

AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Inflation and Politics

Even in Germany, where political activities are restricted to the cabals of the Fuehrer's hierarchy and are concerned with only an infinitesimal part of the population, reports indicate that the effects of inflation are permeating the economic system. Nevertheless, symptoms of inflation in the Reich have been slow in making their appearance. Inflation in Germany has manifested itself primarily by exorbitant prices in the black markets, while official prices have remained stable. The situation is so different in this country that we could scarcely hope to limit the effects of inflation with the same degree of success had we been engaged in costly warfare for more than two and a half years.

It is being all too clearly demonstrated that our Government's surrender to political considerations is nullifying its attempt to check the effects of inflation on the Nation's economy. The first and most serious fault, the responsibility for which is shared both by the President and by Congress, is the failure to tax away the new buying power that the Government's war spending is distributing to the public. The logical means of accomplishing this is available in a broad sales tax, but the President has expressed his opposition to this form of levy, and a majority of Congress could not be mustered for it in an election year.

Of course, the surest way to avoid the effects of inflation is to prevent the development of inflation in the money-credit system. Failing this, it is still possible to postpone the full impact of inflation on the price structure through economic controls. This the Government has attempted to do in its Emergency Price Control Act. Here again, Congress has bowed to political considerations and has failed to extend the same controls over the prices of farm commodities that are imposed on other classes of goods. Even the broad exceptions made in the Emergency Price Control Act to appease the Farm Bloc might not nullify the effects of the controls if the Government could more freely dispose of its large stocks of farm commodities held by the Commodity Credit Corporation. In order to sell any of these surpluses at reasonable prices, the Government is being forced as a recompense to give the farmers another bonus in the form of 100 per cent of parity loans.

Food costs are the most important item in the wage earners' household budget, and soaring farm prices have so raised the cost of living that organized labor has demanded and been granted by the Government wage

increases to compensate for higher living costs. The conception of wage increases to offset increases in the cost of living is contrary to the President's statement of the duties of civilians in wartime: that they must sacrifice part of their high living standards in making their contribution to the war effort.

These considerations are no secret in Washington. They are known to the President, to the majority of the members of Congress, and to Government economists. The minority groups, whose demands are so greatly increasing the difficulties of price stabilization, might be persuaded to forego temporary advantages if by courageous leadership the Administration and Congress stood firmly for sound economic principles. Of course, it is much easier to promise people the chance of getting a temporary advantage than it is to persuade them of the need for preserving intact the heritage that they already have.

Playing politics with inflation is almost as hazardous as playing politics with war. In fact, there is no clear-cut distinction between the two, because the soundness of the Nation's credit is an integral part of the program for the successful prosecution of the war. There is some hope that Congress and the Administration will adopt a more realistic anti-inflation program after the fall election, when political considerations will temporarily be less urgently present in the minds of our elected officers.

THE FUNDAMENTALS

Industrial Production

The Institute's preliminary index of industrial production for June has been revised from 156.0 to 159.6. The data representing the production of Government arsenals and shipyards are included in the figures from which the revised index of industrial production is calculated. This information is not revealed separately, and there is no way in which it can be included in the estimates for determining the Institute's preliminary index. Therefore, when, as at present, the output of Government plants is expanding rapidly, the revised indexes, based on data for the full month, usually indicate a higher level of operations than was evident from the preliminary indexes calculated from incomplete information. The preliminary index for July is 160.0.

About half of the Nation's manufacturing activity is now being devoted to prosecution of war, and it is estimated that 70 per cent of the capacity of the durable goods industry has been adapted to this type of

activity. Production classed in this category includes the output of basic materials to be used to supply plants having Government contracts, the manufacture of equipment for war plants, the manufacture of clothing and other supplies for the armed forces, the processing of food for our own forces and for lend-lease shipments, and the manufacture of finished implements of war.

The Nation's entire economy has not been transformed to war activity to as great a degree as has the operation of factories and mines. A great deal more than half of our agricultural production is currently destined for civilian consumption, and the service trades are in general not adaptable to direct war activities. On the other hand, recent data indicate that about three quarters of the activity of the Nation's building industry must be classified as a contribution to the war effort. The Nation's transportation system is carrying an increasing proportion of materials for war, but it is still substantially below the 50 per cent level.

The steel-ingot production rate was unchanged at 98 per cent of theoretical capacity last week. *The Iron Age* pointed out the serious nature of the present steel-scrap situation and said the industry could not "continue to perform miracles in rapid furnace repair and production of quality steel with deteriorating scrap quality. Only a recognition of the profit motive, such as perhaps a \$2 rise in the scrap ceiling and more freedom to manipulate different classifications at will under the ceiling can possibly alter disintegration of the scrap collecting organizations. With the critical position of certain alloying elements becoming so obvious, the industry is on the threshold of a series of metallurgical innovations that will tax the ingenuity of all concerned."

	1929	1932	1937	1938	1941	1942
Per Cent of Capacity	95.5	22.0	82.0	37.0	99.5	98.0
(Latest 1942 weekly data; corresponding week earlier years)						

Last week there was a substantial increase in electric power output, and reports indicated that a new high record was made in the number of kilowatt-hours generated. The Pacific Coast region made the most favorable comparison with output a year ago.

	1929	1932	1937	1938	1941	1942
Billion Kilowatt-Hours	1.72	1.44	2.26	2.08	3.20	3.57

Although shipments and orders reported by the lumber industry last week were larger than they were in the preceding week or in the corresponding week of 1941, the production record was less favorable. The seasonally adjusted production index declined from 123.5 to 117.7 per cent of the 1935-1939 level last week.

	1929	1932	1937	1938	1941	1942
New York Times Index	134.2	38.5	92.0	72.4	125.8	117.7

The Harwood Index of Inflation

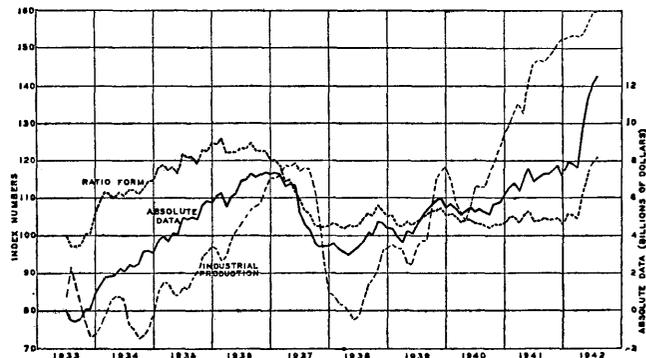
The revised Index of Inflation for June at 119.7 was only fractionally higher than the preliminary Index of 119.0. The preliminary Index for July at 121.0 is based on data as of July 15, and therefore the increase of about one per cent is probably smaller than the gain that will be indicated by the figure based on data for the full month.

The chart on page 119 shows the Index in ratio form, which is the ratio of all purchasing media available for use to the portion that is not inflationary. The dotted line on this chart shows the actual totals of inflationary purchasing media. (The scale for the ratio form is at

the left side of the chart, and the scale in billions of dollars for the total of inflationary purchasing media is at the right.) The actual total of inflationary purchasing media, as of July 15, was \$12,600,000,000. It was less than half this total at the height of the inflation that accompanied the first World War, and was less than \$8,000,000,000 at the height of the 1936-1937 inflation.

In order to facilitate study of the fluctuations that have occurred during recent years, the Index has been reproduced on a larger scale in the chart accompanying this discussion. In addition to the Index in ratio form, the absolute data (inflationary purchasing media) for the Index of Inflation and the Institute's industrial production index are shown.

HARWOOD INDEX OF INFLATION, RATIO FORM, ABSOLUTE DATA, AND INDUSTRIAL PRODUCTION

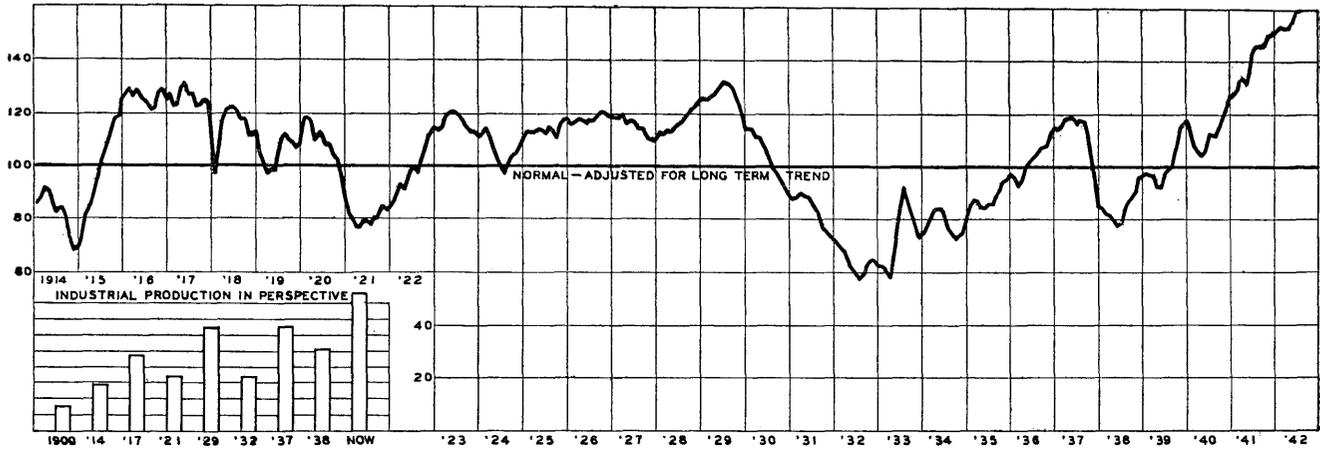


The trends of the money-credit curves are now governed almost entirely by United States Treasury operations. The high rate of Federal expenditures involves the outpouring of about \$4,000,000,000 into the hands of the public each month. Part of this is returned to the Treasury through taxes and part by the purchase of War Bonds from the people's savings. However, Federal taxes plus savings fall far short of meeting all expenditures, and the difference must be met by the funding of Federal debt by the commercial banking system. This process is inflationary at a time, such as this, when the commercial banks are not receiving new savings deposits.

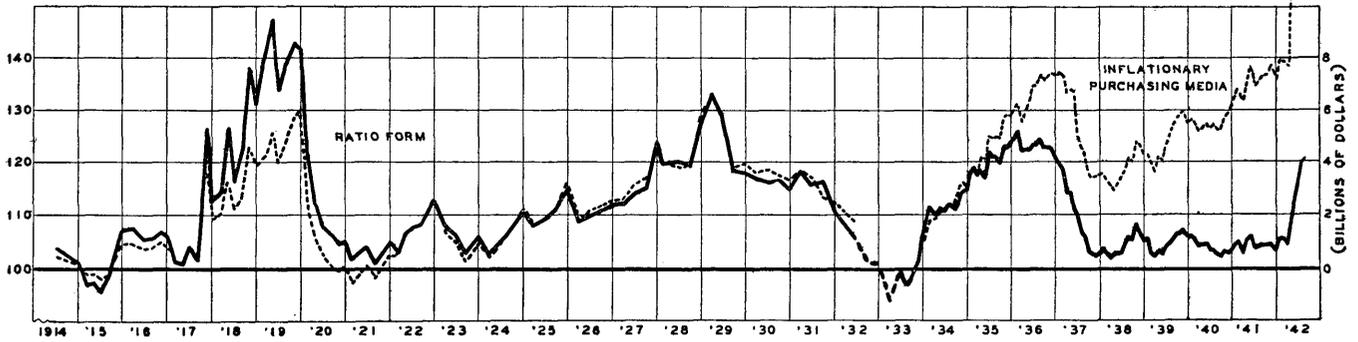
It is this portion of the Treasury's deficit that cannot be financed through savings that the Government authorities have referred to as the "inflationary gap." It is through this gap that is pouring the newly created purchasing media that, when used by the public, appear in the market as active demand for consumer goods and thus bring pressure to bear tending to raise prices.

During the first half of July, the commercial banks increased their holdings of Government securities approximately \$1,400,000,000, and, inasmuch as there was no increase in the savings deposits of the commercial banking system, the checking-account credits created by the banks in payment for these securities became potential inflationary purchasing media in the possession of the Treasury. The increase in the Index of Inflation was only moderate in view of this increase in purchasing media available in checking accounts, because the Government did not immediately disburse the funds acquired in payment for its new debt. Deposits in the Federal Reserve Banks and other Government depositories to the credit of the Treasury

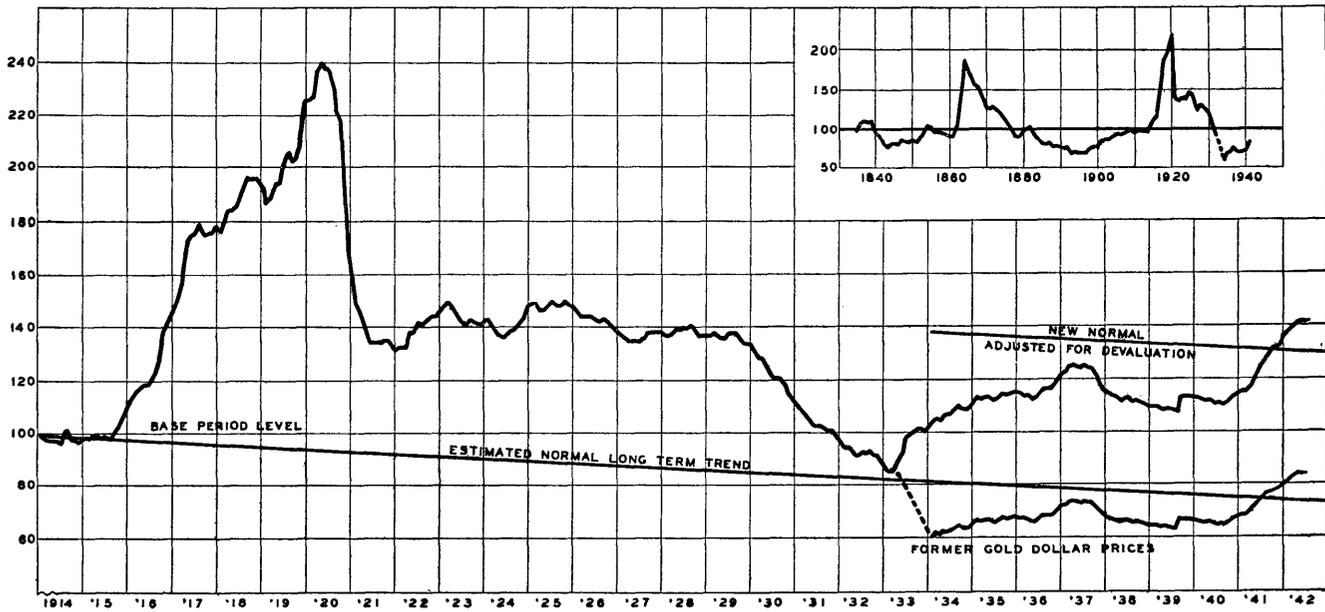
INDUSTRIAL PRODUCTION



HARWOOD INDEX OF INFLATION



COMMODITY PRICES



increased more than \$1,000,000,000 during the first half of July. At the present rate of Government spending, it seems probable that a considerable portion of the new bank balances held by the Treasury will be disbursed during the remainder of the month. If so, this will be indicated by a sharp increase in the revised Index of Inflation for July from the preliminary Index.

Other Demand Factors

Department-store sales last week were five per cent greater than they were in the corresponding week of 1941. The dollar volume of retail sales will probably be well sustained while merchants are advertising special sales to reduce inventories to conform with Government requirements.

Commodity Prices

The United States Bureau of Labor Statistics' combined index of wholesale commodity prices remained substantially unchanged last month. The index was 141.0 per cent of the 1913 monthly average in June and was 141.1 (preliminary) in July. Wholesale prices have been stabilized for the second successive month, but of course so brief a period cannot be taken as an indication of the success of the Government's endeavor to prevent inflation from further affecting the price level. As the chart on page 119 shows, the wholesale price index has advanced without interruption from September 1940 to May 1942, and at least a temporary reaction might normally be expected.

At a time when the wholesale commodity price average is at least temporarily stabilized, it seems appropriate to observe the situation with respect to the price level prevailing in preceding periods. The present level is about the same as that existing during the period 1921-1929 after the first World War price advance had been partially liquidated. However, the current level is substantially higher in relation to the long-term trend line shown in the chart on page 119 than it was during the decade of the 1920's and has advanced beyond the new normal line adjusted for devaluation. It is therefore apparent that the consumer has lost the advantage of lower prices gained during the past two decades through the improvement of manufacturing techniques resulting in savings in production costs. Price changes have not been uniform in the various price groups, and the current prices for all groups are not higher than they were in 1929, although the majority of them are, as is the combined index.

The accompanying table shows changes that have occurred in the major classifications of the index. The July 1942 preliminary indexes are compared with the revised indexes of earlier significant periods.

Last month, there were few changes of greater-than-fractional proportions in the separate classifications shown in the table. The greatest change was an increase of one per cent in the farm products group. There were

UNITED STATES BUREAU OF LABOR STATISTICS WHOLESALE COMMODITY PRICE INDEX (Monthly Average 1913=100)

	July 1929	July 1932	July 1941	June 1942	July* 1942
Farm Products	150.5	67.0	120.0	146.2	147.6
Foods	160.3	94.9	131.9	154.7	153.7
Hides and Leather	160.3	100.7	160.6	174.6	174.6
Textile Products	156.4	92.0	150.4	169.8	168.9
Fuel and Light	135.9	118.0	128.1	129.0	129.7
Metals and Products	111.2	87.2	108.5	114.5	114.5
Building Materials	167.8	123.0	181.8	193.8	194.5
Chemicals and Drugs	†	†	106.2	121.2	121.2
Household Furnishings	167.5	131.5	167.7	185.6	185.6
Miscellaneous	118.6	92.1	117.5	128.9	128.9
Raw Materials	144.0	79.5	125.1	144.6	145.1
Semimanufactures	124.7	74.1	117.4	123.9	123.9
Finished Goods	137.7	101.6	129.8	142.4	142.5
All Commodities	138.2	92.4	127.2	141.0	141.1

* Preliminary Estimate

† Not Available.

no significant changes in the average prices of the three economic classes, raw materials, semimanufactures, and finished goods.

The sensitive wholesale commodity price indexes remained substantially unchanged last week. Moody's Spot Commodity Price Index was 231.9 on July 16 and 231.1 on July 23. The Dow-Jones Index of Commodity Futures closed at 85.87 on July 16 and at 85.35 on July 23.

FINANCE

New Capital Issues

The volume of new capital issues of corporate securities during June this year aggregated \$77,000,000. This was somewhat smaller than the preceding month's total of \$103,000,000 and was also smaller than the total of \$90,000,000 issued during June 1941.

Of the \$77,000,000 par value of new capital issues last month, \$56,000,000 was borrowed by industrial concerns; \$18,000,000, by the utilities; and only about \$3,000,000, by the railroads. The \$497,000,000 borrowed during the first half of the year was divided as follows: four per cent by the railroads; 23 per cent by the public utilities; and 73 per cent by industrial companies.

New corporate financing in June and in the first six months of each year during the past 16 years is shown in the accompanying summary.

NEW CORPORATE FINANCING IN THE UNITED STATES

Year	First Six Months		Year	First Six Months	
	June (In millions of dollars)	June (In millions of dollars)		June (In millions of dollars)	June (In millions of dollars)
1926	273	2,471	1935	14	101
1927	520	2,760	1936	152	458
1928	582	2,685	1937	276	829
1929	553	3,771	1938	202	362
1930	441	3,521	1939	31	218
1931	131	1,307	1940	10	270
1932	4	160	1941	90	380
1933	12	60	1942	77	497
1934	9	99			

Source: *Commercial and Financial Chronicle*.

Statistical Summary; Production, Purchasing Media, and Prices

	1941						1942						
	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	*July
Index of Industrial Production.	146.8	146.5	147.3	148.9	151.3	152.0	152.7	153.4	153.2	153.9	156.3	159.6	160.0
Index of Inflation (Ratio Form)	104.0	104.4	104.3	104.4	104.6	103.1	105.8	105.3	104.8	111.0	116.1	119.7	121.0
Commodity Price Index.....	127.2	129.4	130.9	131.4	132.5	134.1	137.5	138.5	139.8	141.4	141.5	141.0	141.1
Commodity Price Index..... (In terms of former gold dollar)	75.3	76.6	77.4	77.8	78.4	79.3	81.4	82.0	82.7	83.7	83.7	83.4	83.5

*Preliminary Estimate.