

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

February 2
1942

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

COMING EFFECTS OF CURRENT EVENTS

Mr. Churchill on the War

A keen interest in the probable duration of the war is not incompatible with the determination to win. It is only part of the duties of business executives in planning for the future. Public information concerning the strategy of the war and its progress must necessarily be vague not only for military reasons, but also because in such wide theatres of operations decisive actions are slow in developing. Mr. Churchill's frank and able speech defending his position before the House of Commons probably shed as much light on the subject as it is now possible to obtain. We therefore believe that it is appropriate to consider the economic significance of his address.

Mr. Churchill's speech was primarily a defense against the charges made by critics of his conduct of the war strategy. The fact that freedom to criticize the conduct of the war is permitted in the democratic nations is reassuring for more than one reason. Primarily it proclaims the existence of a freedom for which we are fighting; but it has further implications. Among the democratic nations criticism and unrest are promptly expressed when serious reverses occur. Successes in war are approved by the people under any form of government. However, it should not be forgotten that failures engender the same attitude among the people in totalitarian nations as in the democracies, although in the former it cannot be expressed publicly. If military losses continue over a long period, the discouragement created will sooner or later have seriously adverse effects on the economic front.

Another characteristic of the war that was brought out by Mr. Churchill is the "touch and go" nature of the military operations. It is now conceded that the Allies have escaped further important reverses by a narrow margin. At first thought, this appears to indicate the probability of a long drawn-out conflict, but it also shows the possibility of an early climax through a favorable combination of circumstances no more miraculous than those that attended the change in the course of battle in Russia at a time when the Soviets were becoming reconciled to the fall of Moscow.

On the basis of his record, Mr. Churchill is not given to minimizing reverses when the military situation allows him to discuss them, and he is likewise chary in claiming successes that are only tentative. Therefore, it is possible that his estimate that we shall begin to win the war in 1943 may represent the longer rather

than the shorter limit. Of course, as long as the war lasts, the Nation's economic resources must be employed primarily for destruction instead of to provide for human necessities and comforts.

Some of the important considerations revealed by Mr. Churchill and by other published information that indicate the probability of a long war may be summarized as follows:

1. Mr. Churchill referred several times to the slender margin of defense power possessed by Great Britain. Limited resources of materials and of men must be spread over immense areas of conflict. He confessed the necessity of following a Fabian policy in the conduct of the war up to the present time. The outcome of the only offensive campaign now being waged in Libya is still in doubt, and Rommel was characterized as "a great general."

2. Hitler is at the moment the ruler of Europe, except for a small part of European Russia. The Japanese high command has almost equal power in the Pacific area. There are great difficulties in coordinating the war efforts of the "inter-Allied or inter-United Nations." Mr. Churchill pointed to the danger of "having more harness than horse." His most pessimistic statement related to this aspect of the larger war strategy. He said: "The physical and geographical difficulties of finding a common center for the leaders of the nations and the great staffs of the nations which cover the whole world are insuperable. Whatever plan is made will be open to criticism and many valid objections."

3. Congressmen have been asking whether the serious lack of coordination between the major branches of our armed forces that was revealed by the Roberts' report on Pearl Harbor is typical of the entire defense system.

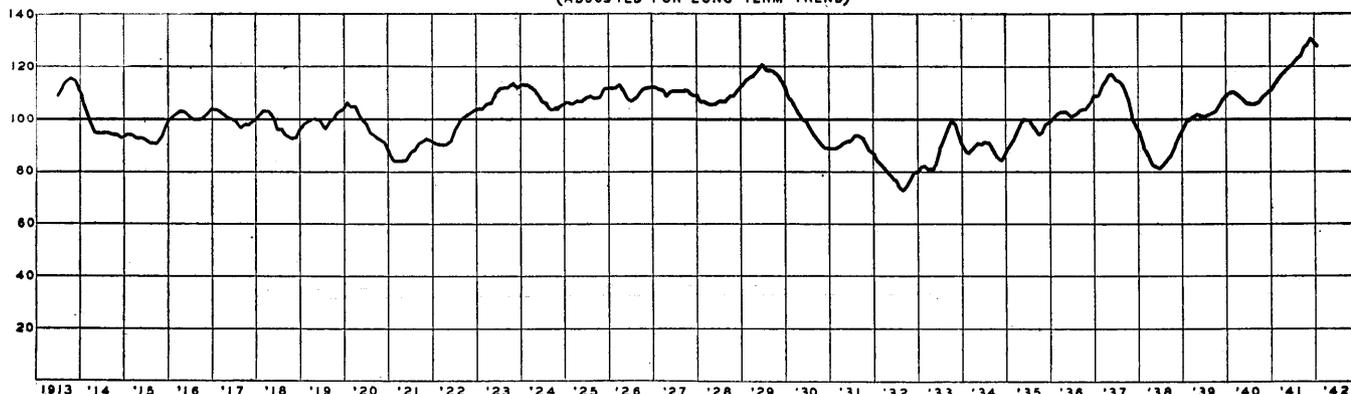
4. In both Germany and Japan there must be realization that only military success can prevent terrible disaster from being visited on the people of those nations, and this lends the endurance of desperation to their efforts.

Some of the developments that may tend to shorten the war may be summarized as follows:

1. The unexpectedly strong resistance of Russia and China has finally enabled them to take the offensive. The great manpower of these nations, if adequately supplied with war materials, is a potential threat to our enemies.

2. As in 1918 the impact of the United States war effort will fall on an enemy depleted in manpower and probably in industrial power by several years of struggle.

INDEX OF LIVING STANDARDS
(ADJUSTED FOR LONG TERM TREND)



3. The material resources of both major opponents may be nearer to exhaustion than is revealed by their present striking power. One of Germany's most powerful offensives in the first World War was carried out only a few months before the virtual collapse of her armies.

4. The fact that the organizational weaknesses in the United States armed forces was revealed early in the conflict may make possible a more efficient coordination than otherwise could have been achieved.

Obviously, it is still necessary to prepare for the worst, a long and intense struggle. Furthermore, we should realize that more than dollars and machines will be needed.

BUSINESS

Index of Living Standards

Since the index of living standards was presented and discussed in the January 5, 1942 bulletin (pages 3-4), the index has been revised in accordance with revisions of the basic data made by the Federal Reserve Bank of New York. The revised index follows the same general pattern as the earlier one. The index shown in the accompanying chart reflects the volume of consumer goods produced and distributed per capita in the United States and is adjusted for seasonal influences and long-term trend.

From the middle of 1938, when it was nearly 20 per cent below normal, the index advanced with only two interruptions, one in the summer of 1939, and the other in the summer of 1940, until it reached a level more than 30 per cent above normal in November 1941. The index declined in both December 1941 and January 1942. Production of consumer goods reached a record high level in June last year, but, measured by physical volume, has since then been decreasing gradually. The index of production of consumer goods, compiled by the Federal Reserve Bank of New York, declined from 108 per cent of estimated long-term trend in June 1941 to 100 per cent in December. Preliminary data indicate that this declining trend is continuing at an accelerated rate.

The existing favorable position of the index was made possible by the large volume of goods that were produced several months ago. When these are distributed through retail channels, a lower level of living standards will be inevitable. Already some of the important commodities used by consumers are no longer

obtainable or are available in quantities insufficient to meet total demands.

The index shows that the Nation has recently indulged in a splurge of consumer goods buying and therefore we may find it all the more difficult to become reconciled to a more Spartan existence when stocks of consumer goods are depleted. However, a considerable part of the mechanical equipment recently purchased may last for the duration of the war and can be used if the fuels and supplies for its operation can be obtained.

Priorities Disemployment

An appraisal by the United States Department of Commerce of the probable extent of unemployment resulting from the radical change in economic activities occasioned by the war indicates that no serious situation is anticipated. The following comment was made in the January issue of the *Survey of Current Business*, published last week:

"Over the next few months the workers released by curtailment of civilian output may possibly exceed the number absorbed in expanding arms industries. However, such factors as conversion of plants to wartime use, further construction of new facilities, increased raw-material supplies, and expansion of the armed forces will all result in speedy reemployment. Over the longer period, the total labor force must be regarded as the ultimate limiting factor to the size of war output, and unemployment will undoubtedly be cut to an irreducible minimum.

"This was the experience in both England and Germany where some temporary unemployment was created during the transition to the maximum war output."

Postal Receipts

Postal receipts in fifty of the largest city postal districts during December 1941 exceeded the volume 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	33.1
October	35.7	26.7	31.7	30.9	35.2	36.9
November	32.7	26.1	30.7	31.4	33.2	33.8
December	40.8	33.1	42.0	42.5	45.4	48.8

December 1940 by a substantial margin. The gain of postal receipts over those for the corresponding period of the preceding year was 7.5 per cent, compared with a gain of 6.2 per cent for the twelve-month period. The monthly series for 1941 and for earlier significant years are shown in the table on page 18.

THE FUNDAMENTALS

Supply

The steel-ingot production rate advanced another half point to 97 per cent of theoretical capacity last week. Although the rate was the same as it was in the corresponding week of 1941, production of actual tonnage was larger, because new producing equipment has come into service during the past year. Even the steel industry, which supplies the basic material for warfare, is beginning to feel the adverse effects of an abnormal demand situation. This was indicated by *The Iron Age* in the following statement: "The sharp increase in demand for structural shapes and concrete reinforcing bars for construction of new war plants and the rehabilitation of damaged equipment will fall heavily upon the structural mills. Such factors lead to the conclusion that bar, pipe and sheet mills and some other units face curtailment in varying degrees in the months ahead. For non-integrated steel mills, the situation is already grave. Some have already suspended operations. The heavy drain on semi-finished steel for allocation and high priority orders has been felt by some non-integrated sheet and strip mills whose supply of material had to be cut despite their heavy bookings of priority rated material."

	1929	1932	1937	1938	1941	1942
Per Cent of Capacity	85.0	28.5	82.0	32.5	97.0	97.0
	(Latest 1942 weekly data; corresponding week earlier years)					

Electric-power production of 3,440,163,000 kilowatt-hours last week was substantially the same as output in the preceding week. The gain in output from that in the corresponding week of 1941 increased fractionally from 14.5 to 14.8 per cent.

	1929	1932	1937	1938	1941	1942
Billion Kilowatt-Hours	1.73	1.59	2.22	2.10	3.00	3.44

The activity of the cotton-goods industry increased contraseasonally last week, and the adjusted index advanced from 162.0 to 167.1 per cent of estimated normal. The cotton mills are operating at a rate about 13 per cent higher than that which prevailed a year ago.

	1929	1932	1937	1938	1941	1942
<i>New York Times</i> Index	*	89.7	136.9	85.2	147.6	167.1
	* Not available until third week of March.					

The report of lumber operations for the past week were not obtainable in time for publication. For purposes of comparison, data for the latest week available are presented.

	1929	1932	1937	1938	1941	1942
<i>New York Times</i> Index	145.2	39.3	69.9	53.1	143.0	135.7

Demand

A tapering off in the rush to buy consumer goods was evident last week. For the time being, consumers are evidently better supplied in "scarce" commodities than they were a month ago. The sales of some other commodities have been restricted by the retail outlets themselves because of difficulties in restocking. Merchants expect that there will be sporadic buying waves

whenever rumors are spread of prospective shortages of commodities, the supply of which has not been previously threatened. The dollar volume of department-store sales last week was 34 per cent greater than that for the corresponding week of 1941, compared with a gain of 45 per cent for the preceding week.

Prices

Fluctuations in the sensitive wholesale commodity price indexes last week resulted in only moderate changes. Moody's Spot Commodity Price Index was 224.5 on January 22 and 225.3 on January 29. The Dow-Jones Index of Commodity Futures closed at 87.67 on January 22 and at 87.71 on January 29. At its present level, the spot commodity price average is about eight per cent higher than it was at the height of the 1936-1937 inflationary price advance. The futures index is now thirty per cent above the high point recorded in 1937. Apparently the reason for the different relationship of the two indexes to their 1937 peaks is that the spot commodity price index has a wider representation of commodity items than the futures index, which primarily reflects changes in the prices of agricultural commodities.

The General Motors-Cornell Index of Wholesale Prices of 40 basic commodities for the United States has advanced 51 per cent since the war began in September 1939. The index for England has risen 60 per cent. Most of the advance in prices in Great Britain (40 per cent) occurred during the first year of the war and was attributed primarily to increased costs of imported materials as a result of the depreciation of the pound. This factor has not been operative in the United States, but prices here have recently been increasing as rapidly as the British price index rose early in the war. If the present trends continue in Britain and in the United States, our living costs may rise to a higher level relative to the pre-war period than those in Great Britain.

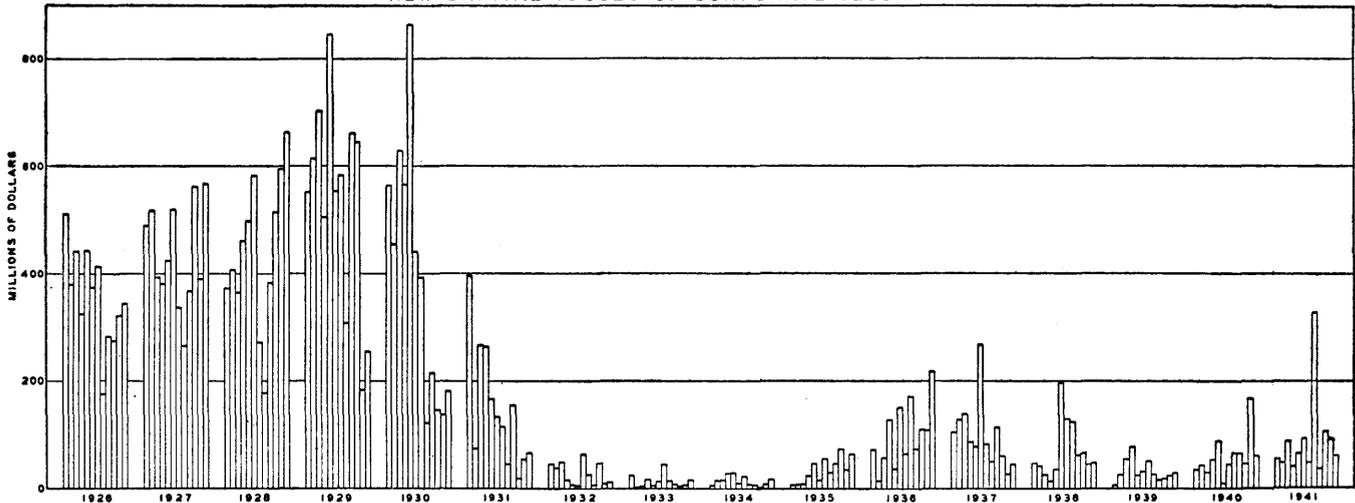
FINANCE

The Harwood Index of Inflation

There was a fractional advance in the Index of Inflation in ratio form from 107.4 for the week ending January 14 to 108.1 for the week ending January 21. The commercial banks' investment-type assets increased only moderately, but there was a decrease of more than \$200,000,000 in the Treasury's bank deposits and gold in the working balance of its general fund. This represented distribution to the general public of inflationary funds previously hoarded, in effect, by the Government and was the primary cause of the advance in the Index.

A decrease of nearly \$100,000,000 in the banks' savings-type liabilities was also a contributing factor in the advance of the Index. The withdrawal of savings deposits that we discussed in last week's bulletin (pages 14-16) is apparently continuing. During the week when nearly \$100,000,000 was withdrawn from the commercial banks by savings depositors, sales of United States Savings Bonds aggregated about \$200,000,000. The mutual savings banks have about as great a total of savings deposits as the commercial banks, and, if the experience of the two types of banks is similar, as appears probable, most of the funds for investment in savings bonds represent merely a transfer from savings

NEW CAPITAL ISSUES OF CORPORATE SECURITIES



institutions to investment in Government securities. As we pointed out in last week's bulletin, the campaign to check inflation through sales of Government Savings Bonds will be ineffective if savings depositors continue to make large withdrawals from the banks.

New Capital Issues

The chart at the top of this page shows the volume of new corporate financing in the United States by months for the years 1926-1941 and facilitates comparison 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 1941 was substantially greater than the total in each of the preceding three years but failed to equal the aggregate in 1936 or in 1937. The record for August 1941, the only month in which there was an impressive volume of new capital issues, was made possible by a single transaction, that for the American Telephone and Telegraph Company.

The chart reveals no tendency for corporate financing to revive to the levels typical of the 1926-1931 period. On the other hand, there was a fair volume maintained during the period of prewar defense effort, when the volume of Government financing was increasing rapidly.

During December 1941, the first war month, nearly half of the new private issues represented borrowings by the railroads; about 12 per cent, by the public utilities; and the remainder, by industrial corporations. The new private-capital markets did not dry up immediately upon our entrance into the war as they did in Great Britain. This may be accounted for by arrangements having been made for issues marketed during December before the war began. There is no assurance that private new-capital markets in the United States may not parallel the experience in the United Kingdom, where only £4,000,000 of new private capital was obtained in 1940, compared with an annual average of £148,000,000 for the preceding ten years.

New corporate financing in December and for each year during the past sixteen years is shown in the following summary.

NEW CORPORATE FINANCING IN THE UNITED STATES

Year	December (In Millions of Dollars)	Twelve Months	Year	December (In Millions of Dollars)	Twelve Months
1926	343	4,286	1934	16	159
1927	568	5,217	1935	65	402
1928	663	5,294	1936	217	1,202
1929	253	6,407	1937	47	1,225
1930	181	4,807	1938	60	869
1931	67	1,759	1939	31	380
1932	10	324	1940	62	735
1933	16	161	1941	59	1,037

Source: *Commercial and Financial Chronicle*.

SECURITIES

Bonds

Although prices of high-grade bonds tended to advance last week, the more speculative bonds were in less demand. The Dow-Jones average of forty bonds was 90.22 on January 22 and 90.26 on January 29.

Stocks

There was no decisive trend revealed in the stock market last week. The market is apparently affected by war news, and this has recently been a mixture of good and bad. We see no reason to expect a prolonged rise as long as both tax uncertainties and war uncertainties remain in the degree now existing.

RECOMMENDED BOOKS

"*An Economic Survey of Ancient Rome*," by Kenney Frank. Johns-Hopkins Press. (\$5.75.)

We know that other civilizations have risen only to fall, during the long course of man's history on this planet. However, the Roman civilization is the only one for which we have records in sufficient detail to make comprehensive historical studies possible. This volume is especially interesting at the present time, because many developments in this country, which more or less parallel the trend toward totalitarianism that has been so evident in Europe for some time past, are strikingly similar to the trend of events in Rome during the decline and fall of the Empire. For readers interested in these comparisons, as well as the student of history, this volume is highly recommended.