

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

October 6
1941

R E S E A R C H R E P O R T S

COMING EFFECTS OF CURRENT EVENTS

How to Strangle Enterprise

The disturbance in the security markets following Secretary Morgenthau's proposal that the weapon of taxation should be used to limit corporate profits to six per cent of invested capital was only temporary. The subsequent recovery can probably be attributed to the generally unfavorable reception of the trial balloon, if such it was. Perhaps Mr. Morgenthau's echo of an identical pronouncement made by Herr Hitler a year ago was taken less seriously because reports that have come out of Germany indicate that the six per cent limit on profits in the Reich has been nullified by government lenience in accounting practices. Perhaps it would be unwise for business to assume that the New Deal Administration would be equally lenient.

Although the Secretary of the Treasury set forth his proposal as a temporary emergency measure, this should not invite complacent acceptance of a potentially ruinous fiscal principle. For one reason, there is a tendency for emergency legislation to become permanent. (Mr. Roosevelt has surrendered none of the emergency powers granted "temporarily" to promote economic recovery.) Another reason for avoiding a measure calculated to strangle private enterprise is the urgent need for stimulating production in a time of national emergency. Although the most ruinous effects of the application of such a principle would be felt only over a long period of time, the incentives for good business management would immediately be lessened, and a fatalistic attitude on the part of business managers generally would be fostered.

The most serious aspect of a drastic limitation of profits is that it would tend to bring about the destruction of the fittest; the new industries requiring high risk rates for development would be eliminated. (Had such a limitation been placed on industry thirty years ago, the automobile industry as we know it today would never have developed.) The same dead hand would be laid on any industry having a rapid growth rate that required the "plowing back" of earnings to promote further development. The proposal might appropriately be entitled "How to Perpetuate Industrial Stagnation."

Mr. Morgenthau's proposal demonstrates once again the Administration's belief that it is smart strategy to keep private business under a constant barrage of threats. The New Deal group can hardly fail to appreciate the serious effects of such policies on the managerial efficiency of industry and on the national

defense effort. The conclusion is inescapable that many in the Administration, although proclaiming the imminent threat of foreign aggression, continue to strive harder for social reform than for national security.

The Social Security Delusion

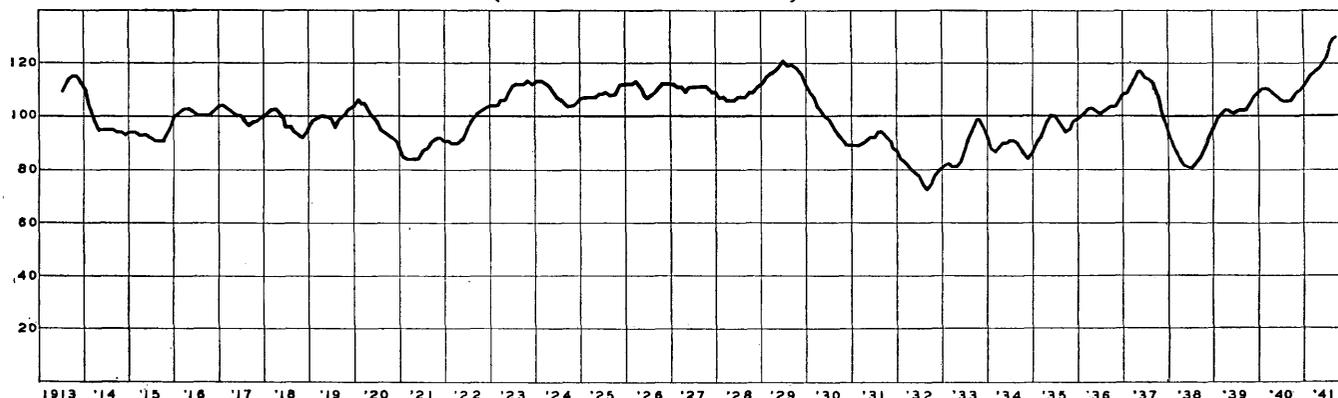
The announcement made last week that President Roosevelt plans to advise Congress to enlarge the scope of the social security program so that it will include all classes of the productive population was not a surprise, because, for several months, such a proposal had been discussed in New Deal circles. Three years ago (August 13, 1938) in a speech celebrating the third anniversary of the Social Security Act, the President stated: "Today many of our citizens are still excluded from the old-age insurance and unemployment compensation because of the nature of their employment. This must be set right, and it will be." The inclusion of farm operators and farm labor, self-employed persons, domestic servants, casual laborers, employees of nonprofit organizations, and public employees all formerly excluded from the provisions of the Act would bring within its scope 27,000,000 more persons than the 40,000,000 individuals that are now covered by the old-age pension system.

The cost of administration of the social security program has increased during each year since the Act came into force and was \$31,500,000 for the 1941 fiscal year. These costs will probably be increased out of proportion to the additional persons registered if the amendments that are proposed are adopted. The task of checking up on farmers and housewives and of maintaining a system of control that would keep track of the employment of casual workers who are not accustomed to making reports to the Government would be more involved than that required in checking business records. Furthermore, the expansion in the scope of the Act would probably tend to increase the disparity between social security tax receipts and expenditures. The terms of social security benefits are relatively favorable to individuals who have fulfilled only the minimum requirements to make them eligible for benefits.¹

Many persons who have been paying social security taxes for several years even now do not realize that the taxes collected under the provisions of the Act have been spent just as have other tax receipts to meet expenses of the Government. In order to make the books balance, Government notes and certificates of indebtedness have been issued to the fund. The result

¹This is explained more fully in the Institute booklet, *What Will Social Security Mean to You?*

INDEX OF LIVING STANDARDS
(ADJUSTED FOR LONG TERM TREND)



has been that the social security taxes have partially financed the Federal deficits during the period in which they have been collected. A fund has been established only in the sense that several billion dollars of the rapidly increasing public debt represents an obligation to the aged and the unemployed who will later be eligible for benefits.

If the scope of the social security program is broadened, the increase in tax collections (in excess of immediate outlays) may temporarily act as a deterrent to inflation, but the increased burden on the Government in future years will tend to aggravate the problem of balancing the Federal budget. There will then ensue the sequence of large budgetary deficits leading to inflation and the consequent depreciation of the value of the old-age benefits through higher living costs. The delusive character of the social security scheme may not be revealed for some years to come, but enlarging the scope of the Act will tend to shorten the interval between now and the time when the Government will be face to face with the unhappy consequences of an undertaking to provide pensions for all regardless of the Nation's ability to assume such a burden.

What Next?

The Continuing Record

The latest available information regarding the more significant indicators of future trends is summarized in the following table. A plus sign indicates an advance in the indicator; a minus sign, a decline; and a zero, an unchanged position.

	Latest Indication
Private Engineering Contracts (September)	-
Machine-tool Activity (August)	+
Orders for Steel Boilers (July)	+
Capital Goods Stock Prices (Last Week)	+
Durable Goods Employment (August)	+
Steel-Ingot Production (Last Week)	+
Prices of Metals and Metal Products (Last Week)	0
New Capital Issues of Corporate Securities (August)	+
Velocity of Purchasing Media (August preliminary)	+
Carloadings of Heavy Products (Last Week)	+
Lumber Production (Last Week)	+
Harwood Index of Inflation (September preliminary)	0

The number of favorable indicators of cyclical trends increased since the summary was published a month ago. Then there were four pluses, five minuses, and three zeros. In this summary, there are nine pluses, one minus, and two zeros.

BUSINESS

Index of Living Standards

The Institute's index of living standards advanced during September, but the increase was less rapid than it was in any of the earlier months this year. The index shown in the chart at the top of this page 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 time required for such goods to reach the hands of consumers. It is adjusted for long-term trend by adapting "weights" given to the component series of the index each year, so that each item has an influence proportional to the value of the year's production.

The volume of consumer goods produced increased during each month of the first six months of 1941 but decreased moderately during each of the past three months. After the goods that were produced in May and June of this year (the months in which record high levels in consumer goods production were established) have been distributed, the Institute's index of living standards will probably decline from its present position of about thirty per cent above estimated normal. New Federal taxes effective October 1 will probably have an adverse effect on sales of consumer goods, even though the effect of the more drastic income taxes levied on the lower income groups will not be an important deterrent to public spending until next March.

Postal Receipts

The volume of business in fifty of the largest city postal districts during August exceeded the volume for August 1940 by 4.8 per cent. This was a somewhat smaller gain than was recorded earlier in the year. For

POSTAL RECEIPTS IN FIFTY LARGE CITIES (In Millions of Dollars)

Month	1929	1932	1937	1938	1940	1941
January	31.6	25.3	27.9	27.5	30.4	32.3
February	30.0	24.1	27.8	27.0	29.7	30.5
March	34.4	26.7	33.8	31.8	32.7	34.0
April	32.4	24.3	31.1	29.6	31.6	34.9
May	32.4	22.6	29.8	28.2	32.3	33.7
June	29.3	22.0	29.6	28.0	28.7	31.2
July	29.1	23.8	26.6	24.6	27.6	30.6
August	29.3	23.9	26.3	26.6	29.0	30.4
September	30.5	25.8	30.0	29.5	30.3	
October	35.7	26.7	31.7	30.9	35.2	
November	32.7	26.1	30.7	31.4	33.2	
December	40.8	33.1	42.0	42.5	45.4	

the first eight months of 1941, there was an increase of 6.4 per cent over receipts for the corresponding period of 1940. The dollar volume of postal receipts is primarily an indicator of commercial activity. The monthly series for the first eight months of 1941 and for earlier significant years are shown in the table on page 160.

THE FUNDAMENTALS

Supply

Recent reports from industry reveal a diminution in the high rate of activity that was attained this summer. The fact that July and August are months when industrial production is normally below the monthly average for the year accounted in part for the high level reached in those months by the seasonally adjusted Federal Reserve index of industrial production. September and October are normally the most active months of the year, so that a decline in the index would be recorded even if actual production remained at the high level reached in August.

Many of the Nation's leading industries were geared to maximum practical capacity this summer, and further gains this fall are unlikely. Statistical evidence is beginning to appear, indicating that the general volume of production is decreasing contraseasonally. Electric-power production is probably the most promptly available indicator of miscellaneous manufacturing activity, and the trend of this indicator has been somewhat less favorable during the past two weeks. Although Government officials are exhorting industry to new productive efforts for national defense, there are certain factors in the present situation that may bring about at least a temporary decline in general industrial activity. The war effort was begun more than a year ago, and industrial equipment has probably suffered greater-than-normal wear. The efficiency of many of the newly employed workers is obviously inferior to that of industry's normal personnel. Furthermore, general overall efficiency of a plant usually suffers during a period of rapid expansion in output.

There are other influences that threaten to curtail industrial activity. When the Government's priority system was first established, it did not seriously affect most industries, because they had sufficient inventories of raw materials and semifinished products to continue operations for several months, but Government controls have now been in effect so long that the less fortunate industrial companies are forced to curtail operations because of the lack of materials. Furthermore, during a period of active industrial operations, interruptions caused by strikes are frequent. Although strikes of a spectacular nature have been kept to a minimum within recent months, outlaw strikes and strikes of small union groups throughout industry have been frequent. Their aggregate effect on production has been appreciable.

The steel-ingot production rate last week advanced from 97 (revised) to 98½ per cent of theoretical capacity. The *Iron Age* stated: "For another seven days the flow of incoming orders to steel manufacturers has followed an irregular pattern, rising for some companies and declining for others. Although business has fallen off for some of the largest producers, backlogs, which are estimated to run for five to seven months, have been little affected. Nondefense manufacturers are

finding their orders placed months ago continually being pushed back because of defense requirements, hence delivery, for them, becomes one postponement after another."

	1929	1932	1937	1938	1940	1941
Per Cent of Capacity	85.0	17.5	71.0	48.0	93.0	98.5

(Latest 1941 weekly data; corresponding week earlier years)

There was a small gain in electric-power production last week, but it was less than seasonal. Power generated last week was 14.8 per cent greater than output during the corresponding week of 1940. This was less than the usual gain of 17 to 19 per cent reported during July, August, and early September.

	1929	1932	1937	1938	1940	1941
Billion Kilowatt Hours	1.78	1.50	2.28	2.14	2.82	3.23

Operations in the automobile industry increased substantially last week. Production increased from 60,615 cars and trucks to 78,535 units. In the corresponding week of 1940, 95,990 units were produced. Data submitted to a congressional investigating committee by five of the largest automobile companies indicated that employment for defense work in the industry would not be great enough to absorb employees thrown out of work by the curtailment in car production ordered by the Government.

	1929	1932	1937	1938	1940	1941
Units (000 omitted)	83	13	46	25	96	79

Cotton-mill activity increased less than seasonally last week, and the adjusted index declined from 169.4 to 167.8. The industry is still awaiting a decision on its request for revision of price ceilings on cotton yarns. Until this is rendered, activity may tend to decline.

	1929	1932	1937	1938	1940	1941
<i>New York Times</i> Index	120.4	104.4	127.1	109.4	122.8	167.8

Lumber production increased contraseasonally last week and the adjusted index advanced from 124.5 to 130.0 per cent of the 1935-39 monthly average.

	1929	1932	1937	1938	1940	1941
<i>New York Times</i> Index	123.2	36.8	77.8	72.4	116.3	130.0

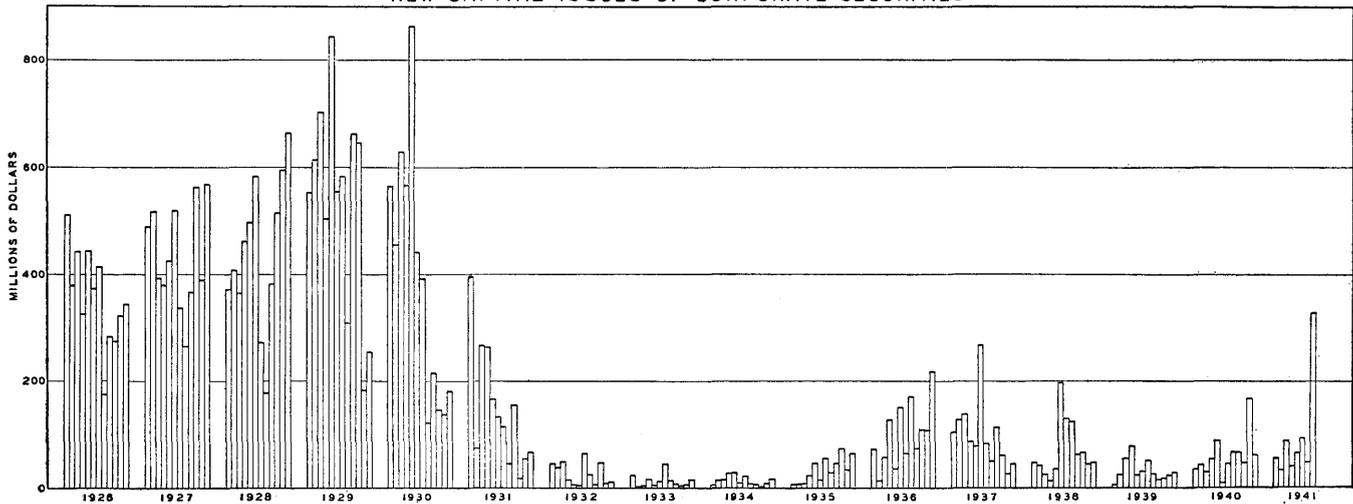
Demand

The rush to buy articles on which new Federal excise taxes were scheduled for October 1 during the final week in September revived the retail-trade boom that was subsiding earlier in the month. The Federal Reserve index of department-store sales was 24 per cent higher last week than it was in the corresponding week of 1940. A decrease in the volume of consumer goods purchases may be expected in October. If income payments are sustained, the public will gradually become accustomed to the higher price level for goods. However, it may be a long time before the physical volume of consumer goods is as large as it has been during the past three months.

Prices

The sensitive wholesale commodity price indexes were stronger last week. The futures index more than recovered the losses sustained in the preceding week, and there was a more limited recovery in spot prices. Moody's Spot Commodity Price Index was 214.3 on September 25 and 214.6 on October 2. The Dow-Jones Index of Commodity Futures closed at 81.67 on September 25 and at 83.00 on October 2.

NEW CAPITAL ISSUES OF CORPORATE SECURITIES



FINANCE

New Capital Issues

The accompanying chart shows the volume of new corporate financing in the United States by months since January 1926 and facilitates comparisons between the flow of new capital into industry during recent months with that during the corresponding periods shown. The data for investment-trust issues are excluded to avoid duplication.

The volume of new capital issues during the first eight months of 1941 was substantially greater than the total in the first eight months of 1940, but failed to reach the aggregate in the first three quarters of 1937, the best postdepression year for the corporate capital market.

The volume of new capital issues of corporate securities in August 1941 was greater than it has been in any month since January 1931. This does not necessarily indicate so pronounced a trend toward revival of the new capital markets as the figures appear to show, because one issue of \$234,000,000 (the American Telephone and Telegraph Company's debentures) accounted for about three-quarters of the total of \$327,000,000. Of the remaining issues, \$23,000,000 was borrowed by the railroads; \$40,000,000, by oil companies; and \$26,000,000, by other industrial concerns.

In general, new capital issues of corporate securities are purchased with the Nation's savings by individuals, banks, insurance companies, and other institutional investors, and the funds are invested in new plants, equipment, and capital facilities. Both opportunity for business expansion and confidence on the part of investors are required for an active market in new capital issues. A substantial flow of capital into industry is essential for the long-term growth of the Nation's economic system.

The volume of new security issues intended to provide new capital equipment for industry is normally one of the more important indicators of future trends. The chart shows that the new capital market has expanded somewhat since the national defense effort was undertaken on a large scale, but the increase in the volume of new issues was not commensurate with the great industrial expansion that has occurred. Sev-

eral factors probably combined to account for this disparity. First, the Federal Government has provided funds for new plant facilities for defense industries; second, official reports show that bank credit advanced to industrial concerns has been employed for the expansion of plant facilities; third, corporate executives, realizing that the present extraordinary demand for heavy-type products is temporary, make more efficient use of existing facilities (primarily by three-shift operations) and where possible avoid the expensive type of plant construction that was undertaken in the 1914-18 World War.

New corporate financing in August in the first eight months of each year during the past sixteen years is shown in the accompanying summary.

NEW CORPORATE FINANCING IN THE UNITED STATES

Year	First Eight Months (In Millions of Dollars)		Year	First Eight Months (In Millions of Dollars)	
	August	First Eight Months		August	First Eight Months
1926	176	3,062	1934	8	127
1927	256	3,354	1935	30	186
1928	180	3,137	1936	171	691
1929	310	4,664	1937	51	961
1930	122	4,035	1938	125	617
1931	46	1,468	1939	25	293
1932	26	249	1940	69	388
1933	14	126	1941	327	736

Source: *Financial and Commercial Chronicle*

SECURITIES

Bonds

Bond prices advanced steadily and substantially last week following a two months' period of declining trend. The Dow-Jones average of 40 bonds advanced from 89.39 on September 25 to 90.34 on October 2.

Stocks

Stock prices improved moderately last week, but the extremely light volume of transactions indicated that the many uncertainties in the outlook still inhibit speculative activity.

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