AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

54 Dunster Street, Harvard Square - Cambridge, Mass.

WEEKLY BULLETIN

October 13 1941

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Foreign Situation

The confused reports seeping through the system of foreign censorship do not permit an accurate appraisal of the extent to which Russian army resistance has been impaired. The possibility that Moscow will fall before the German onslaught is evidently so grave that the public is being prepared for this contingency. Inasmuch as events in Eastern Europe may have an important effect on the extent of our involvement in the war, it is prudent at least to consider the significance of the loss of the Russian capital to the Germans. There appear to be two major possibilities:

1. If Moscow is taken but the Russian army remains substantially intact, as it has been during the first phase of the campaign, and the German army establishes a line for the winter from Leningrad to the Caucassus, a decisive conclusion of the Russian campaign will again be postponed. The German army will have gained a vital part of Russia's communication system and industry but will have acquired a supply problem that might burden its great organizing ability. Once before Moscow measured the high-water mark of a military dictator's power.

2. On the other hand, if the Russian army is completely disorganized and home morale is so shaken that the Stalin regime is overthrown, Russia, like France, will cease to offer effective resistance to Hitler.

The fact that the Russian army has maintained its capacity for resistance during its retreat across half of European Russia during the past four months is ground for hope that the first possibility (if Moscow falls) is the more probable one.

Delusions of Economic Grandeur

The allusions to the Four Freedoms that have frequently appeared in the press since President Roosevelt's annual message was delivered to Congress last January have gradually acquired a pleasantly vague connotation in the popular mind. The nebulous character of our potential commitments was indicated more recently by the suggestion that the enlarged social security program may become a fifth freedom. Meanwhile, the public has apparently forgotten, if it ever comprehended, the vast dimensions of a crusade to establish even four freedoms "everywhere in the world." In order to remind our subscribers of the magnitude of the program as originally outlined, we are quoting below the passages from the President's message enumerating the Four Freedoms:

"In the future days, which we seek to make secure, we look forward to a world founded upon four essential human freedoms.

"The first is freedom of speech and expression—everywhere in the world.

"The second is freedom of every person to worship God in his own way — everywhere in the world.

"The third is freedom from want — which, translated into world terms, means economic understandings which will secure to every nation a healthy peacetime life for its inhabitants — everywhere in the world.

"The fourth is freedom from fear — which, translated into world terms, means a world-wide reduction of armaments to such a point and in such a thorough fashion that no nation will be in a position to commit an act of physical aggression against any neighbor — anywhere in the world."

Petroleum Supplies

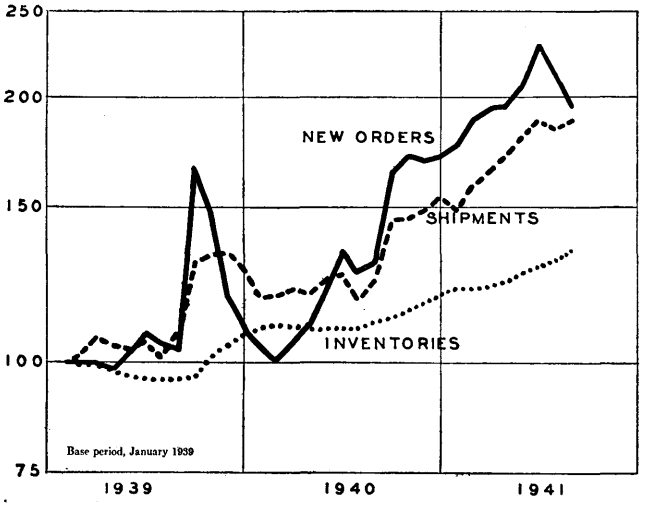
Information about the adequacy of gasoline and fuel oil supplies for the Eastern Seaboard remains in a state of confusion. Statements alternating threats and reassurances continue to come from Government offices. The public was favored with one of the latter last week when Mr. Ickes announced that the British shipping authorities might be able to release "at least temporarily" for use on the Atlantic Seaboard a limited number of American tankers now assigned to British service.

Such action should serve the Administration in two ways. If the threatened shortage was fictitious from the start, the addition of a few more tankers to the coastwise service would enable the Coördinator to claim some credit for a subsequent sufficiency of supplies. The release of some tankers assigned to the British might also enable the Administration to answer charges made by non-interventionist members of Congress that tankers essential for our domestic supply were unnecessarily allocated to British service. They contended that the Empire had ample tanker tonnage for the Atlantic service if ships employed for deliveries to its remote neutral customers were reallocated.

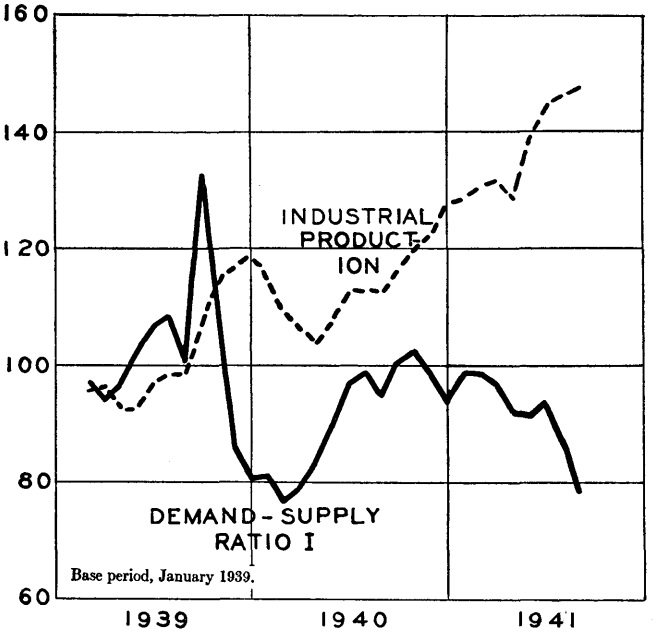
Demand-Supply Ratios

The United States Department of Commerce published its revised indexes of manufacturers' new orders, shipments, and inventories for July and its preliminary figures for August last week. The chart in the upper left-hand corner on page 166 was published first in the September 15, 1941 bulletin (page 147), together with a discussion of the significance of comparisons between the trends of the separate indexes. Although there

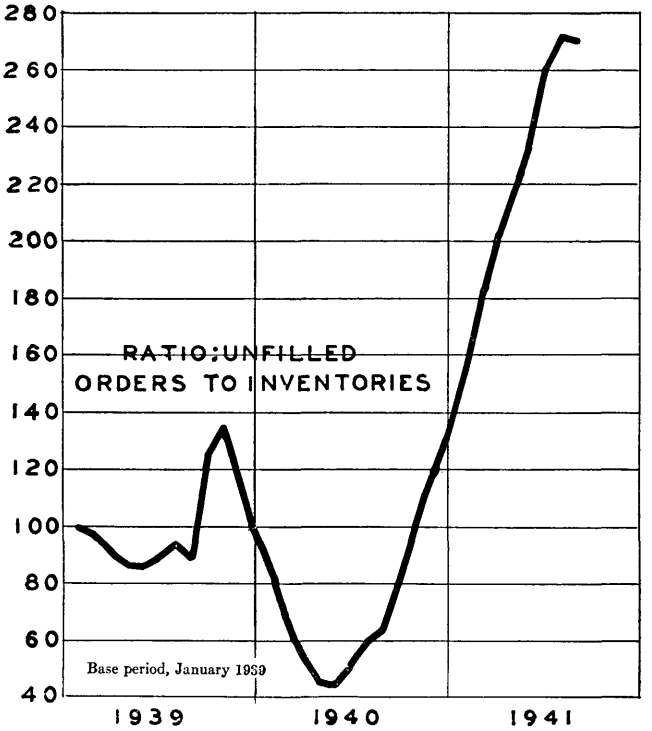
INDEXES OF MANUFACTURERS' NEW ORDERS, SHIPMENTS, AND INVENTORIES



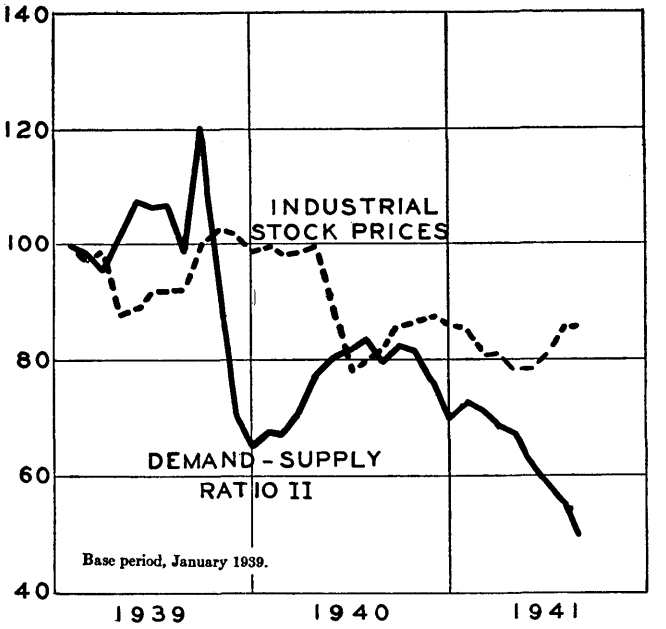
DEMAND-SUPPLY RATIO I VS. INDUSTRIAL PRODUCTION



RATIO OF UNFILLED ORDERS TO INVENTORIES



DEMAND-SUPPLY RATIO II VS. INDUSTRIAL STOCK PRICES



were no appreciable revisions made in the indexes of shipments and inventories for July, the new orders index was revised from 226 to 212. This downward revision was further emphasized by a decline in the preliminary new orders index for August to 188. During July and August when the volume of incoming orders was decreasing, the volume of shipments remained about unchanged.

During the final quarter of 1940 and the first half of 1941, the vertical distances between the shipments and new orders curves showed that the value of unfilled orders on the books of manufacturers was increasing greatly. Although the value of manufacturers' inventories has increased substantially during the period shown by the chart and the trend continued upward during July and August when the new orders index was declining, the volume of inventories do not yet appear to be high in relation to the existing level of unfilled orders.

The ratio of unfilled orders to inventories shown in the next chart in the same column was computed by dividing the backlog of orders (obtained by calculating the excess of the new orders index over the shipments index for the period shown on the chart) by the index of inventories. The great advance in the ratio of unfilled orders to inventories from the middle of 1940 to the

middle of 1941 shows that, in spite of the substantial increase in inventories during this period, they were small in relation to the incoming volume of orders. There was only a slight decline in this ratio from the July to the August level.

The chart at the top of the next column on page 166 shows the Institute's Demand-Supply Ratio I (new orders divided by shipments times inventories) with the Institute's Index of Industrial Production that is adjusted for long-term trend. Demand-Supply Ratio I was following a moderately downward trend from October 1940 to June 1941, primarily because the index of shipments (a supply factor) was advancing. The sharper decline in Demand-Supply Ratio I during July and August was the result of the decline in the new orders index representing the demand factor. The Index of Industrial Production advanced in July and August but at a less rapid rate than had been the general rule during the preceding twelve months.

The next chart shown in the same column presents the Institute's Demand-Supply Ratio II with the index of industrial stock prices. This ratio includes industrial production as well as shipments and inventories in the supply factor, and it has declined more than has Demand-Supply Ratio I during the past year, because of the great increase in industrial production during this period. The factor of rising industrial activity as a depressing element in Demand-Supply Ratio II may be absent during the months immediately ahead. The influence of the Government is being exerted to transfer production from nondefense to defense purposes, and the latter type of activity will probably continue to increase, but the Nation's total production volume may remain at about current levels or even decline.

During the first two years shown on the chart, the major movements of Demand-Supply Ratio II preceded similar changes in the trend of the industrial stock price index. However, since the middle of 1940 industrial production has been increasing so rapidly that Demand-Supply Ratio II has followed a downward trend; although industrial stock prices have been stabilized. Demand-Supply Ratio II may reflect demand-supply factors that have a decisive influence on stock market movements, but the trend of the market may of course be dominated by other factors, such as war news or political developments. It is possible that the factors indicated by Demand-Supply Ratio II have been influential in restraining a rise in stock prices to levels commensurate with the increase in corporate earnings that have been reported during the past year. Furthermore, the trend of this ratio in the past two months suggests the advisability of an exceedingly cautious attitude toward speculation in stocks during the near future.

BUSINESS

Telephones in Use

During September there was an increase of approximately 160,000 telephones in service, compared with an increase of 120,000 in September 1940. The Institute's index of the number of telephone stations in service per capita increased from 121.4 in August to 122.3 in September. This index, expressed as a per cent of the 1935–1939 monthly average, has advanced consistently and substantially since 1934.

During the first nine months of 1941 there was a greater gain in the number of instruments placed in service than there has been in any previous full calendar year. Although greater industrial activity necessitates some additional telephone installations, even more are required when there is a commensurate increase in commercial activity. The recent advance in the index probably reflects the expansion of consumer outlets accompanying the recent trade boom.

THE FUNDAMENTALS

Supply

The rate of steel-ingot operations last week decreased from 98½ to 98 per cent of theoretical capacity. The slight decrease in the rate was attributed by the *Iron Age* to: "(1) Strikes and slowdowns, (2) shortages of iron and steel scrap, and other vital raw materials, and (3) priorities curtailments and shutdowns."

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Per Cent of Capacity	84.0	17.5	65.0	41.5	94.0	98.0

(Latest 1941 weekly data; corresponding week earlier years)

There was a substantial recovery in electric-power production last week when output exceeded production in the corresponding week of 1940 by 17.8 per cent, compared with an increase of 14.8 per cent in the preceding week. The gains were distributed fairly evenly throughout the seven geographic regions for which separate reports are made by the Edison Electric Institute.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Billion Kilowatt Hours	1.82	1.51	2.28	2.15	2.79	3.29

Automobile production decreased contraseasonally last week from 77,035 units (revised) in the preceding week to 76,820 cars and trucks last week. During the corresponding week of 1940, 105,153 units were produced. Last week's decrease was attributed primarily to scattered strikes in the industry.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
Units (000 omitted)	82	13	72	33	105	77

Cotton-mill activity increased slightly more than seasonally last week, and the adjusted index advanced from 167.8 to 168.6. The Office of Price Administration has not yet acted on appeals for the revision of price ceilings.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	108.3	103.9	121.2	109.9	121.8	168.6

Lumber output decreased more than seasonally last week and the adjusted index declined from 130.0 to 125.6.

	1929	*1932*	*1937*	*1938*	*1940*	*1941*
New York Times Index	121.9	37.0	76.1	75.1	113.4	125.6

Demand

The index of income payments compiled by the United States Department of Commerce advanced from 132.6 (per cent of the 1935–1939 level) in July to 133.5 in August. The per cent increase in income payments was greater than the per cent increase in the cost of living, but the difference was less than it was earlier in the year. Officials of the large credit companies anticipated a reduction in demand for installment credit after Government restrictions were imposed September 1 but reported that there were no discernible effects during the first month. The established trade practices for installment sales of many products were no more liberal than the maximum terms that could be extended

under the official limitations. For those goods for which down payments were increased and the time periods for payments were shortened, there was usually an increase in the proportion of cash sales instead of a decrease in the total sales volume. The Federal Reserve index of department-store sales was 34 per cent higher last week than it was in the corresponding week of 1940.

Prices

The average price of commodities traded on the exchanges declined consistently last week. Moody's Spot Commodity Price Index was 214.6 on October 2 and 211.1 on October 9. The Dow-Jones Index of Commodity Futures closed at 83.00 on October 2 and at 81.19 on October 9.

There was another fractional increase in the cost of living during August according to the National Industrial Conference Board's index. Consistent with the recent trend, the largest increase was in the food item, but a more substantial increase in clothing prices was reported than there has been in any preceding month of the present upward price movement. The composite index and separate items for August 1929, 1932, 1940, and for July and August 1941 are shown in the accompanying summary.

	Aug. 1929	*Aug. 1932*	*Aug. 1940*	*July 1941*	*Aug. 1941*
All Items Combined	101.1	76.9	85.4	88.9	89.4
Food	110.4	68.5	77.4	86.2	87.3
Housing	92.0	71.2	86.9	88.4	88.6
Clothing	99.5	64.3	73.0	73.8	74.5
Fuel and Light	92.3	85.5	84.8	87.8	88.6
Sundries	99.1	93.7	98.1	98.7	98.8

FINANCE

Treasury Operations

Last week the Treasury Department announced a $1,500,000,000 bond issue, only $200,000,000 of which represented refunding. The new Government borrowing will therefore add $1,300,000,000 to the existing public debt and will bring the total interest-bearing debt to about $51,700,000,000, an increase of $8,200,000,000 during the past twelve months.

The available evidence indicates that the new Treasury issue will be inflationary to a greater degree than have previous issues for financing the defense program. Research Report subscribers are aware of the important distinction between deficit financing by the sale of Government securities to individual investors and savings institutions and their sale to commercial banks, whose savings-type liabilities are (at present) failing to increase appreciably.

A recent declining trend in the sale of Savings Bonds suggests that investors are becoming reluctant to support the Treasury in the style to which it had become accustomed. The following statement of sales of United States Savings Bonds during recent months was reported by the Treasury.

1941	*Millions of Dollars*
May	375
June	321
July	354
August	271
September	238

The market for the new Treasury bond issue is probably somewhat different from that for the Savings Bonds that are sold primarily to the small individual investor. The market for major Treasury issues is comprised mainly of the commercial banks; the savings institutions, such as the large insurance companies; and wealthy individual investors. Inasmuch as the funds available for investment by the savings institutions are derived from the small investor, the trend of funds available from this source may be similar to that of the subscribers to the Savings Bonds, in which case there will be a diminishing flow of funds from this source. The increased tax burden placed on wealthy investors and the elimination of the tax-exempt feature from Government bonds will probably result in smaller purchases by this class of investor. If this analysis of the situation proves to be correct, a substantial portion of the new Treasury issue will probably be financed by the commercial banking system and will result in the creation of demand deposits credited to the Treasury.

The effects will not be immediately inflationary. Until the new checking account credits are spent, the purchasing media created will not be available to the public. However, at the Government's present rate of spending in excess of Treasury receipts (deficits have been more than $1,000,000,000 per month for the fiscal year beginning July 1), the purchasing media will soon appear as effective demand in the market place.

Tax Parity with Britain

During the early years of the New Deal's campaign for the redistribution of the Nation's wealth, adherents to the Administration's philosophy frequently pointed to the smaller tax burden borne by the United States citizens than that imposed in Great Britain. This condition need no longer irk the social reformers, because we have at last achieved parity with Britain in this respect. The following comparison appeared in a recent issue of *The Washington Review*, a publication of the Chamber of Commerce of the United States:

"It is true that for some years after the World War the British tax burden was heavier than ours, both as a percentage of national income and on a per capita basis. A few years ago, however, our tax burden began to approximate that of Great Britain due to increases in the burden of our Federal and State taxes.

"The additional levies imposed by the Revenue Act of 1941 will bring the tax burden in the United States above that in Britain, whether measured on a per capita basis or as a percentage of national income.

"A conservative estimate that Federal, State, and local taxes will approximate $22.5 billions during the current fiscal year gives a per capita tax burden of $168 in the United States, as compared with $165 in Great Britain (converting at four dollars to the pound). This estimate of $22.5 billions of course must be greatly increased when allowance is made for the effect of a full year of new taxes; the figure then is likely to reach 24 billion dollars, which would give a per capita tax burden of $180. The comparable figure for Britain, after allowing for a full year of effective operation of the new British taxes, would be $173.

"If the national income in the United States should amount to $90 billions during the current fiscal year, taxes will take 25 per cent of that income, as compared with 22 per cent of an estimated 36 billion dollar national income in Great Britain, or nearly one-seventh more."