AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

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RESEARCH REPORTS

THE BACKGROUND OF INVESTMENT

Characteristics of Major Fields of Enterprise

Federal statutes forbid the maintenance of monopolies (except as specified by the patent laws) in the products of manufacturing companies, and, although examples exist of restricted competition in the production of some types of goods, the distribution of industrial products in general proceeds under conditions of active competition. The nature of services offered to the public by some other types of organizations limits the scope of competitive opportunity, so that monopoly conditions are the only ones practicable. For example, the conditions of their development have given the railroads of the country an essentially monopolistic character. The necessity for heavy investments in fixed trackage along avenues of commercial traffic has left no other practical possibility.

The Railroads

The possession of monopoly by enterprises carries with it both advantages and disadvantages. It is an old adage that the price of monopoly is regulation, and sometimes this price is found to be heavy indeed. The Interstate Commerce Commission has for many years established the rates that the railroads may charge for their services and has gradually assumed dictation over virtually all of the affairs of these companies. Nevertheless, this quasi-judicial body recognizes the rights of the railroads to a reasonable return on invested capital in determining the establishment of rates for their services that will be fair to the public.

The relinquishment of full control over operations by the owners and management of the railroads is not the only price that has been paid for their monopoly position. The management has been robbed of the spur of competition that has proved so powerful in developing the Nation's manufacturing enterprises. Although in the early days of railroad development in this country engineers made names for themselves in establishing workable grades across difficult terrains, the names most famous in railroad history are those made by men who have effected vast consolidations, rather than those who have improved transportation techniques. However, during recent years, there has been a growing tendency among railroad managements to recognize the suicidal character of an attitude of reliance on monopoly position as a substitute for aggressive policies in the improvement of operating methods.

According to reports made by the Interstate Commerce Commission, the steam railroads of the country have a total capitalization of $23,500,000,000, of which $8,000,000,000 is represented by common stocks, $2,000,000,000 by preferred stocks, and $13,500,000,000 by bonds. (This of course does not represent the market value of these securities that constantly fluctuates.) This is about a third as large as the capitalization of the Nation's industrial companies, but a larger proportion is represented by funded debt. These railroad securities, at the beginning of this century, were rated in both the New York and London markets as the world's choicest investment media. Although the vicissitudes of the past thirty years have resulted in an impairment of their preferred position in the investment field, railroad properties possess an earning power that afford their securities a place in the individual's investment program.

After a long period of growth that started early in the Nineteenth Century, operations of the railroads first gave indications of approaching maturity during the first World War period. The upward trend of freight statistics, adjusted for population growth, became less marked at that time. Government control of the railroads had resulted in deterioration of ways and equipment, and this, coupled with a slackening in the growth of business and high operating costs, made it desirable to raise freight rates, which reached a high record in 1921. However, the sharp deflationary movement in general business that year and the loss of traffic to competing forms of transportation soon necessitated the reduction of the high rates, and a long series of downward adjustments were subsequently effected.

Although many railroads enjoyed the greatest prosperity in their history during the boom period of the later 1920's, freight traffic was curtailed so greatly during the succeeding depression that many railroads were unable to earn their fixed charges, and many receivership proceedings resulted. The postdepression improvement in freight tonnage was slow because of the character of the recovery movement, which centered primarily in the consumer goods industries. These were the principal beneficiaries of the New Deal's spending-for-recovery program. Prosperity of the railroads is more dependent on the heavy industries, and the activity of the durable goods industries was greatly stimulated by war demands. The financial position of the roads has been improved so extensively during the war period that their outlook for the postwar period is more favorable than would have seemed possible a few years ago.

As soon as the war is over, the railroads will presumably lose virtually all of the heavy traffic now represented by Government shipments. Nevertheless, this should be partially offset by a substantial increase in other freight. An extended period of reconstruction and rehabilitation will be needed, and economic activity may well continue on a high level for some time There are other aspects that appear to favor the railroad's position. The physical equipment of the roads is being better maintained during the present conflict than was the case during the first World War, and it seems reasonable to hope that this situation will obtain for the duration of the war. Other means of transportation will resume their normal functions and compete actively for the available business, but the railroads will be helped by the extension of Federal controls over competing agencies that were not imposed in earlier years. Because the roads are reducing their indebtedness substantially through the purchase of their bonds future interest requirements will be less burdensome. Finally, the attitude of the investing public toward the roads' securities has been greatly improved during the period of large wartime earnings, and this confidence may be retained if the men charged with directing the systems recognize the importance of operating the properties as active enterprises, rather than as vested interests.

Regional considerations are of primary importance even for the largest railroad systems in the country. The railroads truly live from the territories they serve, and, other things being equal, roads that are located in sections of the country that enjoy economic trends superior to the general average for the whole country are preferred investment risks. A study of railroad operating statistics recently made by this Institute indicates that the most favorable economic growth trends are found in the South and in the Far West. The roads having the best records in the Western District are the Western Pacific, Louisiana and Arkansas, and St. Louis Southwestern. Those in the Southern District with the best records are Seaboard Air Line and Southern Railway. Although records show a less favorable trend for the Eastern District, its representation in an investment list may be advisable for reasons of geographic diversification, and New York, Chicago and St. Louis and Baltimore & Ohio have records above average in the East. There are other roads operating in these territories that have sufficiently favorable records to warrant their inclusion in diversified investment lists.

Our discussion of the characteristics of major fields of enterprise will be continued in a subsequent bulletin.

THE FUNDAMENTALS

Industrial Production

The Institute's preliminary index of industrial production for April is 182.0, slightly higher than the revised index of 181.7 for March. The Federal Reserve index of industrial production, from which the Institute's index is calculated, is based on the combined data for eighty-three separate industries. Of these, twenty are classified as durable manufactures, most of which are now primarily devoted to the production of war materials. During the past four months, the Federal Reserve index of durable manufactures advanced about nine per cent, whereas the nondurable goods index remained about unchanged. The advance in the durable goods index during this period was attributed primarily to expansion in the output of coal mines, steel mills, and armament plants. The increase in the production of merchant ships has been especially great.

The steel-ingot production rate advanced from 98½ per cent of theoretical capacity in the preceding week to 99 per cent last week. Although last week's per cent of rated capacity was one point lower than it was a year ago, the industry's output is estimated at the equivalent of 1,716,100 net tons of ingots and steel for castings, compared with 1,657,900 net tons produced in the corresponding week of 1942.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
Per Cent of Capacity	98.0	22.0	92.0	32.5	100.0	99.0

(Latest 1943 weekly data; corresponding week earlier years)

There was a contraseasonal increase in electric power generated last week. The gain in output, compared with production during the corresponding week of 1942 was 18.4 per cent, the largest recorded this year.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
Billion Kilowatt-Hours	1.71	1.47	2.18	1.95	3.31	3.92

Last week there was a greater-than-seasonal increase in lumber production, and the adjusted index advanced from 104.5 to 109.1 per cent of the 1935–1939 monthly average. Except for minor fluctuations, lumber production has followed a steady downward trend since July 1942. Unfavorable weather has impeded operations this year, and it is estimated that output during the first quarter of 1943 was three quarters of a billion board-feet smaller than it was in the corresponding period of 1942.

	1929	*1932*	*1937*	*1938*	*1942*	*1943*
New York Times Index	134.8	40.5	86.0	57.2	116.7	109.1

The Harwood Index of Inflation

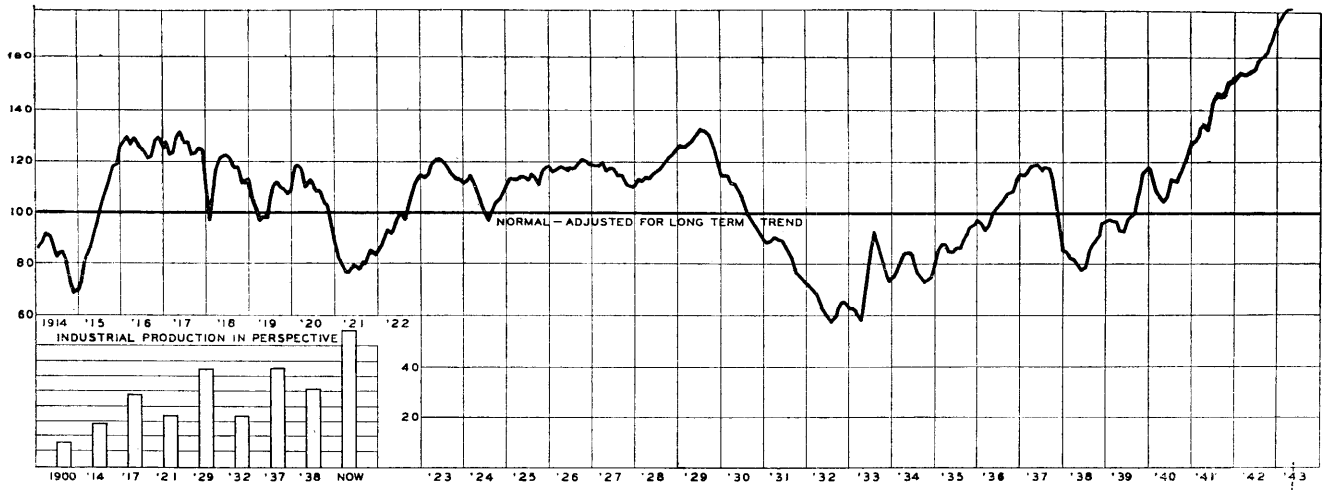
The preliminary Index of Inflation in ratio form for April at 160.5 is nearly six points higher than the revised Index for March (154.7). As the chart on page 67 shows, the current level (as of April 14) was higher than it was at any time during the first World War period. The dotted line on the same chart shows that the absolute amount of inflationary purchasing media far exceeds that available to the public at any previous period during the past three decades.

The factor primarily responsible for the sharp increase in the degree of inflation during the latest period shown was the action of the Treasury in spending the funds previously accumulated in its commercial bank and Federal Reserve depositaries. At the end of March, the Treasury had nearly $4,000,000,000 in deposit in its bank accounts, and this was approximately cut in half by the middle of April.

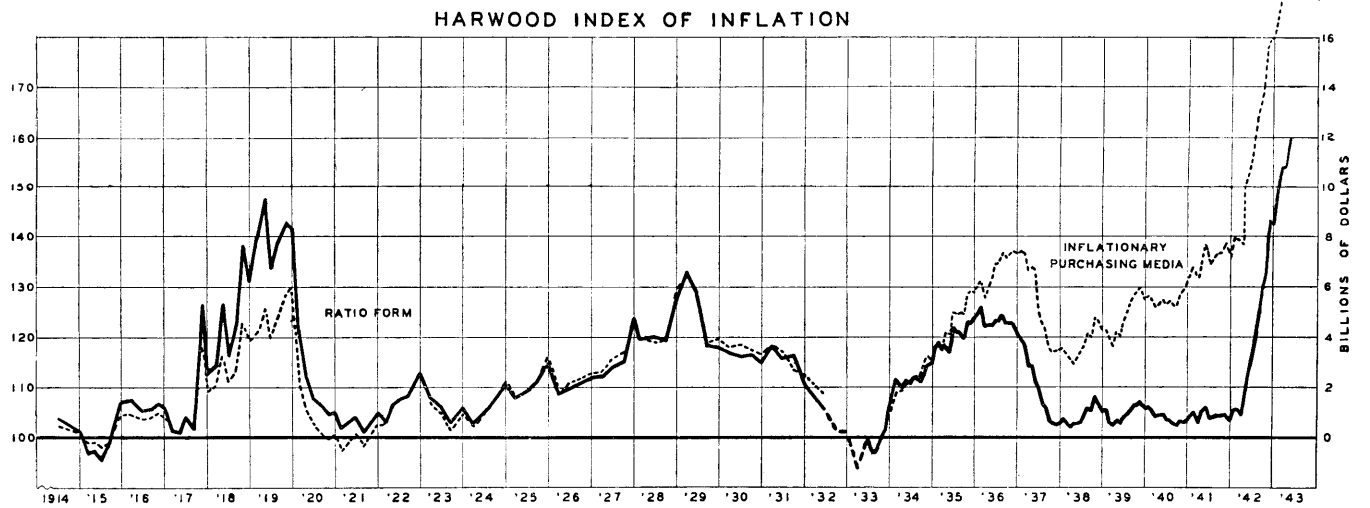
It is obvious that the Treasury felt safe in taking this action, because its accounts would soon be replenished by its large-scale borrowing operations this month. The decrease in the Government's bank balances indicated the distribution of purchasing media to the public of approximately $2,000,000,000 during this short period.

If the Second War Loan drive is successful, the revised Index of Inflation for April will probably be lower than is indicated by the preliminary Index. Secretary Morgenthau stated that it is the objective of the Treasury to obtain $8,000,000,000 of the $13,000,000,000 total included in the operation from nonbanking investors. Preliminary reports show that the response to the drive by institutions such as insurance companies and mutual savings banks has measured up

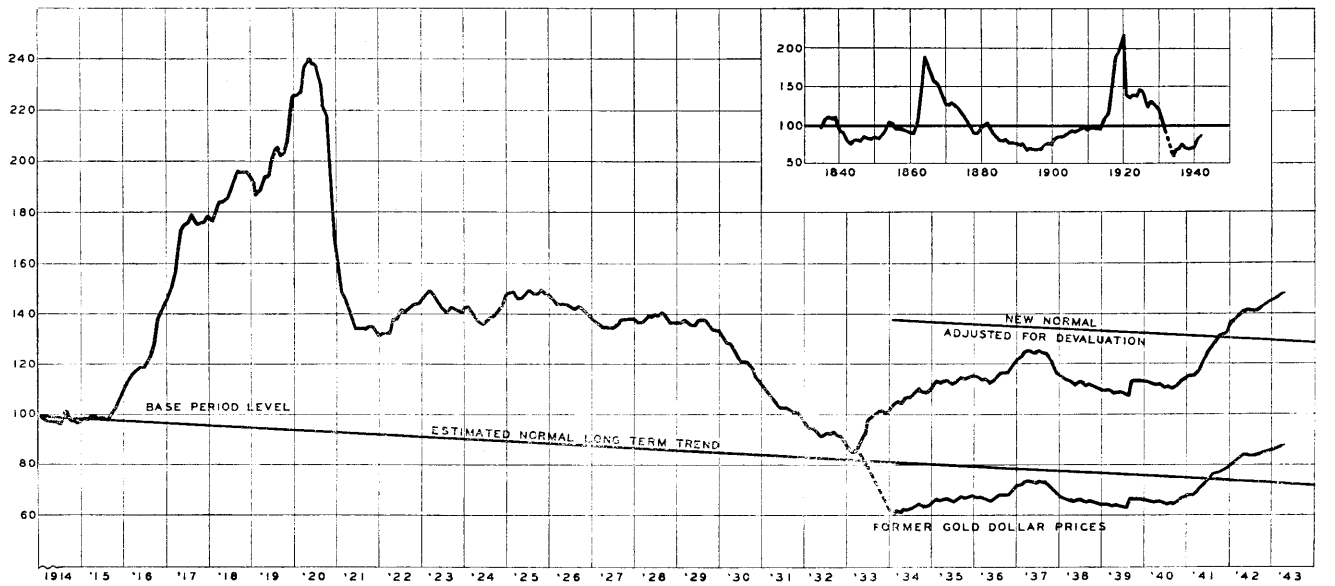
INDUSTRIAL PRODUCTION



HARWOOD INDEX OF INFLATION



COMMODITY PRICES



to expectations of the Treasury officials but that purchases by individual buyers of small denomination bonds have been disappointing. In making this announcement, the Secretary of the Treasury failed to consider the possibility that the Treasury itself could be held responsible for the reluctance of the "men and women who have new jobs in shipyards and in war-production lines" to make as heavy purchases of War Bonds as had been hoped. The Treasury is primarily responsible for the present tax muddle in Congress. While tax liabilities remain in dispute, individuals cannot so plan their personal budgets as to determine how large a portion of their incomes can be invested in War Bonds. Had the House of Representatives been allowed to accept the Ruml plan, we believe that the Treasury would have had a favorable popular response to its campaign even without the resentment against the Japanese aroused by the execution of our aviators.

Other Demand Factors

Since the United States entered the war, marked regional changes in demand have occurred. A study just completed by the Board of Governors of the Federal Reserve System shows that growth in demand, as evidenced by department-store sales, has been most substantial in Middle Western, Western, and Southern regions. This has been made possible "by exceedingly favorable agricultural conditions and by the bringing into operation of large new munitions plants." In consequence, income payments in these regions have increased greatly, thereby stimulating retail sales.

Commodity Prices

There was another advance last month in the combined wholesale commodity price index compiled by the United States Bureau of Labor Statistics, but it was smaller than the monthly increases that have proceeded without interruption since July 1942. The preliminary index for April was 148.1, only slightly higher than the March index of 147.9.

In the accompanying table, the April preliminary indexes of the major commodity price classification are compared with indexes for earlier periods. Changes in the separate classifications were generally confined to farm products and foods. In the three economic classes, raw-material prices increased about one-half a point, but changes in semi-manufactures and manufactured products were confined to small fractions.

There were no important changes in the sensitive wholesale commodity price indexes last week. Moody's Spot Commodity Price Index was 246.6 on April 15 and 247.1 on April 22. The Dow-Jones Index of Commodity Futures closed at 91.11 on April 15 and at 91.58 on April 22.

There was an increase during March 1943 of a full point in the combined cost-of-living index prepared by the National Industrial Conference Board. According to this index, there has been a 24 per cent increase in living costs since August 1939. The increase in food prices continued to lead the way toward higher living costs. The rise in clothing prices has been the next most influential factor, although the average has remained about unchanged during the past few months. The composite index and separate items for February and March 1943 and for earlier significant periods are shown in the accompanying table.

United States Bureau of Labor Statistics
Wholesale Commodity Price Index
(*Monthly Average 1913=100*)

	Apr. 1929	*Apr. 1932*	*Apr. 1942*	*Mar. 1943*	*Apr.* 1943*
Farm Products	146.7	68.8	146.2	172.7	174.4
Foods	152.6	95.0	153.7	167.1	167.9
Hides and Leather	158.3	110.1	175.0	173.9	173.9
Textile Products	159.9	97.9	170.5	168.9	168.9
Fuel and Light	133.6	114.5	125.8	131.8	131.8
Metals and Products	112.7	88.4	114.3	114.4	114.4
Building Materials	169.8	127.9	194.4	194.7	194.7
Chemicals	125.8	100.7	121.1	124.7	124.8
House Furnishings	167.0	135.5	182.6	185.1	185.1
Miscellaneous	117.3	92.7	129.4	130.7	130.7
Raw Materials	141.0	80.7	145.3	163.4	164.0
Semi-manufactures	126.6	79.6	123.9	124.0	124.2
Manufactured Products	136.9	102.4	142.2	145.0	145.1
All Commodities	138.4	93.8	141.4	147.9	148.1

* Preliminary Estimate

	July 1914	*June 1920*	*Aug. 1939*	*Feb. 1943*	*Mar. 1943*
All Items Combined	61.3	192.0	84.0	101.8	102.8
Food	66.1	147.2	75.3	110.2	112.9
Housing	57.7	91.2	86.3	90.8	90.8
Clothing	58.8	149.9	71.9	88.6	88.6
Fuel and Light	63.3	98.6	84.0	92.2	92.6
Sundries	59.0	107.3	96.9	106.7	106.8

FINANCE

New Capital Issues

There was a reasonably substantial volume of new corporate financing during March this year. The aggregate of $57,000,000 was somewhat smaller than the total issued during the corresponding month of 1942 but represented a large increase from the aggregate reported during any other month since last August. Most of the issues were for the purpose of financing the expansion of industrial plants. Only about $5,000,000 of the total represented borrowings by the railroads, and $4,000,000 was borrowed by the public utilities.

New Corporate Financing in the United States

Year	*March* (*In Millions of Dollars*)	*First Three Months*	*Year*	*March* (*In Millions of Dollars*)	*First Three Months*
1926	441	1,331	1935	8	20
1927	393	1,402	1936	59	145
1928	363	1,144	1937	139	390
1929	703	1,868	1938	24	111
1930	629	1,651	1939	58	87
1931	267	739	1940	31	111
1932	48	134	1941	87	186
1933	3	27	1942	79	206
1934	14	33	1943	57	71

Source: *Commercial and Financial Chronicle.*

Statistical Summary; Production, Purchasing Media, and Prices

	1942									1943			
	Apr.	*May*	*June*	*July*	*Aug.*	*Sept.*	*Oct.*	*Nov.*	*Dec.*	*Jan.*	*Feb.*	*Mar.*	*Apr.**
Index of Industrial Production.	153.9	155.4	156.0	159.3	161.8	167.0	170.4	173.7	176.2	178.5	180.6	181.7	182.0
Index of Inflation (Ratio Form)	111.0	116.1	119.7	125.1	130.8	133.6	140.7	143.5	142.7	149.2	154.6	154.7	160.5
Commodity Price Index.....	141.4	141.5	141.3	141.4	142.1	142.3	142.8	143.4	144.4	145.7	146.7	147.9	148.1
Commodity Price Index..... (In terms of former gold dollar)	83.7	83.7	83.6	83.7	84.1	84.2	84.5	84.9	85.4	86.2	86.8	87.5	87.6

*Preliminary Estimate.