

# AMERICAN INSTITUTE for ECONOMIC RESEARCH

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54 Dunster Street, Harvard Square - Cambridge, Mass.

## RESEARCH REPORTS

### COMING EFFECTS OF CURRENT EVENTS

#### *No Hope for Nondefense Economy*

Recent statements by Government officials recommending reductions in nondefense expenditures aroused only a glimmer of hope in the minds of those who recall the Administration's past spending policies. Even this was extinguished by the President's message to Congress last week asking for a large WPA appropriation. The size of congressional majorities for farm hand-outs shows that no better chances for economy exist in the Legislative than in the Executive branch of the Government.

Now that labor shortages are developing throughout industry, the continuation of the WPA demonstrates that it is a permanent, not an emergency, institution. It is becoming entrenched as a political asset of the party in power. The President's argument that "there are many of the presently unemployed who have little chance to be absorbed by the defense effort" fails to take into consideration the Federal Reserve index, which shows that the current level of industrial activity is at an all-time high even after allowing for population growth. If this "emergency" device must be maintained when employment opportunities are abnormally plentiful, it surely will never be abandoned under less favorable circumstances. Ending the eighteen month limit on WPA employment and the annual check-up of the means status of the workers, as the President recommends, will make the WPA an even more convenient political device.

If no worthwhile reduction can be made in WPA spending when unemployment has been sharply reduced and if largess to the farmers is actually increased during a period of rising farm prices, the chances of economy in any nondefense Government activity is slight. The conclusion is inescapable that the huge defense and lend-lease expenditures will be superimposed on a swollen New Deal budget.

### THE FUNDAMENTALS

#### *Supply*

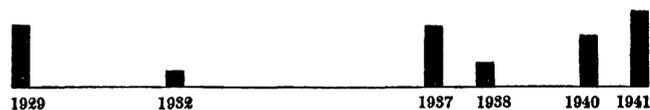
The rate of industrial production during April decreased somewhat more than was indicated by the Institute's preliminary index, because the effects of the bituminous-coal strike were more serious than was shown by the early figures. However, recovery was rapid after settlement of the strike, and the prelimi-

nary index for May, adjusted for long-term trend, exceeded the high records made in 1917 and in 1929 for the first time since the Great Depression. The Institute's preliminary Index of Industrial Production for May is 133.2, compared with a revised index of 128.0 for April.

The customary summer lull in manufacturing activity will be discernible in only a few highly seasonal consumer goods industries this year, primarily because the Nation's basic industries have orders for capacity production, but also because the effects of the war boom are reaching industries not directly concerned with the production of defense materials. A continued upward trend in industrial activity is threatened only by strikes, but interruptions to work will probably become less serious as the public's attitude toward organized labor's demands become sufficiently clear to the politicians in power.

By the middle of May the steel industry had regained the high rate of activity that prevailed before the coal strike in April. Steel-production capacity in the United States has increased greatly during the past twenty years. A revised monthly series of steel production recently published in the *Survey of Current Business* makes it possible to obtain an accurate appraisal of trends in this basic industry since our entry into the World War in 1917. The total tonnage produced in October 1918, the peak-production month of the 1914-18 World War, was 4,562,000 short tons; whereas 6,758,000 short tons were produced in April 1941. It is estimated that production during May 1941 exceeded output in the same month of 1929 and 1937, the preceding periods of great activity shown in the bar charts, by at least 15 per cent.

#### IRON AND STEEL PRODUCTION



The steel-ingot production rate increased from 99½ to 100 per cent of theoretical capacity last week. The *Iron Age* stated: "Much of the new business that is now being placed with the mills is for defense requirements. With their regular customers the mills some time ago established monthly quota arrangements,

Notice to *Annual Sustaining Members*: A copy of the 1941 edition of *Insurance and Annuities from the Buyer's Point of View* was mailed to you last week. If you did not receive it, please let us know.

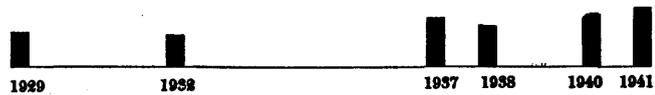
but these are being greatly disturbed by the necessity of working defense orders into current rollings. It seems to be obvious that consumers who do not have preference ratings will be subject to longer delays on shipments and possible curtailment of their quotas. While new steel orders in the aggregate have been declining, they are still greater in volume than shipments. Except for defense work, mills are placing restrictions on orders and are turning down a great many."

	1929	1932	1937	1938	1940	1941
Per Cent of Capacity	96.0	22.0	92.5	30.5	74.0	100.0

(Latest 1941 weekly data; corresponding week earlier years)

Production of electric power during May 1941 exceeded output in May 1940 by approximately 15 per cent and exceeded production in May 1929 by 65 per cent. The demand for electric power is relatively stable, and the considerable increase in output during the past two decades reflects the industry's favorable long-term trend.

#### ELECTRIC POWER OUTPUT

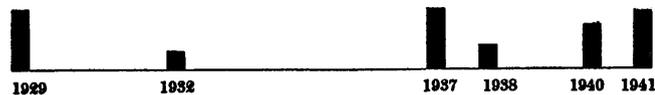


Last week electric-power production maintained about the same rate of gain over output in the corresponding week of 1940 that was recorded earlier in the month. The Pacific Coast region was the only one from which a small gain was reported.

	1929	1932	1937	1938	1940	1941
Billion Kilowatt Hours	1.71	1.44	2.20	1.97	2.42	2.80

The bar charts show that the automobile industry was active during May, but production failed by a relatively small margin to equal that in the corresponding months of 1929 and 1937. Inasmuch as demand for the new models is reported to be taxing the production rate, it may be assumed that output is at present limited by labor troubles, by the difficulty of obtaining materials, and because a part of the capacity of the industry has been diverted to armament manufacture

#### AUTOMOBILE PRODUCTION

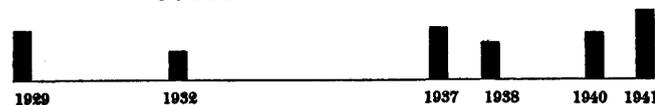


The automobile industry produced 127,225 cars and trucks last week, slightly less than the preceding week's total of 132,380 units. Last week's reduction in output was attributed to the suspension of work in the automobile parts industry, where there were labor disturbances.

	1929	1932	1937	1938	1940	1941
Units (000 omitted)	136	44	138	47	98	127

Operations of cotton mills continued at a high level during May. Production was about the same as it was in the preceding month and exceeded output in May 1940 by 45 per cent.

#### COTTON-MILL PRODUCTION

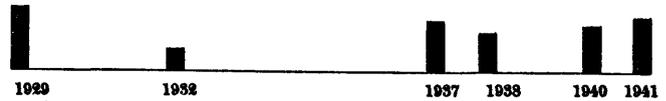


Last week the cotton-mill operating rate decreased slightly when a seasonal increase was expected, and the adjusted index declined from 170.0 to 161.6.

	1929	1932	1937	1938	1940	1941
New York Times Index	119.5	69.0	140.9	80.8	117.3	161.6

Lumber production during May 1941 remained at about the same level recorded in April. Although the industry has been stimulated by national defense demands, it has failed to participate in the "benefits" to the extent that other leading industries have.

#### LUMBER PRODUCTION



Lumber production decreased contraseasonally last week and the adjusted index declined from 121.7 to 116.1.

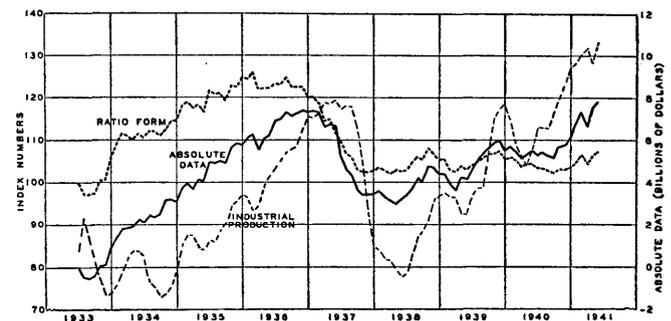
	1929	1932	1937	1938	1940	1941
New York Times Index	132.3	42.1	93.8	58.7	107.0	116.1

#### The Harwood Index of Inflation

The preliminary Index of Inflation for May, at 107.2, was fractionally higher than the April Index (revised from 105.8 to 106.6). The Index is now (as of the middle of May) at the top of the range within which it has fluctuated since the 1937-38 deflation. The Index is shown in ratio form on page 85. (The ratio form shows the relationship between all purchasing media available for use and the portion of the total that is not inflationary.)

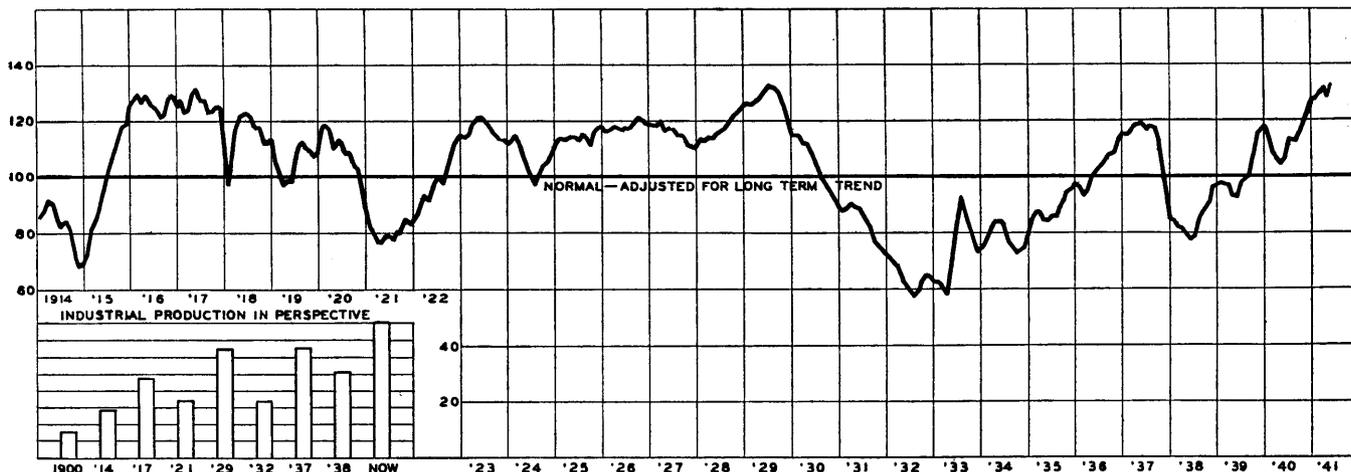
The advance in the Index from the May level was the result of an increase of about \$150,000,000 in the commercial banks' investment-type assets and a decrease in the Treasury's deposits with the Federal Reserve Banks and with the commercial banks from \$1,600,000,000 to \$1,500,000,000. This indicated the distribution of \$100,000,000 of Government funds to the public. There was no appreciable change in the banks' savings-type liabilities.

#### HARWOOD INDEX OF INFLATION, RATIO FORM, ABSOLUTE DATA, AND INDUSTRIAL PRODUCTION

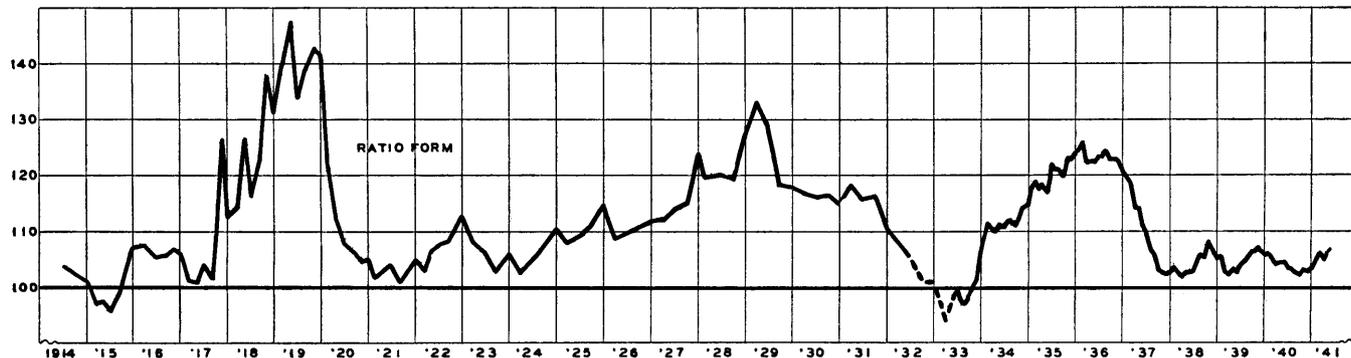


In addition to the Index in ratio form, the accompanying chart shows the absolute data and the Institute's Index of Industrial Production. The scale at the left of the chart refers to the Index of Inflation in ratio form and to the Industrial Production Index. The scale at the right of the chart refers only to the absolute-data curve. The most significant feature of the chart is that the solid line representing the absolute amount of inflationary purchasing media in use has reached a

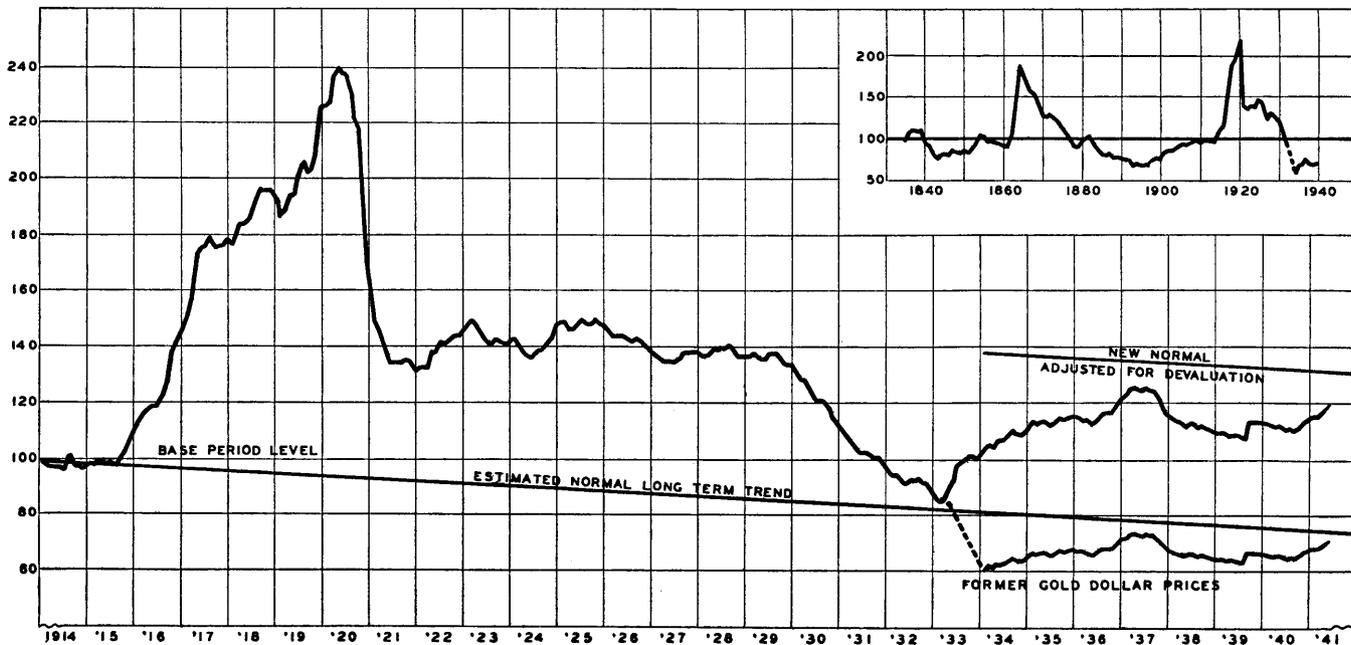
### INDUSTRIAL PRODUCTION



### HARWOOD INDEX OF INFLATION



### COMMODITY PRICES



higher point than that attained at the crest of the 1936-37 inflation, although the dotted line showing the Index in ratio form is still well below its 1936 peak. The difference in the trends of these two money-credit curves was caused by the increase in purchasing media from other than inflationary sources.

During the period from the spring of 1938 until after passage of the Lend Lease Bill, the most important source of additional purchasing media, other than that derived from inflationary bank credit, was monetary gold. Recently, additions to monetary gold stocks as a result of imports have been greatly curtailed, but the absolute-data curve has continued to advance more rapidly than the curve of the ratio form of the Index (although the difference in the trends of the two curves is not so great as it was when gold imports were at their maximum), because purchasing media from commercial loans have recently been increasing more rapidly than at any time in recent years. Although commercial loans result in the temporary creation of purchasing media that is in addition to the total available to the public, such credit creations are not inflationary because they represent goods on the way to the market and will presumably be retired when the goods reach the hands of the consumers.

During the next few months the Index of Inflation will probably continue to advance at about the rate followed in the early part of this year. There may be temporary declines during the months when income taxes are due. Since the Defense Bonds and Stamps were put on sale, they have provided sufficient funds to meet half of the Treasury's deficits, the other half being financed from short-term bank credit, which is usually inflationary. As defense spending increases, the deficits will be larger, at least until the additional taxes to be imposed by Congress begin to return revenue to the Treasury. However, sales of Defense Bonds may increase if "salary deduction plans" are introduced by the large corporations. The Treasury has just announced a "wholesale borrowing" in the form of a \$600,000,000 issue. Apparently, its policy is to supplement its receipts from regular sales of the Defense Bonds by occasional large issues of bonds or intermediate-term notes. Sales of 90-day bills will maintain the Treasury's bank balances at the desired level between major financing dates.

The sales of Defense Bonds should be followed carefully, and the trend will be reported in these bulletins. If, as seems probable, sales during the first half of May were at a faster rate than can be expected to continue, inflationary borrowings on an even larger scale than has been seen recently will follow.

#### Other Demand Factors

Reports from merchants throughout the country indicate that the demand for consumer goods shows no

sign of slackening from the high rate attained this spring. Prices of department-store merchandise have increased less than three per cent during the past 12 months, and this apparently has had no adverse effect on sales. Department-store sales last week were 12 per cent greater than they were in the corresponding week of 1940.

### Commodity Prices

There was another substantial advance in the combined wholesale commodity price index compiled by the United States Bureau of Labor Statistics last month. The preliminary index for May was 120.3, and the revised index for April was 118.6. The index has advanced seven per cent during the past 12 months and is approximately 12 per cent higher than it was before the war started. Reference to the chart on page 85 shows that, although the current position of the index is at a lower level than it was in the summer of 1937, it bears about the same relationship to the normal long-term trend line that existed at the height of the inflationary boom in 1937.

Last month, prices of all three of the economic classes advanced, but the largest gain was recorded in the raw-materials classification, with gains in prices of semimanufactures and finished goods being about equal. Price changes in all of the separate classifications shown in the table were upward, but advances in metals and metal products and in building materials were only moderate. The price situation for these products was probably effected by the efforts of the Office of Price Administration, which has concentrated its early efforts on keeping down the prices of products essential for defense.

UNITED STATES BUREAU OF LABOR STATISTICS  
WHOLESALE COMMODITY PRICE INDEX  
(Monthly Average 1913=100)

	May 1929	May 1932	May 1940	April 1941	May 1941*
Farm Products	143.0	65.2	95.0	103.8	105.0
Foods	152.6	92.4	111.2	121.2	123.1
Hides and Leather	156.7	106.5	148.8	153.0	154.6
Textile Products	158.3	94.8	127.2	140.3	142.1
Fuel and Light	134.6	115.4	117.0	119.7	122.2
Metals and Products	111.4	88.2	104.1	107.7	107.8
Building Materials	168.5	126.1	163.1	176.4	176.9
Chemicals and Drugs	†	†	95.6	102.1	103.6
House Furnishings	167.0	132.8	157.2	162.7	163.9
Miscellaneous	117.5	92.3	111.3	112.0	113.2
Raw Materials	138.5	78.4	104.7	111.3	114.0
Semimanufactures	124.1	77.6	104.5	113.4	114.6
Finished Goods	136.4	101.3	117.1	123.3	124.9
All Commodities	135.7	92.2	112.3	118.6	120.3

\* Preliminary estimate

† In process of revision

*American Institute for Economic Research is a non-political, non-commercial organization engaged in impartial economic research.*

### Statistical Summary; Production, Purchasing Media, and Prices

	1940								1941				
	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May.*
Index of Industrial Production..	107.6	113.1	112.9	112.8	116.3	119.8	122.6	127.0	128.5	130.2	131.8	128.0	133.2
Index of Inflation (ratio form) ..	104.6	103.6	103.5	102.8	102.3	103.2	103.0	103.6	104.9	106.5	104.5	106.6	107.2
Commodity Price Index.....	112.3	111.0	111.2	110.9	111.7	112.8	114.3	114.6	115.8	115.5	116.8	118.6	120.3
Commodity Price Index.....	66.5	65.7	65.8	65.6	66.1	66.7	67.6	67.8	68.5	68.3	69.1	70.2	71.2

(In terms of former gold dollar)

\*Preliminary Estimate.