

AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Next Year's Income-Tax Levy

The recommendations of the House Ways and Means Committee for revision of the Federal tax schedules applied to 1942 incomes are of assistance in estimating the individual's future tax burden. The major recommendations of this Committee's report are usually accepted in considerable part by both the House and the Senate.

As we stated was probable in the March 9 Research Report bulletin, taxpayers in the middle income classes can expect to pay about double the assessment on this year's income that is being paid on last year's. The treatment of investment profits and losses may be altered somewhat, but no basic change is indicated.

Although the income-tax base was broadened last year to an extent that was then deemed drastic, the new rates, if enacted as proposed, will reach into the pocket-books of millions of people who consider themselves close to the subsistence level, as viewed from the pedestal of American living standards. This development resulting from the war emergency may ultimately prove to be highly beneficial if the majority of the voters in the country thereby become aware that the spending of public funds must be paid for by the people and cannot be created by monetary manipulations. This tax consciousness may be more definitely assured if a broad program of sales taxes is adopted some time in 1943.

Congress appears to be just as reluctant to adopt the Treasury's recommendations for a withholding tax as it is to impose a sales tax, but both of these devices may be found necessary next year. In the meantime, Congress will serve the country's interests by enacting its tax legislation at as early a date as is compatible with the need for examining all of the implications contained within the text of the measure.

The Rubber Situation

The public's confusion resulting from conflicting statements by Government officials with respect to the rubber situation was by no means removed by the report of the Truman Committee to the Senate last week. This committee has been engaged in investigating the national defense program and should be able to speak as authoritatively as any agency on the rubber situation. The committee has apparently come to the conclusion that the future for the country's rubber supply during the remainder of the war cannot be deter-

mined, but that the gloomiest view should be implanted in the public's mind. Senator Truman took occasion to criticize on the floor of the Senate the *New York Times* editorial entitled "Rubber Hope" in which it was pointed out that American industry, specifically the oil industry, might come to the Nation's rescue with large-scale production of synthetic rubber.

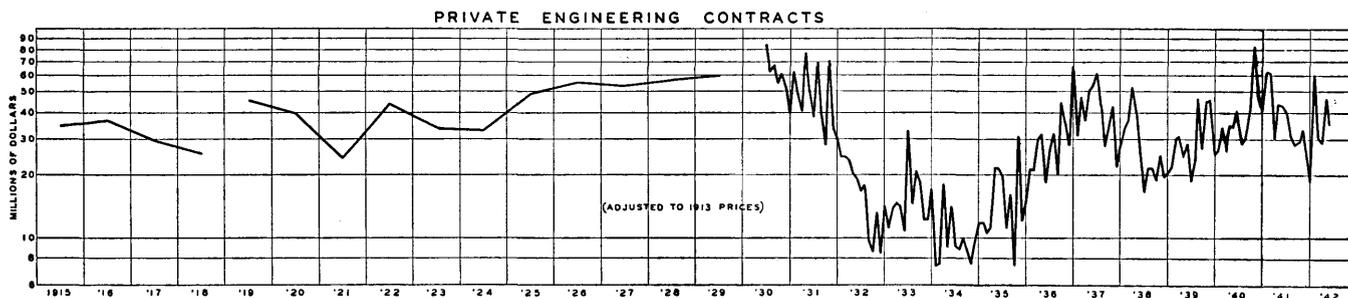
There is every reason to accept the Truman Committee's position that, although the United States has the largest rubber stock pile in the world, the supply of natural rubber will not be adequate for the military needs of the United Nations during the war. Of course, there will be none available for civilian consumption. Much of the Nation's home economy is dependent on the operation of automobiles, and the hope for providing the necessary tires before existing supplies are worn out or are seized by the Government for military purposes depends on the early development of rubber substitutes.

We already have an infant synthetic rubber industry, and this if properly fed could grow rapidly. We have the chemical knowledge to develop new processes and the technical ability to translate this knowledge into large-scale production. The abnormal expenditures incident to such an industry could be met by Government subsidies. It has been pointed out that the production of rubber for civilian uses would require machinery and labor needed for war purposes. However, a large synthetic rubber industry will be needed as a war measure and, as it develops, it may produce more than is needed for military purposes.

If enough synthetic rubber can be made to supply civilians with inner tubes, some easily obtainable material may be found that will be a reasonably satisfactory coating for the fabric shoes. It is therefore possible, but by no means assured, that tires for civilian use may become available next year. If they do, we shall owe another debt to American technology and industrial organization.

Private Engineering Contracts

The chart at the top of page 86 shows the dollar total of private engineering construction adjusted for changes in building costs. The data therefore reflect as closely as practicable the changes in the physical volume of construction activity covered by private engineering contracts. The data are plotted only once annually for the years 1915 to 1929, because monthly figures were not available until June 1930. Prior to that date there are two breaks in the curve; one in 1918, and the



other between 1929 and 1930. These were unavoidable because the data are not continuous for the entire period. Those shown for the years preceding 1930 do not include so large a percentage of all private construction contracts awarded as is included in the data since 1930. However, the earlier figures do give a general picture of trends and totals.

The month-to-month variations in private engineering contracts are so erratic that calculation of a seasonally adjusted index was found to be impracticable. In spite of these irregularities, the longer-term trend of the monthly series is apparent.

During the past decade, two major recovery trends are evident. One extended from the end of 1934 to the end of 1937, and the other from the middle of 1938 to the end of 1940. The general trend was downward throughout 1941, but there was a substantial volume of private engineering contracts awarded in January 1942, and the volume during the next four months has been large enough to indicate that a portion of the engineering projects necessary to the war effort (no others can be undertaken at this time) is being privately financed.

Much of the engineering construction needed to supply new plants for the production of war materials has been financed and supervised by the Government and therefore is not included in the statistical series shown in the chart. Most of the engineering projects that have been privately financed are presumably adapted to peacetime uses, and also many of the Federal engineering projects provide plant facilities that are capable of producing products in demand in peacetime. After the war, there will therefore be ample supplies of producers goods in existence to meet the postwar requirements of the metal industries. In fact, there will probably be overcapacities in most of the transportation-equipment industries, especially in the shipbuilding industry. On the other hand, plants for the production of goods in the luxury classes will be subject to obsolescence. These industries and the new industries that will develop during the postwar period must be depended on to maintain the volume of engineering construction after the war.

Ratio of Retail Inventories to Sales

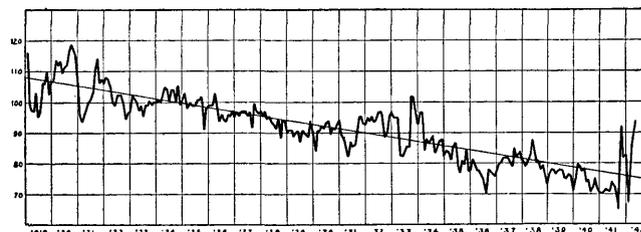
The wide fluctuations in the ratio of department-store inventories to sales during the past few months are attributable to the abnormal demand-supply situation arising from the war. The index of department-store stocks has advanced substantially from the middle of 1941, and in March 1942 was 45 per cent higher than the average level that prevailed during the first half of 1941. In the meantime, the index of department-store sales also advanced greatly but has fluctuated widely from month to month. The following summary of the

Federal Reserve seasonally adjusted indexes of department-store stocks and sales (1923-25=100) shows the influences that have effected the changes in the ratio of retail inventories to sales.

	Indexes	
	Stocks	Sales
1941		
June	77	104
July	82	115
August	87	134
September	92	116
October	97	105
November	95	116
December	92	111
1942		
January	93	138
February	102	128
March	107	124

The chart shown below presents the ratios derived by dividing the Federal Reserve indexes of department-store stocks by the indexes of department-store sales.

RATIO OF RETAIL INVENTORIES TO SALES

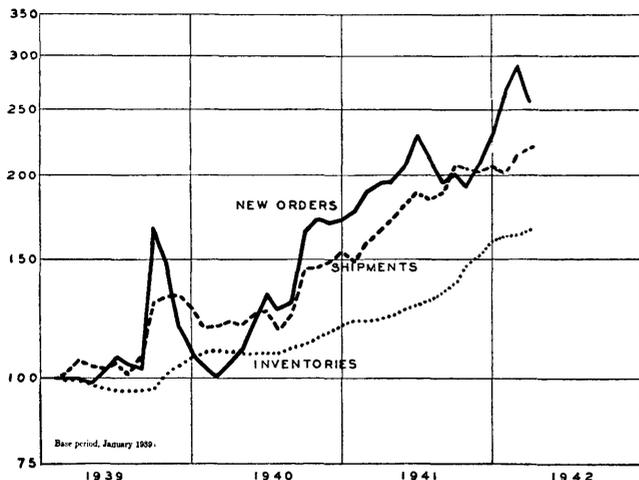


The position of the ratio in March 1942 (the latest month shown on the chart) in relation to the long-term trend line appears to indicate that stocks in the hands of retailers are abnormally large in respect to the volume of sales. Officials of the Federal Reserve System apparently believe that this situation should be corrected and have advised the banks to discourage merchants from holding large stocks of goods on credit. The War Production Board has also prepared regulations limiting purchases of "overstocked" merchants. These Government measures will no doubt prove effective, and later in the year the ratio of retail inventories to sales will probably decline if the dollar volume of sales is sustained at a reasonable level.

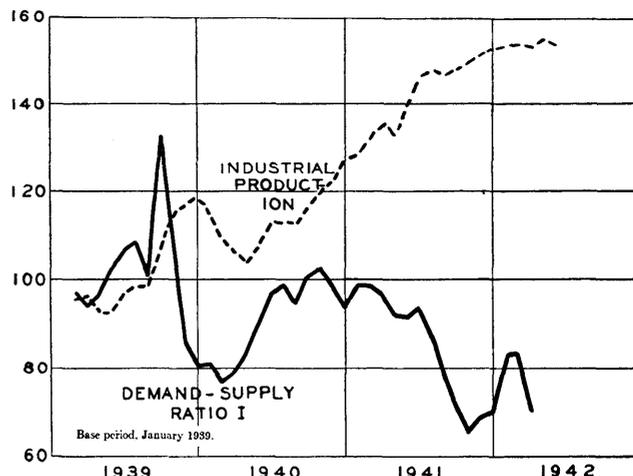
Demand-Supply Ratios

The United States Department of Commerce published its revised indexes of manufacturers' new orders, shipments, and inventories for February and its preliminary figures for March 1942 last week. The chart in the upper left-hand corner on page 87 shows the trend since January 1939 of these three indexes.

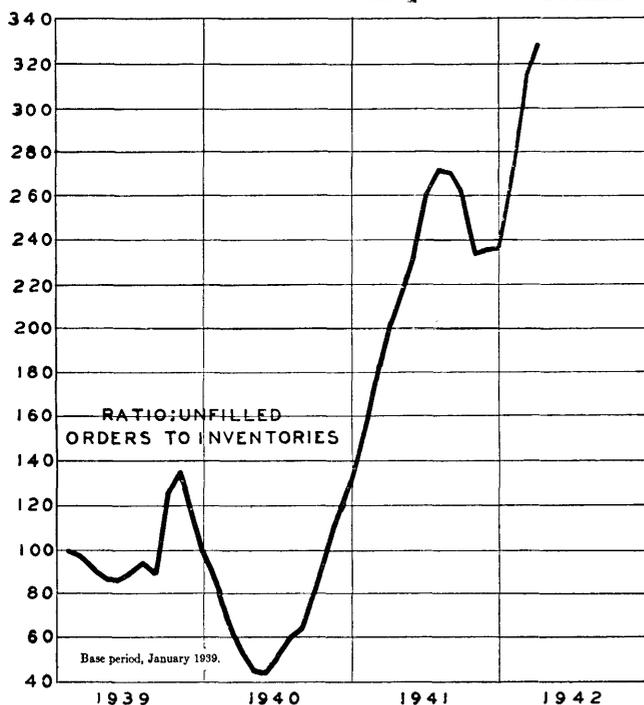
INDEXES OF MANUFACTURERS' NEW ORDERS, SHIPMENTS, AND INVENTORIES



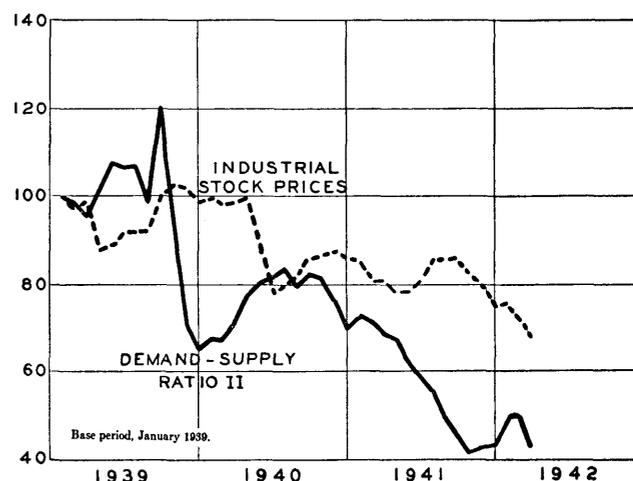
DEMAND-SUPPLY RATIO I VS. INDUSTRIAL PRODUCTION



RATIO OF UNFILLED ORDERS TO INVENTORIES



DEMAND-SUPPLY RATIO II VS. INDUSTRIAL STOCK PRICES



The index of new orders for March showed a decline for the first time since October 1941. Although the decrease in this index was substantial, the index remained at a higher level than it had been before the first quarter of 1942. The lower dollar volume of incoming orders during March apparently reflected the effects of the diminution in the volume of business that manufacturers could accept for civilian goods consumption at a time when the Government had already contracted for a substantial portion of war materials that could be produced by existing industrial capacities. There were moderate increases in the index of shipments and in the inventories index, and both of these reached new high levels.

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. In spite of the decrease in the volume of incoming orders during March, it remained larger than the volume of shipments. Consequently, there was another increase in the ratio of unfilled orders to inventories, inasmuch as there was only a slight change in the inventories index. Even if a limit has been reached to the building up of the backlog of manufacturers' orders, the ratio of unfilled orders to inventories shown in the chart may advance somewhat further if the Government is successful in carrying out its policy of reducing inventories. Manufacturers, as well as wholesale and retail merchants, are included in the Government's program to reduce stocks of goods and materials.

The chart at the top of the next column shows the Institute's Demand-Supply Ratio I (new orders divided by shipments times inventories) with the Institute's index of industrial production, which is adjusted for long-term trend. The reversal in March of the upward trend that Demand-Supply Ratio I followed from October 1941 to February 1942 was obviously caused by the decline in the new orders index. The trend of Demand-Supply Ratio I during the next few months will presumably be governed primarily by changes in

the new orders index, inasmuch as changes in the shipments and inventories indexes appear to be relatively moderate.

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. During recent months, when the industrial production index has remained within a relatively narrow range, Demand-Supply Ratio II has followed a course somewhat similar to that traced by Demand-Supply Ratio I, although the fluctuations have been more moderate. The decline in Demand-Supply Ratio II during March 1942 was caused by the same influence, namely, the reduction in the new orders index, that caused the decline in Demand-Supply Ratio I. The decline in Demand-Supply Ratio II in March suggests that the recent improvement in stock prices should be tentatively viewed as a reaction from an oversold market rather than the initiation of a fundamental upward movement. We have pointed out in preceding bulletins that the action of this ratio indicated the probability of a rally in the market rather than a basic change in its character. If this ratio has the forecasting value indicated by its relatively brief history, it appears advisable for investors in common stocks to retain an attitude of patience rather than to expect an early appearance of opportunities for substantial capital appreciation in the general list.

THE FUNDAMENTALS

Supply

The steel-ingot production rate decreased from 99½ to 97½ per cent of theoretical capacity last week. The reduction was caused by flood conditions in steel-producing areas that interfered with the transportation of materials. This handicap was only short-lived, and its effects on the industry are not expected to be observable next week, when it is estimated that operations will again be close to the full capacity rate.

	1929	1932	1937	1938	1941	1942
Per Cent of Capacity	95.0	22.0	83.0	28.5	99.0	97.5

(Latest 1942 weekly data; corresponding week earlier years)

Electric-power production increased seasonally last week and maintained about the same rate of gain over output in the corresponding week of 1941 that was recorded earlier in the month. Although separate reports are not at present available, there is evidence to indicate that an increasing proportion of the Nation's electric power is generated by Federal systems.

	1929	1932	1937	1938	1941	1942
Billion Kilowatt-Hours	1.62	1.43	2.21	1.97	3.04	3.38

The increase in lumber production last week was slightly smaller than seasonal, and consequently the adjusted index declined from 115.5 to 115.3 per cent of the 1935-1939 average. The volume of new orders was nearly 15 per cent larger than it was in the preceding week.

	1929	1932	1937	1938	1941	1942
New York Times Index	181.0	39.2	94.2	59.0	116.1	115.3

Demand

Public demand for consumer goods, which has recently been curbed as a result of rising prices and

limits imposed on consumer credit, may revive during the next few weeks. Government officials have for some time been frowning on the accumulation of larger commercial stocks of goods than were held before the war began in 1939 and are now taking definite action. Merchants therefore have started "promotion" sales to facilitate the reduction of their stocks. These sales will probably be continued until the merchants' inventory situation is brought into line with Government limitations. Demand in wholesale markets will obviously be restricted while retail merchants are reducing their stocks of goods. The dollar volume of department-store sales last week was two per cent lower than it was in the corresponding week of 1941. In view of the advance in department-store prices the physical volume of sales was more than 20 per cent smaller than it was a year ago.

Prices

The sensitive wholesale commodity price indexes remained within a narrow range last week. Moody's Spot Commodity Price Index was 231.5 on May 21 and 231.3 on May 28. The Dow-Jones Index of Commodity Futures closed at 85.87 on May 21 and at 86.31 on May 28.

The substantial increase in clothing prices was primarily responsible for the increase in the cost of living from the March to the April level, according to the National Industrial Conference Board's index. The "fuel and light" item was the only one of the five for which separate indexes are compiled that failed to show an increase for the month. The small decrease in that item was seasonal in character. The composite index and separate items for April 1929, 1932, 1941, and for March and April 1942 are shown below:

	April 1929	April 1932	April 1941	March 1942	April 1942
All Items Combined	99.0	79.3	86.9	96.1	97.1
Food	103.0	71.8	81.0	97.5	98.8
Housing	92.1	74.6	87.8	90.7	91.0
Clothing	98.8	68.4	73.3	85.8	88.4
Fuel and Light	93.2	87.0	86.4	90.4	90.1
Sundries	100.3	93.9	98.3	103.5	104.1

SECURITIES

Bonds

There was a moderate decline in the bond average early last week followed by recovery in later sessions. The net change was negligible. The Dow-Jones average of 40 bonds was 89.34 on May 21 and 89.35 on May 28.

Stocks

The Dow-Jones industrial average advanced last week, and the volume of transactions increased moderately. The railroad average was only slightly improved, and the utility average remained about unchanged.

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