

AMERICAN INSTITUTE for ECONOMIC RESEARCH

54 Dunster Street, Harvard Square - Cambridge, Mass.

W E E K L Y
B U L L E T I N

June 9
1941

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Sacrifices in Prospect?

The public is gradually being prepared for sacrifices that cannot be avoided when the Nation is committed even to limited war involvement. The fact that until now the public has been virtually immune to adverse effects and substantial groups of the population have even found the situation advantageous should not engender a false optimism. Last December we said: "Although the Nation's living standards should be maintained at an above-normal level this winter, there is no assurance that this condition will continue throughout 1941, even if the United States does not become an active belligerent."¹ Subsequent developments point more definitely to inconveniences if not to hardships in prospect.

Almost daily proposals for restricting the consumption of goods in the interests of national defense are reported, but no one can predict the policies that the Federal Government will actually adopt. Extreme proposals by zealous officials may never be enforced. Nevertheless, the publicity given to the various plans proposed is creating apprehension that is not entirely unfounded.

Ever since the New Era days there has been a surplus of facilities for serving consumers. This has provided a slack that is gradually being taken up, and, once this is accomplished, the Nation may experience some of the inconveniences that are now only talked of.

There are adequate supplies of most consumer goods, and as long as these are distributed through the usual channels of trade, the needs of the public should be met. However, the injection of Government controls into the economic mechanism invariably creates an element of friction. The confusion that attended the establishment of the NRA illustrates the dislocations that develop when a radical change in a complicated economic system is made. The mass of detail normally attended to by individuals engaged in manufacturing and trade can hardly be supervised efficiently by a bureaucracy, especially in the early stages of the transfer of control. Business executives who deal with Government offices no doubt realize the delays and errors that are the inevitable accompaniment of such controls.

Some facilities for the manufacture and transportation of consumer goods have already been devoted to

the defense program, and such instances will multiply. The companies engaged in consumer goods service will find increasing difficulties in planning. The acceptance of orders for goods no longer carries any assurance that deliveries will be made. Even when priority orders do not prevent the production of goods for domestic markets, transportation may not be available or may be delayed.

The recently announced diversion of one-half of our coastwise shipping facilities to trans-Atlantic operation will curtail a relatively small percentage of the country's transportation resources. About 70 per cent of the total tonnage is carried by rail or trucks and less than 10 per cent by coastwise vessels suitable for transfer. Presumably, more efficient use can be made of cargo space remaining in domestic service, and the railroads may assume part of the additional burden. Nevertheless, the populous northeastern seaboard that depends on transportation facilities to bring in its raw materials may be faced with shortages. The problem of bringing adequate petroleum supplies to New England is especially serious.

Progress in living standards during the past two decades has primarily manifested itself in providing new mechanical equipment. Consumers have become accustomed to improved pleasure cars, artificial refrigeration, washing machines, oil burners, radios, and the like. A protracted war effort will limit the production of these goods, even if controls are managed wisely, on the whole.

Index of Living Standards

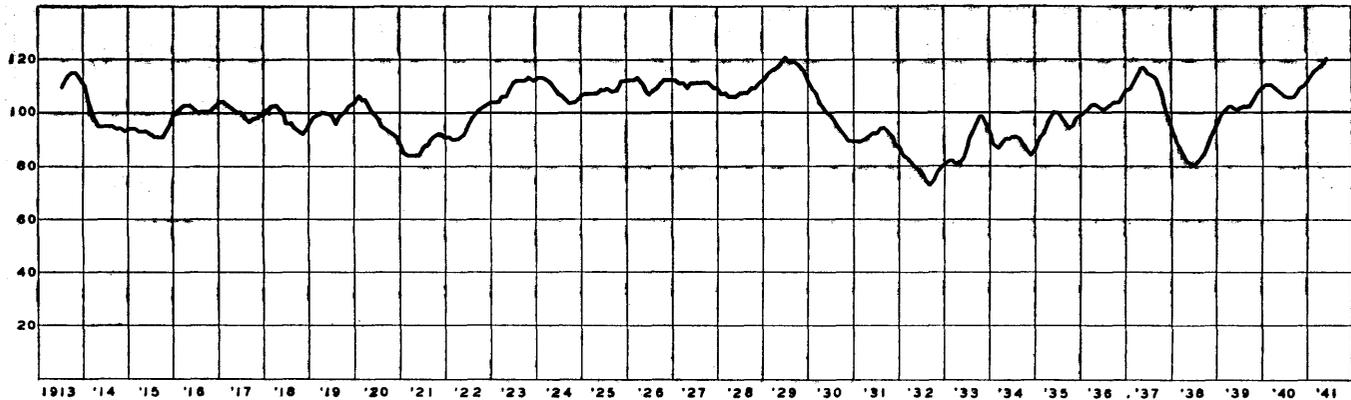
The latest data reflecting the activity of the consumer goods industries shows that production of these commodities has exceeded the volume indicated by preliminary figures; consequently, the Institute's Index of Living Standards has reached a level equal to that existing at the height of the New Era boom in 1929 and is above the best level reached in 1937.

The index shown in the chart on page 92 reflects changes in the per capita volume of consumer goods produced in the United States. It is a six-month moving average plotted at the sixth month to allow for the normal time required for such goods to reach the hands

Notice to Annual Sustaining Members: Because of a printers' delay, we regret that sufficient copies of the new edition of *What Will Inflation and Devaluation Mean to You?* will not be available for all members until next week.

¹ Weekly Bulletin, December 2, 1940, page 205.

INDEX OF LIVING STANDARDS
(ADJUSTED FOR LONG TERM TREND)



of consumers. It is adjusted for long-term trend by adapting "weights" given to component series of the index each year, so that each item has an influence proportional to the value of the year's production.

The index does not include all items involved in living standards because of the lack of comprehensive data. However, it has been found by an examination of such data that are available relating to domestic service, entertainment, travel, and the like that there is a high degree of correlation between the consumption of goods and services.

The elements entering into the calculation of the index have changed radically in importance during the twenty-eight-year period shown. For example, non-commercial automobiles, which now form an important component of the index, were a comparatively negligible factor in 1913. On the other hand, the consumption of meat and other standard food items has declined in importance.

The considerable increase in living standards during the past eight months has been made possible because pay rolls and salaries have increased much more than prices have advanced, thus permitting the public to purchase a greater volume of consumer goods. Probably the recent advance in the index of living standards partially reflects the desire of consumers to acquire clothing, household equipment, and pleasure automobiles in anticipation of higher prices or restrictions that may make them unobtainable in the future. Even if this supposition is correct, the index may continue to advance for a time until prices rise sharply or restrictions on consumer purchases become effective.

The Danger of Impulsive Action

Last week Senator Connally introduced a bill empowering the Government to take over plants in which the defense effort is hampered by strikes. If the Government surrenders to the impulse to cut the Gordian knot by seizing defense plants, the results may be disastrous.

This policy was adopted in France after that Nation's industrial organization had been impaired by Leon Blum's New Deal experiments, but the bureaucratic management was so much less effective than private management that output of vital war materials was curtailed even more drastically than before. The full extent of the consequent breakdown in supply was revealed only after France was conquered.

BUSINESS

Commercial Confidence

Newspaper advertising lineage reported for April 1941 exceeded that reported for the corresponding month of 1940 by about six per cent. An increase of nine per cent in retail advertising contributed most to the gain in total lineage.

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

<i>Newspaper Advertising Lineage Classified</i>	<i>April 1940</i>	<i>April 1941</i>	<i>Per Cent Increase April 1941 From April 1940</i>
	<i>Millions of Lines</i>		
Classified	23.1	24.9	7.8
Display			
Automotive	7.0	6.9	1.4*
Financial	1.8	2.0	11.1
General	17.8	17.6	1.1*
Retail	62.2	67.8	9.0
Total	112.0	119.2	6.4

* Decrease

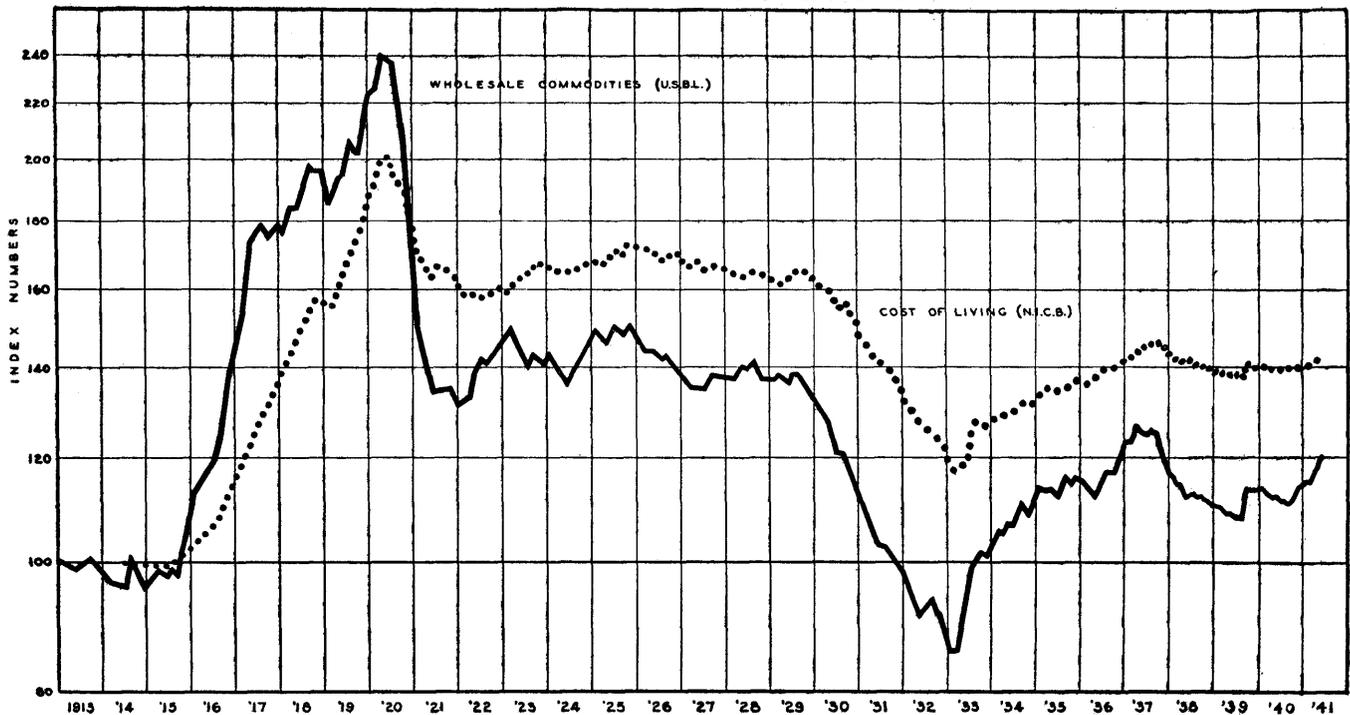
Wholesale Commodity Prices vs. Cost of Living

Although wide movements in wholesale prices are usually reflected in living costs, the relationship between wholesale prices and the cost of living has changed greatly over an extended period of years. The chart at the top of page 93 illustrates the change that has occurred during the past twenty-six years.

The solid line in the chart shows the United States Bureau of Labor Statistics' index of wholesale commodity prices on the basis of the 1913 monthly average = 100. The dotted line represents changes in the cost of living index compiled by the National Industrial Conference Board on the basis of July 1914 = 100. (The general price level was about the same during the year and a half period immediately preceding the outbreak of the World War.) A ratio scale was used to facilitate comparisons of the trends of the two curves.

In the 1914-18 World War period, wholesale commodity prices rose more rapidly than did living costs. However, since 1920, the cost of living has constantly remained at a higher level in relation to the pre-War period. During the period shown on the chart, the cost of living curve has lagged the curve of wholesale commodity prices, and fluctuations have been less

WHOLESALE COMMODITY PRICES VS. COST OF LIVING



extreme. This relative stability of the cost of living curve is attributable to the slower movement of prices for items other than foods.

There are five component groups of the cost of living index. The combined index is made by multiplying the indexes of the groups by their respective weights, adding the products, and dividing by the sum of the weights. The components, together with the weights of these items, are as follows:

Food	33	Fuel and Light	5
Housing	20	Sundries	30
Clothing	12		

The food item is the most responsive to changes in wholesale prices. There is a lag of a few months before retail clothing prices reflect changes in the wholesale cost of the commodities involved. Nearly a year is required for wholesale commodity price changes to influence the cost of housing. Consequently, clothing prices and rents have increased only slightly during the past year; whereas there has been a five per cent increase in retail food costs. The cost of sundries and of fuel and light items is relatively stable. Neither of these components declines so much as wholesale commodity prices nor rises so far above the long-term trend during periods of rising prices. In the "sundries" classification are grouped such items as physician's fees, reading material, house furnishings, and candy and tobacco. Inasmuch as nearly one-third of the expenditures included in living costs is included in this group, its lack of flexibility constitutes a major factor tending to stabilize the combined index in relation to the wholesale commodity average.

The comparison of wholesale commodity prices with the cost of living is of especial interest at present. The wholesale commodity price average has advanced substantially during the past few months, and the effects of this advance are beginning to be reflected in the index of living costs.

It will be observed that, throughout the quarter of a century period shown on the chart, advances in the wholesale commodity price average as extensive as the one recorded during the past nine months have invariably been followed by a substantial increase in the cost of living. It can therefore be predicted with assurance that there will be further increases in living costs during the next few months, merely as a consequence of the higher prices that have already been reported in the wholesale markets. Furthermore, as long as the Government continues to encourage wage demands by labor and to guarantee prices for agricultural products above the free market level, Federal price controls will be at least partially nullified, and prices in the primary markets will continue to lead the way to higher living costs.

THE FUNDAMENTALS

Supply

The steel-ingot production rate increased a half point last week from 99 to 99½ per cent of theoretical capacity. The *Iron Age* commented as follows on the current situation in the industry: "Steel producers and consumers this week are attempting to analyze a series of new developments which point to a further drastic curtailment in steel for commercial consumption and the establishment of mandatory priorities. The latest steel-capacity report of Mr. Dunn, OPM steel consultant, found that passage of the Lease-Lend Act and further increases in the defense program have caused a sharp increase in steel requirements for both military and civilian use. As a consequence, the report finds a deficit of 1.4 million tons for 1941, as compared with a surplus of 10.1 million tons estimated in the first report to the President earlier this year."

	1929	1932	1937	1938	1940	1941
Per Cent of Capacity	96.5	22.0	75.0	26.0	80.5	99.5
	(Latest 1941 weekly data; corresponding week earlier years)					

The comparison of electric-power output last week with production in the corresponding week of 1940 was even more favorable than it was in the preceding week. The increase was 17 per cent.

	1929	1932	1937	1938	1940	1941
Billion Kilowatt Hours	1.69	1.31	2.13	1.88	2.48	2.90

The automobile industry produced 106,395 units last week, compared with output of 60,980 in the corresponding week last year. Reports from dealers indicate that field stocks of new cars are low, and therefore the producing companies will no doubt attempt to maintain production at a high level during the remainder of the month.

	1929	1932	1937	1938	1940	1941
Units (000 omitted)	125	44	135	27	61	106

The seasonally adjusted cotton-mill production index advanced from 168.2 to 170.2 last week. The initial effect of price limitations on cotton yarn, as established by the Office of Price Administration, was a general decrease in offerings. The OPA may have to revise its price ceiling if it is found to be too low to permit profitable operations.

	1929	1932	1937	1938	1940	1941
New York Times Index	127.3	65.5	146.8	79.8	107.5	170.2

Lumber production decreased last week and the adjusted index declined from 115.6 to 108.9. For the first time this year the index fell below the level recorded in the corresponding week of 1940.

	1929	1932	1937	1938	1940	1941
New York Times Index	119.8	38.7	95.8	60.1	109.1	108.9

Demand

The dollar volume of retail sales last week continued to make the favorable comparison with the total for the corresponding week of 1940 that has been reported throughout the spring months. The gain in the Federal Reserve index of department-store sales was 21 per cent. Sales in the farm areas, which were lagging those in the industrial areas earlier in the year, have increased greatly during the past few weeks under the spur of the Administration's agricultural price policies. The breadth of the trade boom is therefore now virtually nationwide.

Prices

The sensitive wholesale commodity price indexes were reactionary from the middle of May to the end of the month, but an upward movement started during the early trading sessions in June. Moody's Spot Commodity Price Index was 194.2 on May 29 and 195.2 on June 5. The Dow-Jones Index of Commodity Futures closed at 67.83 on May 29 and at 69.54 on June 5.

FINANCE

The Harwood Index of Inflation

The Index of Inflation in ratio form advanced from 107.5 for the week ended May 21 to 108.0 for the week ended May 28. This was the eighth consecutive week in which fractional advances were recorded. The withdrawal of purchasing media from public to Government depositaries as a result of income-tax payments in March caused a two point decline in the Index during that month from 106.5 at the end of February to 104.5

at the end of March. Since the end of March, the Government has redistributed through defense expenditures about two-thirds of the \$1,200,000,000 received in the first income-tax installment. This accounted for about half of the three and a half point advance in the Index during April and May. The other factor causing the advance was a substantial increase in the investment-type assets of the banking system during the past two months. Loans on securities increased \$100,000,000, and investments increased \$900,000,000. The trend of the Index will probably be upward until the next income-tax installment is due in July.

At the suggestion of one of our subscribers, we take this opportunity to clarify an aspect of the inflationary process that may be confusing. An increase in the commercial banks' holdings of such investment-type assets as bonds and notes and an increase in the volume of collateral loans on securities, in the absence of an equivalent increase in such savings-type liabilities as time or savings deposits and capital accounts, are usually referred to by us as inflationary. Although an expansion of commercial banks' holdings of investments is the most frequent cause of inflation in the modern banking system, it is really the resulting increase in the amount of the commercial banks' demand deposits created in acquiring investment-type assets that is inflationary.

Inflation is defined as the condition arising when banks or other agencies (such as the Treasury printing press) have created purchasing media in excess of that required to represent goods produced that are currently coming to market. When the commercial banks purchase investments and credit the former holders with checking-account deposits, purchasing media that may be inflationary are thereby created. The commercial banking system's ability to create new purchasing media in the form of checking-account credits is limited only by the requirement that a definite proportion of cash to total deposits be kept with the Federal Reserve Banks. Most banks now have a large supply of excess reserves available for this purpose. Total excess reserves of the Nation's banking system are nearly \$6,000,000,000, and it is obvious that, until reserve requirements are raised, there is no practical limit to the amount of purchasing media that the banking system can create.

SECURITIES

Bonds

Bond prices remained substantially unchanged last week. The Dow-Jones average of 40 bonds was 91.12 on May 29 and 91.02 on June 5.

Stocks

The stock market displayed a better tone last week, although the volume of transactions remained light. Reversing the experience prior to the demand of the Railroad Brotherhoods for a 30 per cent increase in wages, the trend of the railroad average was less favorable than that of the industrial group.

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