1.69	1.54	2.21	2.02	2.46	2.84

The automobile industry produced nearly as many vehicles last week as in the preceding week. Last week output was 125,915 units, compared with production of 126,550 the week before and 103,560 in the corresponding week of 1940. The present high rate of production of cars must soon be curtailed. The Chairman of the Board of Directors of General Motors Corporation stated that, early in March, the Corporation had $683,000,000 worth of defense orders on its books. This is about one-half as much as the Corporation's gross business in 1939, and it may be concluded that this class of work will soon form a substantial proportion of the Corporation's total business.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Units (000 omitted)	140	31	127	54	104	126

Cotton-mill activity remained unchanged last week, when a seasonal decrease was expected. Consequently, the index advanced from 147.2 (revised) to 148.0. It is reported that early deliveries of most types of cloth are now difficult to obtain even at premium prices.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	*	89.2	139.9	91.6	118.6	148.0

*Not available until third week in March.

There was a slightly greater-than-seasonal increase in lumber production last week and the adjusted index advanced from 132.0 to 132.1.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	131.9	38.2	80.4	64.6	106.9	132.1

Demand

The Federal Reserve index of department-store sales advanced from 101 in January to 102 in February. Early reports for March show that the dollar volume of retail sales is being maintained at a high level, but the comparisons with volume last year are somewhat less favorable than they were in February. Merchants attributed this to the later date for Easter this year. With the Nation's income rising (see the chart of income payments and department-store sales, page 44), consumer purchases will probably increase substantially after the first installment of the income tax has been paid and when the peak of the Easter-buying season is reached early in April.

Prices

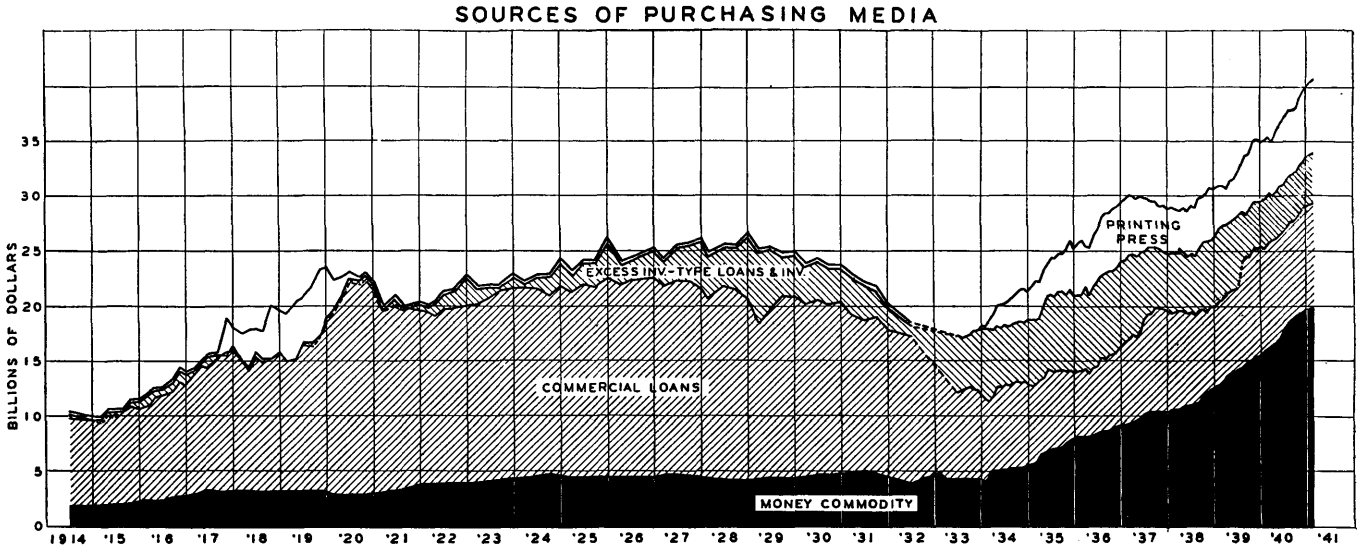
Last week the sensitive wholesale commodity price indexes advanced for the fourth consecutive week. Moody's Spot Commodity Price Index was 176.3 on March 6 and 179.3 on March 13. The Dow-Jones Index of Commodity Futures closed at 58.68 on March 6 and at 60.54 on March 13. There is every reason to expect that the trend will be upward for some time to come.

FINANCE

Sources of Purchasing Media

Total purchasing media from all sources increased less rapidly in February than it did in January this year. The total increase was about $220,000,000 compared with an increase of about $700,000,000 in the preceding month.

There was an increase of $96,000,000 in purchasing media from the money-commodity source (monetary gold) during February. This was the first month since July 1938 in which purchasing media from this source failed to increase by more than $100,000,000. Sub-



scribers who have followed our discussions of the sources of purchasing media will recall that we stated in the July 22, 1940 bulletin (page 127): "Gold imports have recently been the most important factor in augmenting total purchasing media. Imports of the metal from Europe can now presumably be prevented by Germany, and the transfer of gold from Great Britain has probably been substantially completed. The bulk of the South American production will probably continue to be sent here to finance the purchase of war materials for Great Britain, but this supply will probably not be great compared with the flow of gold from Europe since the outbreak of the war. (Gold imports from South Africa during the first six months of 1940 were valued at $150,000,000, about seven per cent of the total.)"

In the December 16, 1940 bulletin (page 211), we said: "As long as the war lasts, there will probably be substantial imports of gold from the British Empire." In view of the terms of the Lend-Lease Measure, the latter statement may be subject to modification if the British Government prefers to use the new gold production of the Empire for other purposes and rely on our credits to pay for war materials bought in the United States.

Purchasing media from commercial loans increased during February. An upward trend in this type of bank credit will probably continue as long as manufacturers expand their inventories of raw materials and semi-manufactured products. In view of the existing urgent demand for finished products, inventories of this class of goods will presumably remain small.

During February there was an increase in purchasing media derived from the third source (credit created by an excess of investment-type assets that represent tangible property with respect to the savings available to the banking system). The commercial banks increased their holdings of Government-guaranteed issues and "other" securities by about $100,000,000.

Purchasing media from the fourth source (the printing press) increased only moderately last month. The Treasury completed a major financing operation in January, and banks that had acquired a large portion of the new Government issues were distributing some of these to customers during February. This tended to offset an increase in the banks holdings of ninety-day bills.

The rate of Federal spending will probably continue to increase this month, but there may be little if any increase in total purchasing media. As we pointed out in last week's bulletin (under the heading "The Harwood Index of Inflation," page 42), Treasury receipts will be augmented by large income-tax payments, which may be sufficiently great to provide a budgetary surplus for the month or at least to reduce the monthly deficit to relatively small proportions.

New Capital Issues

With the exception of November 1940, when new financing included the $140,000,000 American Telephone and Telegraph Company's issue for plant expansion, there has been no important volume of new capital issues of corporate securities in any month since June 1938. During the past three months, the volume has been steadily dwindling from $169,000,000 in November 1940 to $61,000,000 in December, to $53,000,000 in January 1941, and to $32,000,000 in February. The bulk of the Nation's annual savings is being absorbed by the growing Federal debt. The Government's attitude toward private enterprise and the uncertainties engendered by the war have discouraged corporate executives from seeking funds for business expansion.

New corporate financing in February and in the first two months of each year during the past sixteen years is shown in the accompanying summary.

New Corporate Financing in the United States

Year	*February*	*First Two Months*
	(In millions of dollars)	
1926	379	890
1927	518	1,008
1928	409	781
1929	614	1,166
1930	456	1,022
1931	72	472
1932	39	86
1933	1	24
1934	13	19
1935	7	12
1936	14	86
1937	155	251
1938	41	87
1939	24	29
1940	45	81
1941	32	84

Source: *Commercial and Financial Chronicle.*