

AMERICAN INSTITUTE for ECONOMIC RESEARCH

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W E E K L Y
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RESEARCH REPORTS

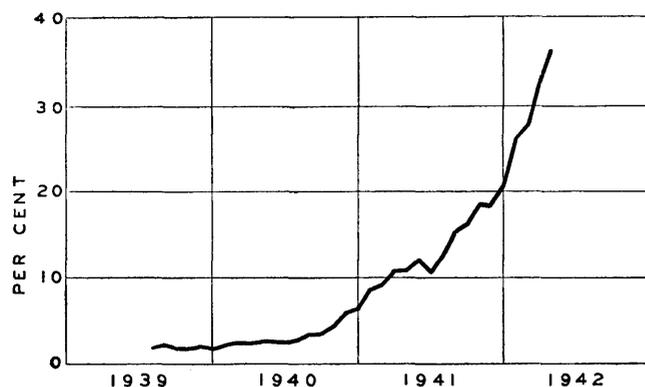
COMING EFFECTS OF CURRENT EVENTS

Progress of the War Effort

During April 1942, the fifth month of our war participation, about 37 percent of the Nation's income was spent for war activity. It is thus apparent that the Government's objective of converting at least half of the Nation's productive capacity into war work this year may be realized ahead of schedule; at least it will be if the progress made during the early part of this year is maintained for a few months more.

The dollar is the only common denominator for arriving at an appraisal of the progress of the war effort in producing the many diversified materials needed for our fighting forces. As a rough measure of our national defense effort, we have therefore computed expenditures for national defense as a per cent of the Nation's total income payments in a monthly series. The data are plotted on the accompanying chart, beginning in July 1939, shortly before the outbreak of war in Europe, through April 1942, the latest period for which income data are available.

PERCENT OF TOTAL INCOME FOR WAR ACTIVITIES



Monthly income payments averaged about \$6,000,000,000 during the first year of the war in Europe but increased substantially after we began to assume the role of "arsenal of Democracy" and in December 1941 aggregated about \$9,000,000,000. There was a seasonal decrease in income payments during January and February 1942, but they again increased in March and April. In the meantime, expenditures for national defense, which were running between \$110,000,000 and \$150,000,000 before we started the armament program, reached \$1,850,000,000 for the month of December 1941. The United States Treasury Department has

recently changed the item in its statement that was formerly called "national defense" to the title "war activities." However, the type of expenditures is essentially the same. By April, these expenditures had increased to \$3,231,000,000, nearly double those for December 1941, and in June had reached a new high record of \$3,823,000,000. Even if total income payments have continued to increase as they did earlier in the year, the proportion of total income devoted to war activities must now be in the neighborhood of 40 per cent of the aggregate.

The production of armaments may now be outrunning the production of transportation facilities needed to place these where they will be effectively used. This does not detract from the basic part that production back of the fighting line will play in the war's outcome. American industry will merely exert a larger proportion of its energies in producing shipping and other transportation equipment than it has hitherto done.

Argentina's Neutrality

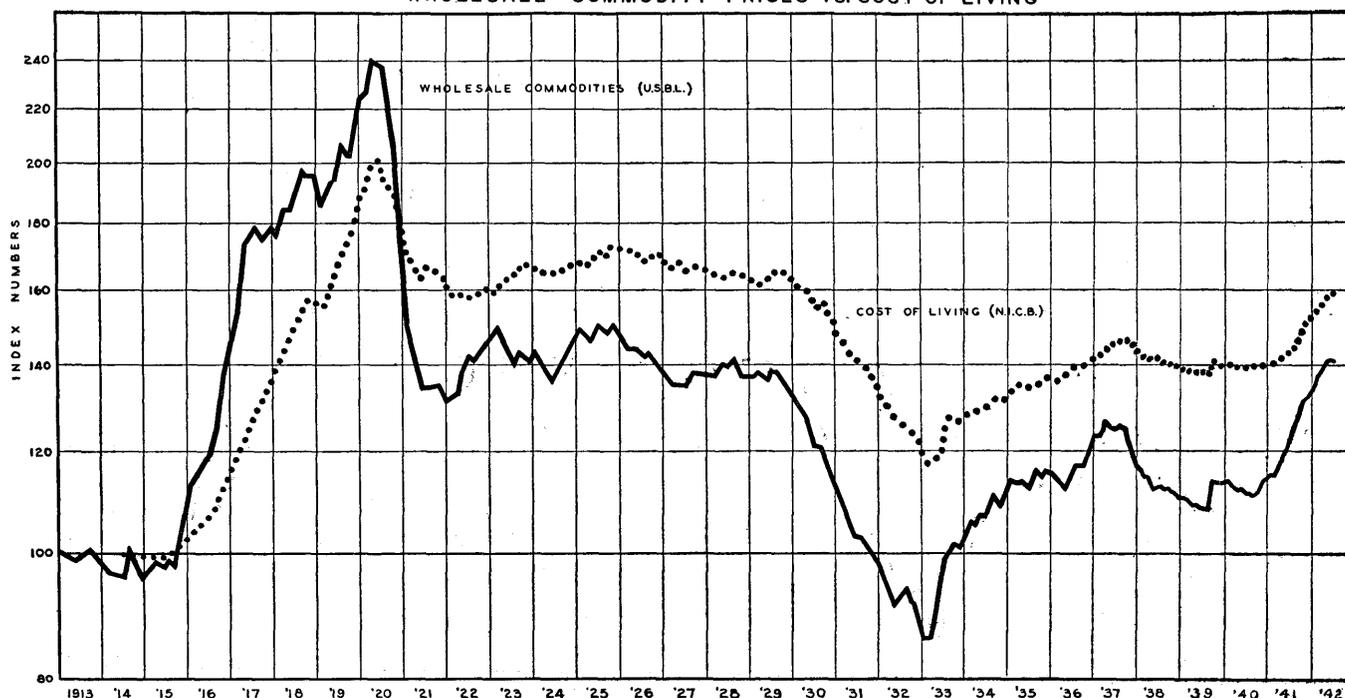
The order of the Government of the Argentine Republic restricting its shipping to the United States to the Gulf ports may not have the effect of insuring Argentina's neutrality that is evidently desired by President Castillo. It is apparent that President Castillo, observing the effect that Nazi ship sinkings had in arousing popular feeling against Germany in Mexico, feared that a similar situation might develop in Argentina. The restriction no doubt reduces the danger of "incidents" calculated to arouse the war spirit in Argentina, but it also will probably curtail further the remaining market for the Argentine's agricultural products.

Before the war began in 1939, Argentina's best foreign markets were the United Kingdom, the Continent of Europe, and the United States. Since traffic on the Atlantic shipping lanes has been disrupted by the war, the United States has been the most important foreign outlet for Argentina's commodities. A Government policy that tends to reduce Argentina's remaining important foreign market may alienate some of the members constituting President Castillo's own numerically small "neutrality" party.

Wholesale Commodity Prices vs. Cost of Living

The comparisons of wholesale commodity prices with the cost of living is of special interest at present because of the great increase in wholesale prices in the

WHOLESALE COMMODITY PRICES VS. COST OF LIVING



past two years, during which there has been a less extensive increase in living costs. Any wide movement in wholesale prices, unless temporary, is of course reflected in living costs. However, there is frequently a lag in the trend of living costs, and the cost-of-living index is not usually subject to so wide fluctuations as is the combined wholesale commodity price index.

The accompanying chart shows the movement of average wholesale commodity prices and the cost of living over an extended period of years. The solid line in the chart shows the United States Bureau of Labor Statistics' index of wholesale commodity prices on the basis of the 1913 monthly average=100. The dotted line represents changes in the cost-of-living index compiled by the National Industrial Conference Board on the basis of July 1914=100. (The general price level was about the same during the year-and-a-half period immediately preceding the outbreak of the first World War.) The ratio scale was used to facilitate comparisons of the trends of the two curves.

In the 1914-1918 World War period, wholesale commodity prices rose more rapidly than did living costs. At the height of the advance, which culminated in 1920, the cost of living was approximately double the prewar level, and average wholesale prices had increased 140 per cent. Following the break in wholesale prices in 1920, the cost of living declined; however, living costs were not reduced in proportion to the decrease in wholesale prices, and, since 1920, the cost of living has constantly remained at a high level in relation to the prewar period.

The high point in the previous postdepression price advance was made by the wholesale price index in April 1937; whereas, the cost-of-living index reached its highest level for the movement in September, five months later. Therefore, even if Government measures intending to control commodity prices are temporarily successful in the wholesale markets, the cost of living may

continue to increase while wholesale prices remain stable.

The combined cost-of-living index is computed by multiplying the indexes of five groups by their respective weights, adding the products, and dividing by the sum of the weights. The components, together with the weights of these items, are as follows:

Food	33	Fuel and Light	5
Housing	20	Sundries	30
Clothing	12		

The following brief summary shows the per cent increase since the war started in the component items of the cost-of-living index and in a few of the components of the wholesale commodity price index that more closely affect the respective cost-of-living items.

Wholesale Commodity Price Index	Per Cent Increase	Cost of Living Index	Per Cent Increase
	May 1942 from August 1939		May 1942 from August 1939
All Commodities	31.5	Combined Index	15.1
Farm Products	71.5	Food	29.2
Foods	48.9	Clothing	23.2
Textile Products	14.7	Housing	5.6
Building Materials	22.0	Fuel and Light	7.7
Fuel and Light	7.2	Sundries	7.6

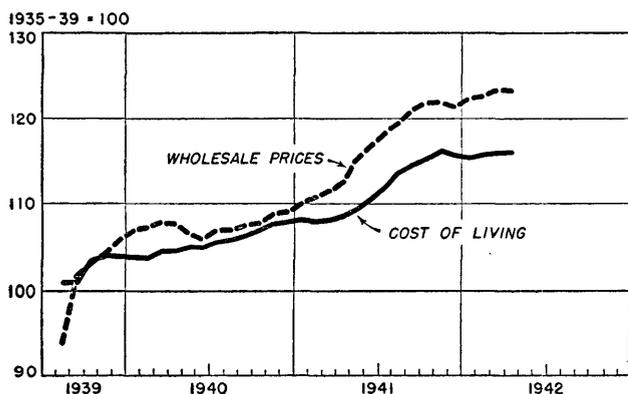
The food item is the most responsive to changes in wholesale prices, and the 29 per cent increase in food costs was the most important influence in the current wartime rise in living costs. Nevertheless, retail food prices have by no means reflected the 71 per cent increase in wholesale prices of farm products and the 49 per cent increase in wholesale food prices. Next to the food item, clothing has been influential in raising living costs. The average price of clothing has advanced more extensively than has the average wholesale price of textile products. This is probably attributable to the

increase in wage rates to workers engaged in manufacturing the clothing from the raw materials. Nearly a year or more is required for wholesale commodity price changes to affect the cost of housing. It is therefore not surprising to find that rentals have increased only 5½ per cent while the cost of building materials has increased 22 per cent. The increase in the retail cost of fuel and light has been more in line with the increase of wholesale costs than have the other items, but this item is the least important of those entering into the calculation of the cost-of-living index. The "sundries" item of the cost-of-living index is the most stable factor in living costs and is an important element in household economy, inasmuch as it comprises nearly one-third of the total budget. This classification includes such items as carfares, physicians' fees, reading material, recreation, insurance, house furnishings, church and charity, candy, and tobacco.

Wholesale Prices and Cost of Living in Canada

Commodity price trends in Canada are being observed in this country in the hope that we may be able to determine the probable effects of price-control measures taken in the United States. The following chart was prepared by the United States Department of Commerce from data compiled by the Canadian Department of Trade and Commerce.

WHOLESALE PRICES VS. COST OF LIVING IN CANADA



The Canadian price authorities relied on price controls over the retail markets to stabilize the price level. Controls were established at the beginning of last December, and the official figures appear to indicate that a satisfactory degree of stability was achieved. During the first two years of the war, beginning in September 1939, wholesale prices in Canada advanced 30 per cent, and the cost of living increased 15 per cent. After price controls were imposed, wholesale prices increased only slightly, and the cost of living remained substantially unchanged.

Before drawing encouraging conclusions from Canada's relatively brief experience, it is necessary to consider certain important differences between the Dominion's price-control policies and those in the United States and also to point out economic changes that have occurred in Canada that are not revealed by the data. The essential difference between the price-control policies in the United States and Canada is that agricultural commodities are exempt from restrictions here

but are not in the Dominion, and, whereas there are no restrictions on wages in the United States, general wage increases can be made in Canada only to the extent that living costs advance.

There is evidence that living costs in Canada, since the restrictions have been imposed, have increased in ways not revealed by the official figures. It is acknowledged that a considerable number of commodities have been allowed to disappear from the markets. These are of course for the most part commodities on which the margin of profit was favorable to the consumer rather than to the merchant. As we are finding out in this country, where the cheaper brands of some standard goods can no longer be obtained, these deficiencies have an important effect on living standards. Travelers in Canada report that such goods and services as are not susceptible to price controls have recently increased in cost.

BUSINESS

Commercial Confidence

Newspaper advertising linage reported for May 1942 was nearly 13 per cent less than that reported for the corresponding month of 1941. No type of newspaper advertising was exempt from the downward trend in linage purchased by advertisers. The disappearance of two-thirds of the automotive advertising was an inevitable development after passenger automobiles were removed from the public market. The volume of retail advertising in the newspapers has been better maintained than has other types, but a greater degree of shrinkage may be observed when a larger variety of consumer goods either disappears from the merchants' shelves or is rationed and can be sold without promotion by the retail stores.

Radio broadcasting is the only important advertising medium that has not suffered serious ill effects from the war. During April 1942, the most recent month for which data are available, there was an increase of eight per cent in the cost of facilities for radio advertising from the level of April 1941. However, it is by no means assured that this gain can be maintained when existing contracts expire. Sponsors cannot afford to advertise goods that can no longer be obtained in sufficient quantities to supply the existing demand.

Newspaper advertising linage in the dailies of 52 cities during May 1941 and 1942 and the percentage decrease of the latter in comparison with the record for the earlier period are shown in the accompanying table:

Newspaper Advertising Linage	May 1941 Millions of Lines	May 1942	Per Cent Decrease May 1942 From May 1941
Classified	25.6	22.3	12.8
Display			
Automotive	6.9	2.3	66.7
Financial	1.7	1.2	29.4
General	18.3	16.5	9.8
Retail	69.8	64.6	7.4
Total	122.4	107.0	12.6

THE FUNDAMENTALS

Supply

The steel-ingot production rate was unchanged last week at 98 per cent of theoretical capacity. The current situation in the steel industry was summarized by *The Iron Age* as follows: "Despite efforts taken so far by the

government, to keep essential production workers in their jobs, industry is concerned more each week over the drafting of sometimes irreplaceable labor. Overworking of steelmaking facilities plus a growing tightness of scrap supplies are factors that are increasingly formidable. Like the steel and other industries, the new mass production aircraft industry would like to see the objectives of definite production schedules more nearly reached. Plane production in this country is now great enough to stand an airing of some of the conditions which are preventing output from being still greater. On the west coast late deliveries and lagging production schedules of subcontractors, particularly for radio, electrical and ignition equipment, are slowing down production of aircraft at a number of plants.

	1929	1932	1937	1938	1941	1942
Per Cent of Capacity	93.0	22.0	78.0	28.0	98.5	98.0

(Latest 1942 weekly data; corresponding week earlier years)

Electric-power output last week established the most impressive gain compared with production in the corresponding week of 1941 that was recorded this year. The increase was 17.9 per cent, compared with an increase of about 10 per cent reported in the preceding week. The increase in power output from the volume of a year ago primarily reflects the effect of the longer hours each week in which the Nation's industrial machinery is in operation now that we are actively engaged in the war.

	1929	1932	1937	1938	1941	1942
Billion Kilowatt-Hours	1.71	1.46	2.20	1.98	2.90	3.42

Last week lumber production increased substantially, and the seasonally adjusted index advanced from 120.7 to 124.2. The outlook for the lumber industry was summarized as follows in the July 2, 1942 issue of *Domestic Commerce*, published by the United States Department of Commerce: "Despite the general increase in production, the lumber supply-demand position which on May 13 necessitated governmental restrictions on mill sales of softwood construction lumber has not improved. Lumber demand in April, which reached the highest monthly level in more than a decade, was 30 per cent in excess of output. New business continued to exceed production during May by 18 per cent. The pattern of lumber production in normal years shows a marked increase during the summer months when weather conditions are generally most favorable. Although the industry now is handicapped by labor and equipment problems, this upward trend will no doubt be repeated. On the basis of the current output, the production rate should reach three billion feet a month in July."

	1929	1932	1937	1938	1941	1942
New York Times Index	126.8	38.3	97.0	61.2	121.4	124.2

Demand

The Federal Reserve index of department-store sales last week showed a decrease of one per cent from the index for the corresponding week of 1941. A year ago at this time, the dollar volume of retail trade had reached a high level but had not yet risen to the boom proportions attained in August and September.

Prices

Movements of the sensitive wholesale commodity price indexes were irregular last week. Moody's Spot

Commodity Price Index was 231.2 on July 2 and 233.6 on July 9. The Dow-Jones Index of Commodity Futures closed at 85.76 on July 2 and at 86.78 on July 9.

FINANCE

The Banks' Reserve Situation

Since January 1941, excess reserves of the Nation's commercial banking system have been reduced from about \$7,000,000,000 to less than \$3,000,000,000. The reduction has been most drastic in the New York City banks, where the required reserve rate is high (26 per cent of net demand deposits). Excess reserves of the New York City banks that were \$3,500,000,000 in January 1941 were reduced in June 1942 to less than \$500,000,000.

In October 1941, when the Board of Governors of the Federal Reserve System made effective an increase in reserve requirements of member banks, the Board proclaimed its action as "a further step in the Government's program for combating inflation." This step will probably soon be retracted, inasmuch as the Treasury must rely heavily on the New York banks to help finance its budgetary deficits. The Federal Reserve System has engaged in open-market operations in Government securities "to contribute to the volume of member bank reserves and to the maintenance of stable market conditions." However, the effectiveness of open-market operations is limited, and it seems inevitable that the Board of Governors of the Federal Reserve System will be forced to relax the reserve requirement rates within the next few months. It may be expected that this action will be postponed as long as possible, inasmuch as it would virtually be a proclamation of surrender to the forces of inflation.

SECURITIES

Bonds

Bond prices last week continued the advancing trend that started during the latter part of June. The advance has continued without interruption for about three weeks, and nearly half of the losses sustained during the May-June decline have been cancelled. The Dow-Jones Average of 40 bonds was 89.00 on July 2 and 89.46 on July 9.

Stocks

Most of the industrial and railroad issues listed on the New York Stock Exchange advanced in price last week. This market action at a time when the war news that is made public indicates a precarious situation in both Russia and North Africa appears to show either that the market is in a strong technical position or that the financial community has encouraging information about the war not possessed by the general public. The former seems to be the more likely supposition.

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