

AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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

COMING EFFECTS OF CURRENT EVENTS

Supplying Our Forces

We have discussed in recent bulletins the vital importance of supply in modern warfare and have presented evidence to show that the United Nations have superiority over their enemies in the production of supplies and gave our opinion that this superiority will ultimately be decisive. In large-scale warfare, such as the present, the transportation of materials to combat areas is as vital a part of the supply problem as is production itself. The manufacture of war supplies is essentially an economic problem, and the delivery of these to fronts where they will become effective is at least partly economic, although guarding transport routes is of course a military and naval problem.

The Germans have shown themselves to be master organizers in supplying their armies during the present war. (The lack of winter equipment in Russia can be attributed to a miscalculation on the part of the military strategists. They evidently underestimated the power of resistance of the Russian Army.) They also have the great advantage of central position, an advantage also possessed by the Japanese.

German military moves indicate that Hitler is trying to cut the supply lines to Russia at both ends of her western warfront. (The Soviets have no eastern warfront yet, but ultimate conflict with Japan appears to be inevitable.) It is no secret that our supply route to England is impaired by German submarine activity.

Our studies obviously do not qualify us to analyze the military aspects of the transport of war supplies. However, we are sufficiently familiar with the economic history of the United States as to be impressed with the ability that this Nation has always shown in developing its resources. The same adequacy that has enabled us to develop great new war industries in amazingly brief periods can and will be applied to the problem of placing these supplies where they will do the most good.

We now have shipyards that did not exist even as blueprints until after we entered the war a few months ago, and the ships that these plants are turning out will ultimately be capable of creating that "bridge across the Atlantic" that may be needed. There is also reason to believe that the same characteristics that have given us economic supremacy will also prove effective in combat operations.

Salvage

It has been generations since the American people have been faced with the necessity of really using things

up and making unsatisfactory things do when the money was available for new purchases. We have developed habits of discarding goods that were partly worn or were beginning to be outmoded. Our prodigality has been an everlasting source of astonishment to visitors from abroad. Even in the industrial nations of Europe, the masses of the people have never been able to depart from the need for wringing the last bit of utility from their possessions. Of course, in less industrially developed countries, the goods which we have become accustomed to view as necessities possess a value beyond the attainment of any save the most privileged few.

American manufacturing methods have developed an efficiency so great that new products can be made with less effort than would have to be exerted for their repair or adaptation. Our machines have enhanced the relative worth of our labor to such a degree that craft work has been relegated from the field of utility to the field of art.

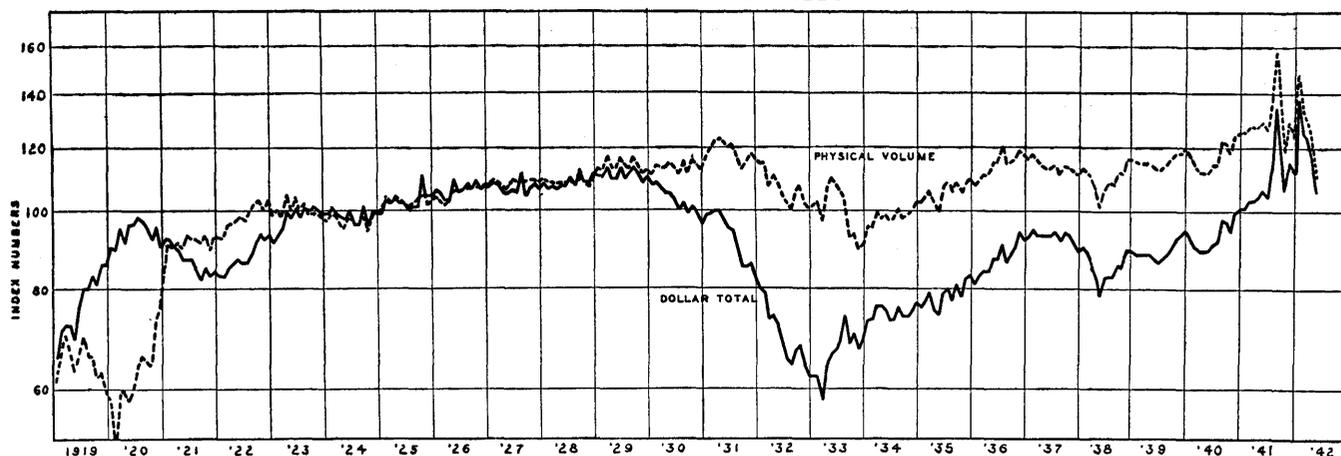
War needs are now changing this situation, because the industrial mechanism must be applied exclusively for the production of war materials and for the absolute necessities of the civilian population. When we entered the war, our stocks of goods were so great that we have not yet been forced to change our habits greatly, but we are experiencing a foretaste of what may occur if the war is protracted.

The atmosphere of superabundance characterizing the New Era period, followed by the anti-thrift doctrine of the New Deal, has ill prepared us for the real conservation of resources demanded in an all-out war. Thus, early in the conflict, we have neither the attitude nor the organization needed to avoid all waste. A few industries have developed for reprocessing materials whose salvage requires a minimum degree of hand labor, but we have no large trained salvage force. The machines and skills that have made our extravagance possible will prove their power in war, but we must expect their diversion to war production to take its toll of our civilian living standards.

It is not easy to change the customs of a people accustomed to prodigality, but it is the responsibility of all of us who are not giving our entire energies to the war effort to develop habits of conservation in our homes. We must realize that efforts to avoid inconveniences, through resort to black markets, are essentially dangerous, increasing the possibility of a disastrously inflationary progression.

The necessity on the part of the civilian population for making things do can best be accepted as a test of

DEPARTMENT-STORE SALES



our adaptive ability. We may find that the wartime lessons will have their value, not only in developing our ingenuity, but also in instilling in us some of the thrifty habits discarded in our years of abundance.

BUSINESS *Retail Sales*

The Federal Reserve's seasonally adjusted index of department-store sales is presented in the chart at the top of this page, together with an index of the physical volume of sales. In order to compute the index of physical volume, the Federal Reserve index of department-store sales (which has as its base the 1923-1925 average equals 100) has been divided by a retail price index based on the same period. By this method, the trend of department-store sales, measured both by the dollar and by the physical volume, can be observed. A ratio scale was used in order to facilitate comparisons between the trends of the two indexes.

During periods when prices remain stable, as they did during the years 1923-1929, comparisons between the two curves are of little significance because the two indexes followed substantially the same paths. However, when abnormally great price changes occur, comparisons between the trends of these indexes reveal the basic changes that are being effected in the consumer goods demand-supply relationship.

It is unfortunate that the data are not available to show the relationship between the physical volume and the dollar volume of sales during the first World War. However, for several years after 1919, the first year covered by the Federal Reserve index, there were abnormal price changes clearly attributable to the wartime dislocations of economic relationships. The chart shows that the physical volume of goods sold was reduced greatly during the winter of 1919-1920, when prices were at the peak of the inflationary movement accompanying the first World War.

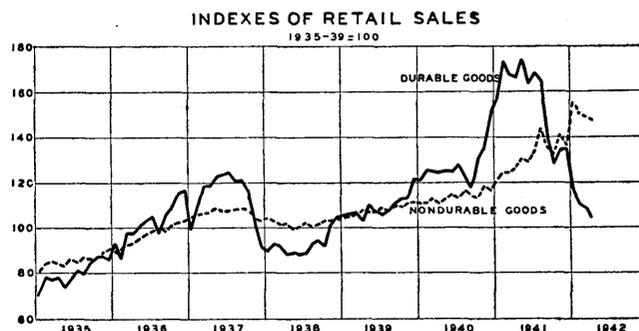
During the depression beginning in 1930, the condition that existed in the 1919-1920 period was reversed. Commodity prices were low, and the physical volume of sales remained at a much higher level than the dollar total. Some of this price advantage was retained by consumers until about a year ago. A year ago this summer, the public began to buy actively in anticipation of shortages to come. They were enabled to indulge in this buying wave primarily because of the buying power that the Government's great national defense program

was supplying. This buying wave, which continued intermittently until recent months, was accompanied by rising prices, and at the latest month shown consumers had lost nearly all of the price advantage over the base period 1923-1925 that they had enjoyed during the preceding eleven years.

If the Government is successful in keeping the effects of the wartime inflation within reasonable bounds, both the physical volume and the dollar total of department-store sales will decrease during the remainder of the year. If not, the physical volume of goods may be expected to decrease while the dollar total remains high.

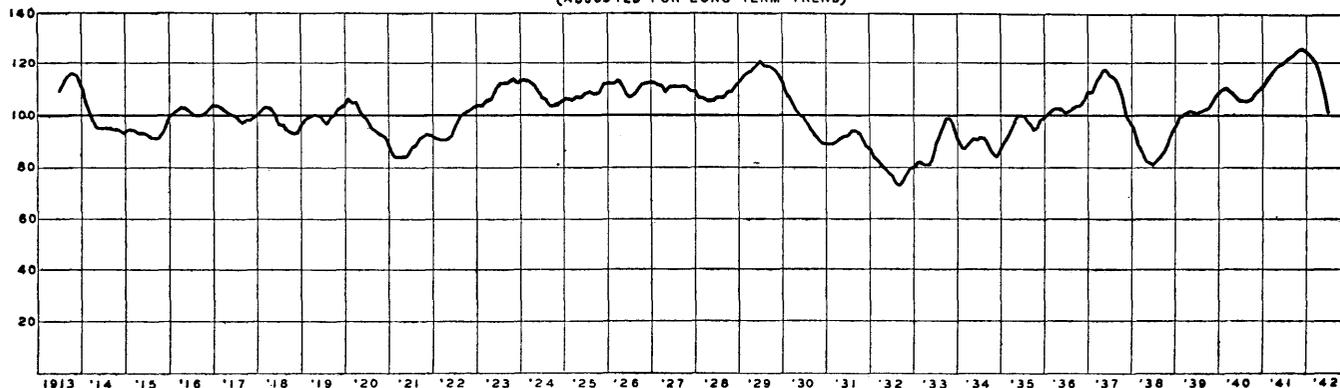
Indexes of Retail Sales

The trend of the dollar volume of department-store sales is generally typical of that of all retail sales. Therefore, when the United States Bureau of Foreign and Domestic Commerce compiled an index of all retail sales last year, we continued to use the Federal Reserve index of department-store sales as a measure of the physical volume and dollar totals of retail sales, because the Board's index is available a month sooner than is the Government's and because the latter covers only the relatively brief period beginning January 1935. However, there are separate indexes for durable goods and nondurable goods sales compiled by the Bureau that reveal additional information.



The foregoing chart of durable goods and nondurable goods retail sales was reproduced in a larger size in the June 8, 1942 Research Report bulletin and is shown here merely to indicate changes for April, the indexes for which have just been published. There was a slight decline in the nondurable goods index for that month, and a more substantial decline in the durable goods

INDEX OF LIVING STANDARDS
(ADJUSTED FOR LONG TERM TREND)



index. Although the former remains far above the level existing before the outbreak of the war in Europe in 1939, the latter has already declined below that level, and there is no indication that this downward trend has been halted. There are no separate price indexes available to use in adjusting these separate indexes of dollar sales to show the physical volume.

Index of Living Standards

The Institute's index of living standards, shown in the chart at the top of this page, is a six months' moving average of the volume of durable and nondurable consumer goods produced in the United States per capita. The index is plotted at the end of the six months' period on the assumption that the average length of time required for this class of goods to reach the consumer after production is three months. The index is adjusted for seasonal influences and for long-term trend and is expressed as a per cent of estimated normal.

Up to the time of our entrance into the war last December, the country was enjoying a period of widely distributed prosperity. Government expenditures for national defense and their stimulating effect on private business were primarily responsible for the movement. The increased incomes available to the public made possible a great demand for consumer goods of all kinds. The public had not yet been forced to curtail its consumer purchases in the interests of national defense; material scarcities had not developed; taxes had not become so burdensome; and retail commodity prices had not yet risen extensively. Since we entered the war the situation has changed drastically. Average incomes have continued to increase, but a much larger share of these is being taken by the Government either by taxes or by borrowing through purchases of war savings bonds and stamps.

The declining trend in the index first observable last December continued during June, and the index for that month was only slightly above the level indicated as normal. Further declines will be inevitable during the remainder of the year, when the effects of the diversion of the Nation's productive facilities from the manufacture of civilian goods to output of war materials is felt more acutely.

THE FUNDAMENTALS

Supply

The steel-ingot production rate declined from 99 to 98 per cent of theoretical capacity last week. The

decrease was attributed to shortages of scrap metal rather than to the Fourth of July holiday, which was not observed in the industry this year. According to *The Iron Age* the steel industry's present capacity could be considerably increased by better control over timing: "Typical cases of poor timing gathered by *The Iron Age* staff include a bomb plant which lacks fuse parts, an anti-aircraft gun plant with plenty of gun tubes but no mounts, an ordnance plant lacking certain essential types of steel. Recently one war plant reported a shortage of ten tons of alloy steel, while a half mile away another war plant had been shipped 20 tons of similar alloy steel which it will not require for 60 days. Such situations are sometimes unavoidable because of design problems but many must be attributed to bad ordering practice and a lack of skillful timing of the flow of material."

	1929	1932	1937	1938	1941	1942
Per Cent of Capacity	94.0	22.0	70.0	24.0	93.5	98.0

(Latest 1942 weekly data; corresponding week earlier years)

The electric-power industry generated more kilowatt-hours last week than it did in the preceding week, but the comparison with output for the corresponding week of 1941 when the industry's activity was expanding rapidly was less favorable than it was in the previous week. In both 1941 and 1942 the normal tendency for contraction in power output during June has been disregarded.

	1929	1932	1937	1938	1941	1942
Billion Kilowatt-Hours	1.72	1.45	2.23	2.01	3.16	3.46

Lumber production decreased moderately last week, when there is normally no change in the level of operations. Consequently, the seasonally adjusted index declined from 123.4 in the preceding week to 120.7 per cent of the 1935-1939 monthly average.

	1929	1932	1937	1938	1941	1942
New York Times Index	130.5	39.2	97.1	64.4	119.8	120.7

Demand

The Federal Reserve index of department-store sales last week indicated a decrease of eight per cent from the index for the corresponding week of 1941. The index of income payments, compiled by the United States Department of Commerce, advanced from 158.6 (per cent of the 1935-1939 level) in March to 161.7 in April. More recent figures are not yet available. During the period of about a year before we entered the war, income payments were increasing much more rapidly than was the cost of living. However, more recently, the

increase in income payments has been approximately proportional to the increase in living costs.

Prices

The sensitive wholesale commodity price indexes were moderately higher last week than they were in the preceding week. Moody's Spot Commodity Price Index was 229.5 on June 25 and 231.2 on July 2. The Dow-Jones Index of Commodity Futures closed at 85.20 on June 25 and at 85.76 on July 2. The Spot Commodity Price Index is now about 13 per cent higher than it was a year ago, when the Office of Price Administration was starting to extend its price controls over basic commodities. The Futures Index has advanced 18 per cent during this period.

The Government is endeavoring to use its price controls for other purposes than the postponement of the effects of inflation on living costs. These objectives were recently summarized in a publication of the United States Department of Commerce, as follows:¹

"One vital function the price system helped to perform was to guide the flow of capital, materials, labor, and management into alternative fields of endeavor. Price changes, as these influenced profits, were perhaps the chief factor determining the relative quantities in which various goods and services were produced. High or rising prices were an invitation to productive factors to move into a given field to increase output there. Low or falling prices tended to divert productive resources and thus discourage production. . . .

"Prices and profits margins will still guide the flow of productive resources not otherwise guided — but the prices set will be subject to the jurisdiction of the Office of Price Administration. Accordingly this agency can adjust profit margins favorably in cases where it wishes to encourage output or distribution, and squeeze the margins in cases where it is necessary in the national interest to discourage the output and sale of an article.

"Another vital function of prices was to guide consumption. Low prices were an invitation to purchase more, and high prices, less, of any given article. Hence, both the choice of goods and the amounts purchased by individual consumers, were determined by prices on the basis of ability to pay. Prices will still influence consumer choices, but they will increasingly be those prices set by the Price Administrator rather than by market decisions. And the quantities consumed per person, at least in the case of scarce articles, will be determined by OPA ration regulations as well as by ability to pay.

"Hence in one way or another, various Government agencies have either assumed the traditional functions of the price system or will supplant them by more direct controls over production and consumption."

FINANCE

The Harwood Index of Inflation

The Harwood Index of Inflation (ratio form) last week declined to 115.3. This represented a decline of about 3½ points from the preceding week's level of 119.0. The change was caused by the increase of \$1,420,000,000 in the Treasury's bank balances resulting from credits of checks previously received in payment of the second installment of the Federal income tax.

¹ *Survey of Current Business*, June 1942, page 20.

In the June 29 monthly bulletin, we pointed out that the preliminary Index of Inflation for June showed a somewhat greater degree of inflation than actually existed because of the delay in crediting the Treasury's bank accounts with the income-tax payments, the bulk of which is made by checks drawn on private accounts. These payments, totaling more than \$2,000,000,000, have now been entered to the Government's credit, and the extent of the withdrawals from private accounts is revealed. The Government's spending rate is now so great that nearly a third of the sum collected from income-tax payers was disbursed in a few days' period. It is thus apparent that the decline in the Index will be of brief duration, because tax withdrawals of comparable magnitude will not be made again until next September, and, in the meantime, the Government must resort to borrowing to a considerable extent from the commercial banks.

The Treasury's latest analysis of the distribution of the Federal debt shows that slightly more than a third of the outstanding Government securities was held by the commercial banks. The commercial banks' savings-type liabilities measure the ability of the banks to purchase investments without inflationary credit creations and these have recently shown a tendency to decrease rather than to increase; therefore, any additions to the banks' investment-type assets through the purchase of Government securities will have inflationary effects.

RECOMMENDED BOOKS

"*The Economics of Public Utility Regulation*," by Irston R. Barnes, F. S. Crofts & Company, New York (\$5.00).

For some time there has been an urgent need for a textbook on public utility economics that would touch on all phases of the subject. Professor Barnes has filled that need. He has concentrated his attention on electric, gas, telephone, and water utilities, because the transportation services are so different as to require separate treatment.

It is difficult to outline this work in a few sentences. It discusses in great detail every phase of public utility economics from a description of the characteristics of public utilities to public ownership, consuming over 900 pages in the process. The breadth of knowledge revealed marks this work as one of the most scholarly in the field.

The economics and regulation of public utilities have changed fundamentally in recent years, and this work has value in being timely. It is adapted for use either by itself as a text for a course in public utilities or in conjunction with a case book. For the latter use, it would be of value in supplying the background necessary to give meaning to the cases. (*Cases on Public Utility Regulations*, by Professor Barnes, is an earlier book published by F. S. Crofts & Company.) It is recommended for students who have completed courses in public utility economics in universities as well as for public utility administrators and regulation officials.

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