AMERICAN INSTITUTE *for* ECONOMIC RESEARCH

GREAT BARRINGTON MASSACHUSETTS

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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Economic Advisers' Report

During the past week the Council of Economic Advisers' summary of their report has become available. This report is seriously in error, and it recommends policies that we consider dangerously unsound.

The first important error is found in the assertion, "The size of the export surplus to date....has not prevented the American consumer from enjoying a general standard of living far above any prewar level." The implication that the American standard of living today is "far above" the prewar level is demonstrably false. The average production of new consumer goods per capita in the last 6 months has been only 5 percent above the average for the last 6 months prior to our entry into the war. The export surplus this year, which was largely manufactured foods and other manufactured goods, may have absorbed all or more than the modest increase in the production of consumer goods per capita since 1941. In any event, it is simply not true that the present standard of living, even when measured only by the current acquisition of new consumer goods, is "far above" the prewar level.

Furthermore, an accurate measurement of the standard of living must take into consideration the quality of the goods that consumers are using. An automobile 6 or 7 years old that is nearing the end of its useful life does not provide the same standard of living in respect to transportation that it did when new. The American consumers' standard of living as measured by transportation facilities, housing, and many other durable goods is *far below* the prewar level. Obviously, then, the general standard of living must be below rather than "far above" the prewar level. At recent rates of production and any rates that are possible for some time to come, several years apparently must elapse before the prewar standard of living will be restored, even if there is no export surplus rather than the substantial one contemplated by the Council of Economic Advisers.

A serious error is indicated by the assertion that "....the general impact of a new foreign-aid program of the assumed size upon the American economy could be sustained, because a larger impact has already been sustained." Presumably, this is based on the assumption that the effects of such procedure are not cumulative; otherwise, the assertion would be too silly to warrant further attention. But the adverse effects of exporting an excess of capital equipment under present conditions are cumulative; they postpone to the indefinite future the increase in our productive capacity and efficiency needed in order to restore prewar standards of living.

It is desirable to remember that our economic system has been subjected to tremendous strain during the past several years. The lend-lease program, the war effort, and the first postwar lending program did not cause a serious breakdown, but no one can be sure that a second foreign-aid program will not be the "last straw." The bland assumption that the American "camel" can bear any load if each additional burden is smaller than the one preceding would be merely ridiculous if it were not so dangerous a basis for future action.

A third major error is found in the assertion, "Since the general impact of a new foreign-aid program would be less than the recent impact of foreign-aid, such a new program would not increase inflationary pressure, above recent levels.." If there is no offsetting deflationary influence, such as a Treasury surplus available for the retirement of bank-held Government bonds, a new foreign-aid program will add more inflationary purchasing media to the huge total already in the hands of the public. In that event, the "inflationary pressures" may be increased substantially above recent levels. Yet the existence of this grave risk is denied by the Council of Economic Advisers.

With respect to the effects on the price level, the Council asserts, "The high foreign demand has added to the inflationary pressure on prices, but the much larger domestic demand has been the principal cause of the upward pressure." This theoretical separation of foreign and domestic demand is not in accord with the facts. The actual course of events has been as follows: Our Government has issued large quantities of inflationary purchasing media, some of which has been loaned to various foreign nations; they have used it to buy goods in our markets, thereby tending to raise prices and removing from the markets here goods for which purchasing media (in the form of salaries, wages, etc.) have already been distributed to domestic consumers as the goods were produced; there then remains in U. S. markets on the demand side both the consumers' incomes representing goods shipped abroad, the inflationary purchasing media paid to American merchants by foreign buyers, and the huge volume of inflationary purchasing media held by American citizens; these sums combined then constitute additional effective domestic demand for goods. The effect on prices has been and is certain to be striking.

There are two aspects of the report, aside from the errors noted and others not mentioned here, that are most disquieting. The first is the complete absence of forthright admission that present domestic demand is excessive in part because of the huge volume of inflationary purchasing media in circulation. The Council members urge that no more be added, but they do not advocate removing any of that already in existence. Yet deflation has been and still is most urgently needed, not merely in order to remedy some of the present distortions but in order to prevent even greater distortions in the months immediately ahead.

The second disturbing, even alarming, aspect of the report is the repeated emphasis on "selective distribution," "regulated use," "discouragement of excessive use," "holding prices," "allocations," and other euphemisms for price control and rationing.

A few months ago we had occasion to point out that the Council of Economic Advisers ".... is using for its analyses certain basic assumptions that may be a quicksand foundation for their structure of economic analysis." Our fears in this respect have been realized. The Council's report advocates adoption of "planning" procedures that have all but wrecked England and, in our judgment, will surely cause serious maladjustments if adopted here.

We hope that the general public will not accept the Council's report as an example of sound economic analysis. It is, on the contrary, seriously in error, illogical, unsound, and dangerously misleading. It is, unfortunately, a typical example of the unscientific work that so freely passes for economic analysis among the ill-informed. We predict a most unfortunate outcome if this report is made the basis for subsequent action.

Inflation or Deflation?

The expected moderate deflation continues. At 184, the Harwood Index of Inflation decreased 2 points in the week ended October 29. The index is now at the lowest level since early 1944 and is about 40 points below the peak reached in 1946.

There is a possibility that the trend will be reversed this month if installment sales increase greatly. However, the continuing scarcity of automobiles and some other items usually sold on this basis may restrict the increase in installment credit to relatively small proportions.

Further deflation in December and January is almost assured by the tax payments due in those months. It now seems improbable that aid to Europe will be on a large enough scale in the meantime to offset this influence.

SUPPLY

Industrial Production

Steel-ingot production, at 96.1 percent of capacity for the week ended November 8, 1947, was 1 percent less than production in the preceding week but was 6 percent more than production in the corresponding week last year. The *Iron Age* expresses doubt as to whether present capacity can be exceeded to any appreciable extent. Output of pig iron has been hampered by poor-quality coke and the need for repairs. Moreover, steel scrap is still not readily available and the price remains high.

	1929	*1932*	*1937*	*1938*	*1946*	*1947*
Percent of Capacity†	78	19	47	58	91	96p
Weekly Cap. (Million Tons)	1.38	1.52	1.51	1.54	1.77	1.75
Production (Million Tons)	1.08	.29	.71	.89	1.61	1.68

Automobile and truck production for the week ended November 1, 1947, was estimated at 105,834 vehicles compared with a revised total of 106,159 reported the previous week. The year's output is now expected to reach about 5,000,000 units.

	1929	*1932*	*1937*	*1938*	*1946*	*1947*
Vehicles (000 omitted)†	73	10	90	73	93	106p

Electric-power production for the week ended November 1, 1947, increased to 5,009,286,000 kilowatt-hours from 4,946,090,000 kilowatt-hours reported for the previous week.

	1929	*1932*	*1937*	*1938*	*1946*	*1947*
Billion Kilowatt-Hours†	1.82	1.53	2.25	2.23	4.63	5.01

Lumber production for the week ended October 25, 1947, increased. *The New York Times* index was 3.3 points above the index for the previous week and was 11.0 points above that reported in the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1946*	*1947*
The New York Times Index†	127	37	78	99	86	97

p=preliminary
†Latest weekly data; corresponding weeks of earlier years

DEMAND

Purchasing Media

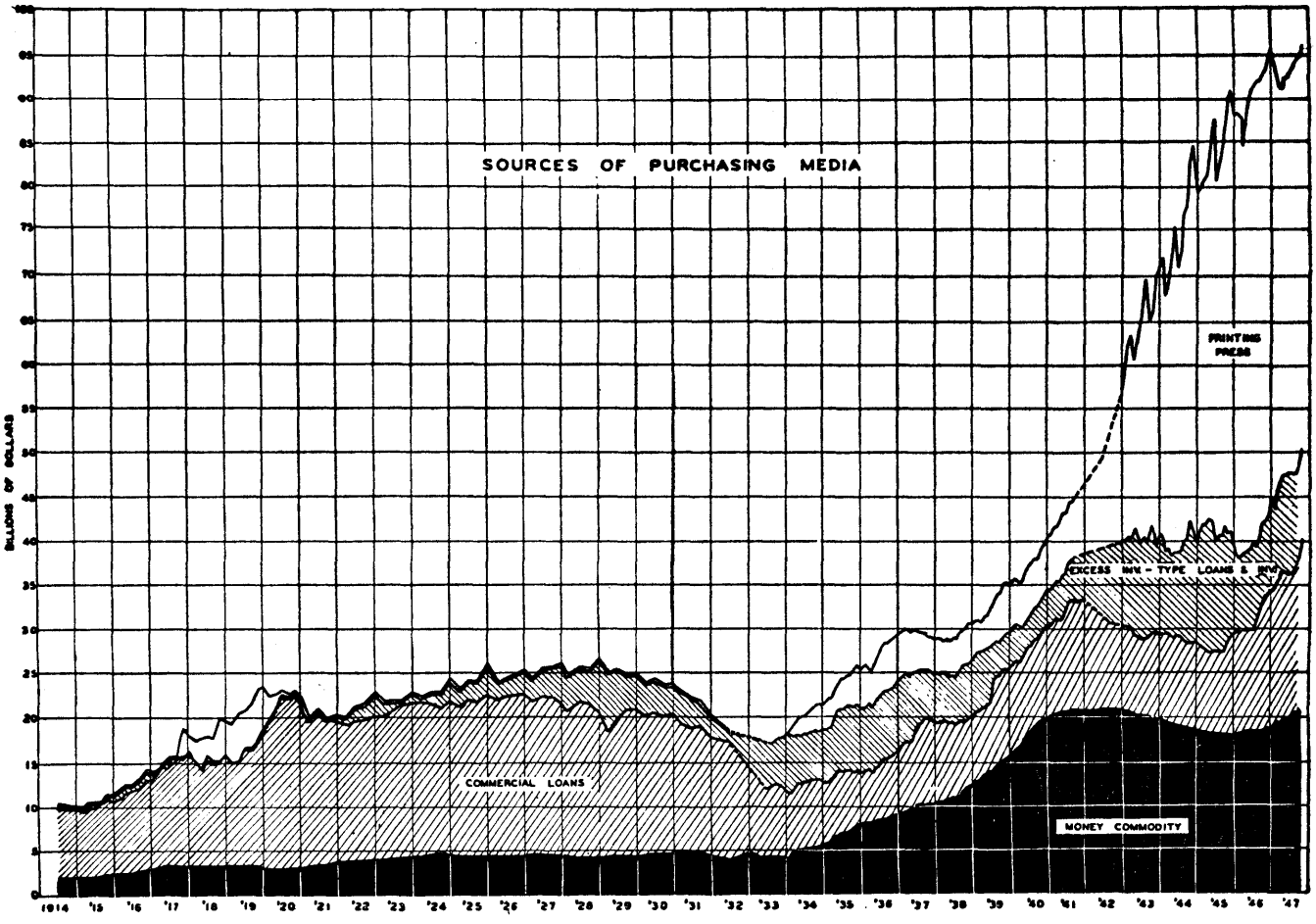
Again the preliminary estimate of the volume of purchasing media indicates that a new all-time high was reached. The amount available to the public late in October was $95,781,000,000, some $852,000,000 more than the revised total reported at the end of September and $2,081,000,000 more than that reported in October last year.

Purchasing media derived from the money commodity, gold, increased slightly more than 1 percent during October. Gold imports have increased as various nations have paid gold for part of our large exports.

A 4-percent increase in the volume of commercial and agricultural loans during October was responsible for a substantial portion of the increase in the total volume of purchasing media. The increase in purchasing media derived from this source has been 17 percent since May. Because the loans made to commercial and agricultural interests presumably represent tangible goods that are in or are en route to the Nation's markets, purchasing media from this source is not inflationary. However, the abnormally high level of prices has tended to increase the amount of individual loans, thereby influencing somewhat the volume of commercial and agricultural loans reported.

The Government's monetary policy in recent weeks has been deflationary and has caused a decrease in the purchasing media derived from the third and fourth sources. Since October 1946, an 8-percent decrease has occurred in the volume of purchasing media derived from inflationary sources, a relatively small part of which occurred during the past month. The index of inflation, which reflects the trend of these inflationary sources and is regularly discussed in the Monthly Bulletin, has indicated that deflation of the wartime credit expansion has been in progress for some time. However, this movement was not so marked during the last 8 months as it was in the preceding 8 months.

Installment credit controls have been terminated.



Many large retail firms have already announced liberal credit terms effective immediately on all items, including furniture, household appliances, and other durable consumer goods. Terms applicable to the purchase of automobiles have been extended. Whether the restrictions will be reinstated in the coming session of Congress remains to be seen, but in the meantime purchasing media from the last two sources discussed above may increase. At least, the purchasing media derived from increased installment loans will offset part of that being withdrawn from circulation through the deflationary influence of Treasury operations.

Demand-Supply Ratio

The index of the dollar volume of manufacturers' shipments rose 3 percent in August to within 3.5 percent of the postwar peak reached in June 1947. However, preliminary estimates of the shipments index for September indicate than an increase of 8 percent occurred during that month, bringing the dollar volume of shipments to a new postwar high. This gain has been attributable largely to the following factors: an improvement in the supply of steel, resumption of work following the summer vacations, a seasonal revival in the so-called soft-goods industries, and the continuing rise of prices.

The index of the dollar volume of manufacturers' inventories rose 1.3 percent in September, bringing the total gain since July to 2.6 percent. Inventories have been increasing continually since December 1945.

The trend of new orders has been generally downward since February of this year. A sharp reversal of the trend that occurred in June was more than counterbalanced by a substantial decline of 6 percent in July. An increase of less than 1 percent occurred during August.

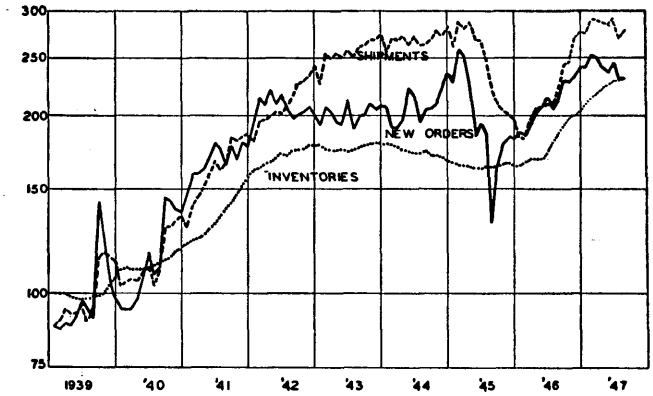
In the August 18 *Research Reports* we discussed an attempt to estimate the extent of the distortion that exists in our ratio of unfilled orders to inventories. As was poined out in that discussion, during most of the period since the end of the war, there has been a greater-than-normal time lag between the placing of orders and the corresponding shipments. Orders recorded at one price have been filled several months later at much higher prices.

We have made the arbitrary assumption that shipments have lagged the corresponding orders since January 1946 by 6 months. Allowance was made for the intervening price changes by inflating new orders to the same value basis as the corresponding shipments. Following this adjustment the unfilled-orders figures and the ratios of unfilled orders to inventories were recomputed.

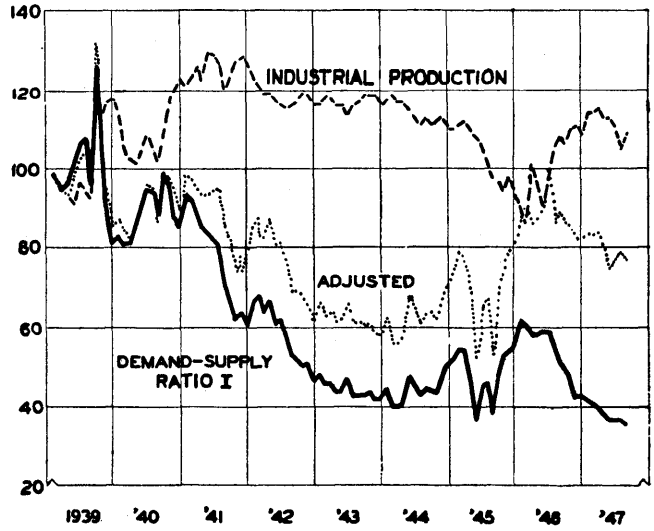
The results obtained have been plotted on the chart that shows the ratio of unfilled orders to inventories. The dotted line on this chart shows that, instead of an 85-percent decrease in the ratio since the peak reached in June 1946 there may have been only a 34 percent decrease and that the peak was reached in September rather than June 1946. Moreover, the level of the adjusted ratio in August 1947 was slightly above the level reported in January 1946.

Although these results are significant, the only safe

INDEXES OF MANUFACTURERS' NEW ORDERS, SHIPMENTS, AND INVENTORIES



DEMAND-SUPPLY RATIO I VS. INDUSTRIAL PRODUCTION



conclusion that can be drawn is that the inventory situation at the manufacturing level, relative to the volume of unfilled orders, is *not* so critical as the original series suggests. We have no basis for accurately estimating the distortion present, because the time lag between the receipt of new orders and the corresponding shipments is not known and has probably varied considerably. Therefore, some decrease in the ratio probably has occurred since September 1946. Until a period of deflation has corrected many of the maladjustments in our economy, an accurate appraisal of the manufacturing inventory situation, as judged by our ratio of unfilled orders to inventories, will not be possible.

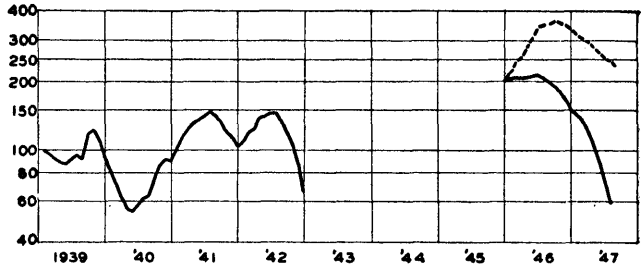
Demand-Supply Ratio I, unadjusted for price changes, decreased slightly in August and fell 9 percent further during September according to preliminary estimates. The adjusted ratio, which apparently has resumed the prewar relationship to the trend of industrial production, decreased 2.5 and 6.5 percent respectively during August and September.

Both the adjusted and unadjusted figures for Demand-Supply Ratio II decreased during August and September and again paralleled the movement of industrial stock prices during this period.

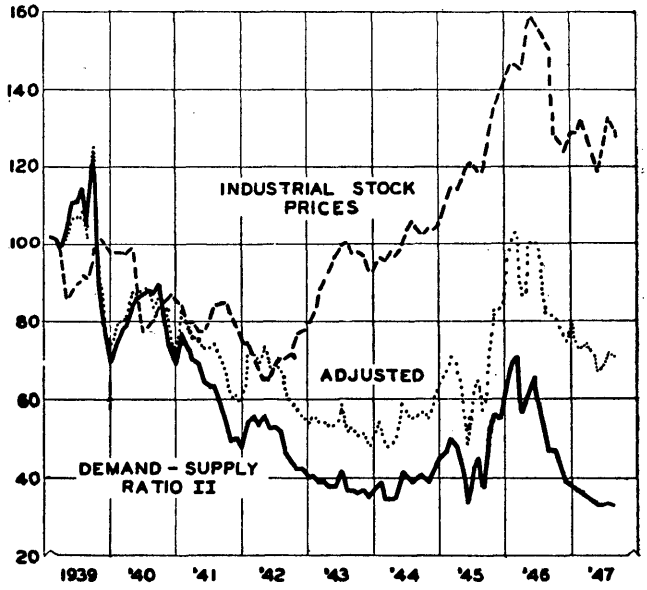
Department-Store Sales

Department-store sales for the week ended November 1, 1947, were 3 percent more than sales reported for the

RATIO OF UNFILLED ORDERS TO INVENTORIES



DEMAND-SUPPLY RATIO II VS. INDUSTRIAL STOCK PRICES



previous week and were 14 percent more than sales of the corresponding week last year.

PRICES

Commodities at Wholesale

(August 1939=100)	*Nov. 6* *1946*	*Oct. 30* *1947*	*Nov. 6*
Spot-Market Prices (28 basic raw materials)	272	342	347
Commodity-Futures Prices (Dow-Jones Daily Index)	240	344	344

BOOK REVIEWS

The Course and Control of Inflation
League of Nations, 1946 ($1.25)

This will be of interest primarily to students of monetary experience. The period covered includes only the first few years after World War I, and there is little discussion of the effects of inflation on the values of securities, commodities, real estate, and so forth.

On Understanding Science by James B. Conant
Yale University Press, New Haven ($2.00)

This publication will be of interest to educators and to laymen who wish to gain an elementary understanding of the methods of science. Dr. Conant outlines a course that might well be given in many colleges. We think it even more important that such a course be part of the high-school curriculum also, because the great majority of our future citizens will complete their formal education in the high schools of the Nation.