

AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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W E E K L Y
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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Transportation

The vital role of transportation in war was emphasized by Lord Halifax last week in his report on Britain's war effort. The problems encountered by the United Nations are especially difficult because of the favorable geographical position of our enemies. All of the ocean-going transportation facilities of the United States as well as of our Allies must be devoted to carrying manpower and materials for the duration of the conflict. The civilian populations must of course be deprived of most of the import products that we have been accustomed to enjoy.

The United States merchant-marine tonnage has not increased appreciably since the war began, because "a very substantial number of ships were transferred to British and other foreign registers." However, there have been great changes in the employment of our tonnage as shipping has been adapted to war transport requirements. We shall probably at least double our merchant marine of approximately 8,000,000 gross tons during the course of the war. After the war is over, we shall have serious decisions to make in respect to our maritime policy as we did after the former World War.

Our railroad transportation system is being required to an increasing degree to devote itself to moving war materials. Of course, the railroads are necessary to maintain the existence of the civilian population, and their services obviously cannot be requisitioned by the Government to the extent that it has taken over our shipping facilities. Fortunately, before the war effort began, the railroads had a surplus of facilities, and this provided a resource that is now being tapped in full. The railroads have recently obtained new equipment, but the carriers' ability to obtain an adequate flow of new rolling stock is now limited by the great need for materials and labor on the part of the war-production industries.

Railroad executives have been more successful in this war than in the last in obtaining efficiency of operation, especially by the cooperation and coordination of the separate roads. Their problems have been made easier by the fact that a considerable proportion of war-materials traffic is moved by main lines between large centers of production or from such centers to tidewater shipping points. The short-haul traffic that primarily serves civilian consumption needs will first be curtailed when the necessity arises, and it would not be surprising

if embargoes are sooner or later placed on some non-essential classes of freight.

The operations of motor-truck carriers reached a record volume in 1941, but gasoline and tire shortages will probably reduce the volume of this type of transportation during 1942. The railroads will probably be unable to carry the short-haul tonnage that the trucking companies must relinquish; therefore, the competitive position of these types of transportation will not be materially affected.

The longer-range future of the Nation's transportation systems may be profoundly affected by the war. The railroads' performance thus far affords the hope that seizure of management by the Government can be avoided. The executives no doubt realize that the penalty for failing to maintain maximum efficiency of operation will be Government ownership.

WHERE ARE WE GOING?

The Background for Inflation

In a preceding discussion of the background for inflation, we presented data showing that, even before the country embarked on the national defense effort, there was much inflationary purchasing media available to the public. We also presented evidence showing that the war could not be financed without greatly adding to the total. Although it is practically impossible for the government of a nation at war to prevent the creation of more purchasing media during a time when goods are becoming scarce, the operation of the inflationary process does not necessarily go wholly unchecked.

Retarding Factors

Factors that tend to retard an inflationary progression may operate to prevent the active use of the new inflationary purchasing media or may through government intervention limit its use.

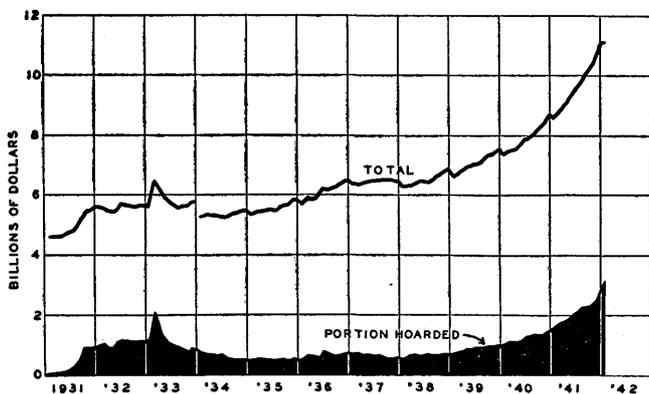
Although the operation of the Nation's money-credit system has been obscured by the complicated modern economic structure and by the habit acquired over many years of treating financial transactions as separate from the trade and industrial processes they actually represent, it is vital to remember that financial transactions ordinarily are the paper records of goods that have been or are being produced. During the New Deal's pump-priming period, it was believed that recovery could be brought about and a general redistribution of wealth could be effected merely by the creation and wide distribution of new inflationary purchasing media. Some theoretical economists do not

realize yet that the new purchasing media might be hoarded instead of appearing as demand in the markets. In such an event, pump-priming neither stimulates production nor appreciably affects the price level, and new buying power will not remain distributed in the manner intended.

Hoarding

Although hoarding of purchasing media cannot be accurately measured, a general idea of its extent can be obtained from the financial data available. As we explained,¹ the purchasing media available to the public consist of currency in circulation plus demand deposits (checking accounts). Both of these classes of purchasing media have increased greatly during the past decade, but, with the exception of the brief period of speculation in 1936-1937 and the period since the national defense effort started a war boom in the United States, a considerable part of the new inflationary purchasing media has been hoarded.

CURRENCY IN CIRCULATION AND PORTION HOARDED



Gold coin omitted from reports beginning January 1934.

The foregoing chart presents a monthly record of total currency in circulation during the past ten years. The shaded section of the chart indicates the amount of currency hoarded during the period shown. The exact amount is of course not known, but the data are obtained from estimates based on methods developed by the statisticians of the Federal Reserve System.² The hoarding that accompanied the banking panic that began in 1931 reached a climax in February 1933 and thereafter declined from a total of more than \$2,000,000,000 in February 1933 to around \$500,000,000 in 1935. Total currency hoarding then remained less than \$1,000,000,000 until after the war started in 1939 but then began to increase and, during the past two years, has absorbed much of the currency entering circulation.

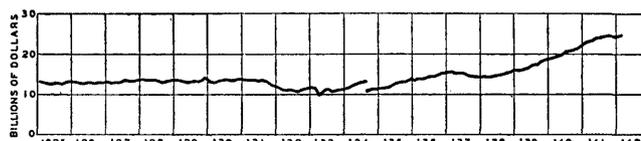
Although the largest number of exchanges are made by using currency as the purchasing medium, bank checks drawn on demand deposits are used for effecting by far the larger dollar volume of transactions. About four-fifths of the available purchasing media exists in the form of checking accounts and only one-fifth in the form of currency. During the past decade, the volume of demand deposits has increased greatly, although the proportional increase was not quite so great as that in the volume of currency in circulation. Approximately

¹ See *Purchasing Media Defined*, March 9, 1942, *Research Report Bulletin*, page 38.

² See *Federal Reserve Bulletin*, November 1934, Pages 711-712.

two-thirds of all checking accounts is on deposit with the 101 member banks of the Federal Reserve System, which make weekly reports of these items. The trend of deposits in these banks is usually typical of that for the entire banking system.

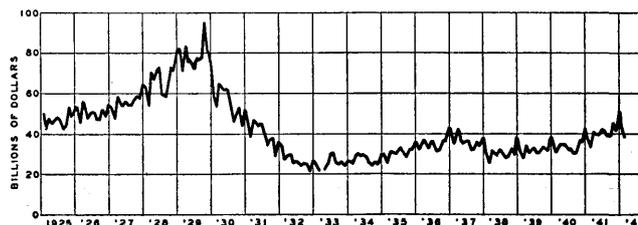
DEMAND DEPOSITS (Reporting Member Banks)



Beginning September 1934, United States Government deposits and items in process of collection excluded.

The activity of demand deposits (checking accounts) can be determined by reports of bank clearings or bank debits covering transactions of the larger banks of the country. Bank clearings are the total value of checks passing through the city clearing houses. Debits are charges against the checking accounts of individuals and companies. The latter is the more accurate measure, because duplications in the record of transactions are eliminated.

BANK DEBITS (141 Centers)



Break in chart in March 1933 caused by bank holiday.

The two groups of banks, for which data are shown in the charts, are not identical but for the most part comprise the same institutions, and the data are typical of those for the banking system as a whole. Although it may not be possible to determine a normal rate of activity or velocity of checking-account deposits, there can be no question but that velocity was abnormally great in 1928 and 1929, when speculation, especially in the stock market, involved large checking-account exchanges. It is also a reasonable assumption that checking-account velocity was at an abnormally low level during the worst of the depression years in the early 1930's.

Since 1932 and 1933, the volume of bank debits has increased, but, except for a brief period in the winter of 1936-37 and at the end of 1941, checking-account exchanges have failed to keep pace with the growth in demand deposits. It is therefore apparent that checking-account velocity has been low during most of this period. (This is confirmed by the index of velocity prepared by the Federal Reserve Bank of New York.) A low rate of turnover of checking-account deposits is evidence that this type of purchasing media, just as currency, is being hoarded. For the purposes of this discussion, it is not necessary to inquire extensively into the reasons why purchasing media are being hoarded, but it can be stated that the lack of confidence in the safety of enterprise or in the probability of profit from enterprise is almost invariably the cause of such hoarding.

Although a close quantitative measure of hoarding purchasing media cannot be obtained, we believe that the evidence presented is sufficient to justify the assumption that much of the new purchasing media that have been created during the past decade have been hoarded. This hoarding also explains the reasons for the moderate effect of inflation on the commodity price structure until the war began to create commodity shortages. Hoarding therefore has been and may in the future be at least one of the most important retarding factors to the development of an inflationary progression.³

Price Controls and Rationing

The Government is relying primarily on the price-control and rationing powers granted by Congress to limit the effects of the wartime inflation it cannot prevent. History provides evidence³ that even stringent price controls cannot be long maintained and are inevitably accompanied by an expanding bureaucracy. After we were involved in the first World War, controls somewhat similar to those now in force were applied. These failed to prevent a "dangerous upward spiral of prices in general," although the controls were apparently partially effective because the full extent of the commodity-price rise did not occur until after the emergency price controls were abandoned at the end of 1918.

Our own controls have not yet been subjected to an adequate test, but, where controls have been applied abroad during the present war, results have not been encouraging, especially where loopholes have been left, such as exist in our own program.⁴ A League of Nations' survey shows that attempts at price fixing were only partially successful even when supported by a system of stringent control over all economic processes. (An exception was noted in the case of rents, which have actually been more or less stabilized in most countries of Europe, in Japan, and in defense areas in Canada.) In Britain, where closer controls have been applied than are at present contemplated in the United States, the commodity-price level has risen 60 per cent during the war and is still rising.

The farm bloc in Congress has been successful in preventing either the release of Government-held agricultural surpluses at reasonable prices or the application of real limits on prices of farm products. The organized labor lobby has been equally successful in retaining wage-hour legislation that is especially harmful in wartime. With these two handicaps, the Government cannot expect to make price ceilings more than temporary affairs. Prices can be pegged only when labor and raw-material costs are stabilized.

Evasions

A period of rapidly advancing commodity prices is frequently accompanied by attempts on the part of sellers to conceal the price changes. The standard prices of some articles may remain unchanged, but the quality of the products may be lowered or the size of the package decreased.

³ For examples of historical evidence of attempted price fixing, see the *Congressional Record*, November 25, 1941, pages A5631-A5633.

⁴ A summary of experience in price controls in other countries during the present war was prepared by the Economic Intelligence Service of the League of Nations and incorporated in the League's publication *World Economic Survey, 1939-41*.

The number of unlawful evasions also increases. Where excise taxes constitute a large part of the cost of a product, bootleggers who do not pay the taxes operate profitably. When the public has the ability to buy, scarce articles can usually be obtained at a premium large enough to compensate the seller for the danger incurred in resorting to illegal transactions. In most of the warring nations, "black markets" have done a substantial business and are probably not unknown even in the most strictly regimented nations.

As the number of consumer goods items that are rationed increases, bidding for the remaining goods will become more active. This influence not only tends to bring more and more products within the range of Government control and therefore to increase the problems of supervision, but it also tends to emphasize in the public mind the desirability of goods over dollars. Unless the war is greatly protracted, a real flight from the dollar will probably not develop until it is over. However, the continuing inflation is laying the foundation for such a development in the more distant future.

BUSINESS

The Trend of Commercial Failures

Both the number of insolvencies and the liabilities involved in commercial failures during February 1942 were less than they were in the corresponding month of the two preceding years. During the past three years, the trend of the statistical series of liabilities of commercial failures has been generally downward, and, although the relatively large size of the liabilities for December 1941 suggested the possibility that this trend had been reversed, the decrease in the figures for January and February this year was about at the level that would be expected if the recent downward trend is to be continued.

Since the national defense program began to interfere seriously with the normal flow of materials and finished goods, and especially since our entrance into the war, many industrial and commercial enterprises have had their activities limited for one reason or another. If the record of commercial failures maintains its present favorable trend, it will indicate an unusually high degree of adaptability to changed circumstances on the part of the Nation's smaller nondefense enterprises.

The number and liabilities of commercial failures during each month of 1940 and 1941 and during the first two months of 1942 are shown in the following table:

COMMERCIAL FAILURES, NUMBER AND LIABILITY

| | Number of Failures | | | Liabilities of Failures (In Millions of Dollars) | | |
|-----------|--------------------|--------|------|---|---------|-------|
| | 1940 | 1941 | 1942 | 1940 | 1941 | 1942 |
| January | 1,237 | 1,124 | 962 | 15,279 | 11,888 | 9,916 |
| February | 1,042 | 1,129 | 916 | 13,472 | 13,483 | 9,631 |
| March | 1,197 | 1,211 | | 11,681 | 13,444 | |
| April | 1,291 | 1,149 | | 16,247 | 13,827 | |
| May | 1,238 | 1,119 | | 13,068 | 10,065 | |
| June | 1,114 | 970 | | 13,734 | 9,449 | |
| July | 1,175 | 908 | | 16,213 | 13,422 | |
| August | 1,128 | 954 | | 12,997 | 11,134 | |
| September | 976 | 735 | | 11,397 | 9,393 | |
| October | 1,111 | 809 | | 12,715 | 7,333 | |
| November | 1,024 | 842 | | 16,572 | 9,197 | |
| December | 1,086 | 898 | | 13,309 | 13,460 | |
| Total | 13,619 | 11,848 | | 166,684 | 136,104 | |

Postal Receipts

Postal receipts in February 1942 failed to exceed receipts in the corresponding month of the preceding year for the first time since 1938. Receipts in February this year were about the same as they were in February 1941. The failure of the upward trend in postal business to continue can be attributed to the gradual contraction in commercial activity that has been evident since the Nation started to adjust itself to a real wartime economy.

The monthly series of postal receipts for January and February 1942 and for each month of earlier significant years is presented in the following table:

| Month | 1929 | 1932 | 1937 | 1938 | 1941 | 1942 |
|-----------|------|------|------|------|------|------|
| January | 31.6 | 25.3 | 27.9 | 27.5 | 32.3 | 32.6 |
| February | 30.0 | 24.1 | 27.8 | 27.0 | 30.5 | 30.5 |
| March | 34.4 | 26.7 | 33.8 | 31.8 | 34.0 | |
| April | 32.4 | 24.3 | 31.1 | 29.6 | 34.9 | |
| May | 32.4 | 22.6 | 29.8 | 28.2 | 33.7 | |
| June | 29.3 | 22.0 | 29.6 | 28.0 | 31.2 | |
| July | 29.1 | 23.8 | 26.6 | 24.6 | 30.6 | |
| August | 29.3 | 23.9 | 26.3 | 26.6 | 30.4 | |
| September | 30.5 | 25.8 | 30.0 | 29.5 | 33.1 | |
| October | 35.7 | 26.7 | 31.7 | 30.9 | 36.9 | |
| November | 32.7 | 26.1 | 30.7 | 31.4 | 33.8 | |
| December | 40.8 | 33.1 | 42.0 | 42.5 | 48.8 | |

THE FUNDAMENTALS

Supply

The steel-ingot production rate was estimated to be 97 per cent of theoretical capacity last week. This was one point higher than the revised rate of 96 per cent for the preceding week. *The Iron Age* stated: "Signs are appearing at many points in the metal-working industry that the United States is planning for an offensive war. Steel order backlogs show, for example, that hundreds of thousands of tons of sheets and wire mesh will be utilized in 1942 for airplane landing mats. From now on, orders affecting the production and use of vital materials like steel will grow still more severe. The biggest industry to be halted, for conversion to war-implement manufacture, has, of course, been the automotive industry. This week, the construction industry is being placed on the block for the good of the Nation. All construction will soon be stopped by an order of the War Production Board. After the stop date, all new construction will be licensed, so that vital metals and other materials may be directed to the war effort."

| | 1929 | 1932 | 1937 | 1938 | 1941 | 1942 |
|----------------------|------|------|------|------|------|------|
| Per Cent of Capacity | 94.5 | 25.0 | 89.0 | 33.0 | 99.5 | 97.0 |

(Latest 1942 weekly data; corresponding week earlier years)

Electric power generated last week exceeded output in the corresponding week of 1941 by 12½ per cent. The gain was slightly smaller than has prevailed earlier in the year. However, a year ago, electric-power production was increasing substantially.

| | 1929 | 1932 | 1937 | 1938 | 1941 | 1942 |
|------------------------|------|------|------|------|------|------|
| Billion Kilowatt-Hours | 1.68 | 1.54 | 2.21 | 2.02 | 2.98 | 3.36 |

Lumber production decreased contraseasonally last week, and the adjusted index declined from 129.8 to 119.9. The virtual discontinuance of private residential construction is depriving the industry of one of its most important markets.

| | 1929 | 1932 | 1937 | 1938 | 1941 | 1942 |
|----------------------|-------|------|------|------|-------|-------|
| New York Times Index | 124.6 | 40.0 | 81.5 | 63.2 | 132.1 | 119.9 |

Demand

Last week the dollar volume of department-store sales was 24 per cent greater than it was during the corresponding week of 1941. The average price of department-store merchandise is 18.4 per cent higher than it was a year ago. Apparently the physical volume as well as the dollar total of sales is remaining above last year's level.

Prices

Prices of commodities quoted on the exchanges remained substantially unchanged for the seventh consecutive week. Moody's Spot Commodity Price Index was 230.2 on March 12 and 229.4 on March 19. The Dow-Jones Index of Commodity Futures closed at 87.41 on March 12 and at 86.68 on March 19.

FINANCE

New Capital Issues

The summary of new capital financing during February 1942 shows that the new capital market is surviving the effects of the war better than might be expected from the experience of the London market, where almost complete stagnation followed the outbreak of war in 1939. To be sure, the total volume, \$55,000,000, was smaller than the \$87,000,000 marketed in January this year, but this volume was the best for the month since February 1937, and the total for the first two months of the year made an equally favorable comparison with the record for the corresponding period of the past few years.

Most of the borrowing in February was done by the public utilities (\$26,000,000) and by the industrial corporations (approximately the same amount as the public utilities). The railroads entered the market only to the extent of \$3,750,000.

New corporate financing in February and in the first two months of each year during the past 17 years is shown in the accompanying summary.

NEW CORPORATE FINANCING IN THE UNITED STATES

| Year | First Two Months | | Year | First Two Months | |
|------|------------------|--------|------|------------------|--------|
| | February | Months | | February | Months |
| 1926 | 379 | 890 | 1935 | 7 | 12 |
| 1927 | 518 | 1,008 | 1936 | 14 | 86 |
| 1928 | 409 | 781 | 1937 | 155 | 251 |
| 1929 | 614 | 1,166 | 1938 | 41 | 87 |
| 1930 | 456 | 1,022 | 1939 | 24 | 29 |
| 1931 | 72 | 472 | 1940 | 45 | 81 |
| 1932 | 39 | 86 | 1941 | 47 | 99 |
| 1933 | 1 | 24 | 1942 | 55 | 142 |
| 1934 | 13 | 19 | | | |

Source: *Commercial and Financial Chronicle*.

SECURITIES

Bonds

Average bond prices were slightly higher last week. The Dow-Jones average of 40 bonds was 90.12 on March 12 and 90.46 on March 19.

Stocks

Last week stock prices rallied briefly from the March 11 low level, but there was no indication of a fundamental change in the trend. The volume of transactions on the New York Stock Exchange remained extremely small.