AMERICAN INSTITUTE for ECONOMIC RESEARCH

GREAT BARRINGTON MASSACHUSETTS

WEEKLY BULLETIN

June 12 1950

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Economic Aspects of National Defense

The urgent desirability of restoring and maintaining conditions conducive to rapid industrial progress here in the United States seems to have been overlooked. Responsible statesmen have instead been preoccupied with more striking programs such as the Marshall Plan, Atlantic Pact aid, Point IV, and other even more grandiose methods of buying national security. However, in spite of the vast propaganda urging foreign aid and in spite of such arguments as President Truman's to the effect that the Marshall Plan is cheaper than a shooting war, we are convinced that maintaining or preferably increasing the industrial superiority of the United States is the keystone in the arch of national defense.

Last week (June 5, 1950, *Research Reports*) we suggested that the Nation's citizens are not "choosing as wisely as we could among the alternative uses of land, labor, and capital." In this concluding article on the economic aspects of national defense, we raise and in part answer several pertinent questions regarding the prospects of maintaining the industrial superiority that the United States has and must continue to have if the Nation is to win any major war in the foreseeable future.

The outstanding threat to future industrial progress is the current trend away from the degree of economic freedom that characterized the Nation's earlier development. In making this assertion we are aware of the danger that those who attack "socialism" will be relegated to the class of those who oppose progress. Justifying socialistic programs by the argument that those who oppose them are against progress, however, is to confuse change with progress.

Apparently, one of the country's major problems is to differentiate between measures that increase and those that decrease economic freedom. When the President of the United States believes that no economic freedom has been lost by farmers who are permitted to vote for or against acceptance of production restrictions established by the Government, reconsideration of the implications and significance of economic freedom would seem to be necessary.

Economic freedom implies at least the following: (1) for every individual, equality of opportunity to develop his talents, have access to natural resources, and use his capital; (2) the right of the producer to have what he produces or its equivalent in value through the process of exchange in free markets; and (3) the absence of special privilege. Economic freedom does not imply license to disregard the equal rights of others.

The results of a large degree of economic freedom can be seen in the industrial progress of the United States during the last two centuries. Economic freedom has enabled men to take advantage of new opportunities: to move out toward the West and develop the untouched land, to seek new natural resources, and to initiate the development of wholly new industries. As a result, the per-capita production of the material things that men want has increased beyond the most extravagant hopes of the earliest settlers. Moreover, the people of the United States have created industrial plant and equipment unequaled anywhere else in the world. Two great World Wars have proven the overwhelming superiority of America's ability to produce.

Unfortunately, economic freedom is easily lost. Although complete freedom was approximated in parts of the Nation during its early history, the degree of economic freedom enjoyed by most citizens has been decreasing for many decades. As a result, large amounts of land, labor, and capital have been lost or used ineffectively. Various abuses have distorted market relationships and interfered with production and exchange. If more and more freedoms are lost, there is reason to fear that, during a transitional period from capitalism to socialism, the Nation would be so weakened industrially that the Soviet Union could attack us effectively.

Questions to Be Raised

As a means of focusing attention on the more important problems, we raise and attempt to answer certain questions in the paragraphs that follow. These questions concern not only the policies of the Federal Government but also those of other important groups of the economy.

Are industrial monopolies destroying economic freedom and retarding industrial progress? Monopolies may prevent the most effective functioning of the market through the arbitrary manipulation of prices. Of course, the distortion of market relationships ordinarily results in a less effective use of land, labor, and capital than would otherwise occur. Probably the best procedure is to continue to fight the more flagrant and obvious business monopolies, but to remember that size alone is not the criterion of monopoly.

Has the increase in the power of labor unions resulted in the lessening of economic freedom and hampered industrial progress? On frequent occasions in the recent past the opportunity to develop natural resources or

make use of capital has been denied because of strikes. Such denials in the steel, coal, automobile, and railroad industry have resulted in the wasting of natural resources, labor, and capital. When one remembers that industrial growth in the United States during the last few decades has been at the rate of only 3 percent per annum, the importance of weeks or months of idleness in a major industry becomes apparent. Until the bargaining power of the two groups, labor and management, is more nearly equal, genuine collective bargaining is not to be expected. And until conditions are such as to assure the economic freedom of both parties and thus encourage genuine collective bargaining, the national defense probably will be weakened by prolonged industrial warfare.

Is the existence of every monopoly privilege a denial of economic freedom and does it discourage industrial progress? Monopoly privileges enable the holders thereof to receive a portion of the Nation's product without contributing to the productive processes. For example, large fertile areas in the middle west as well as immensely valuable lands in many major cities are owned by present members of the British aristocracy, because more than 150 years ago, George III, then King of England, by a stroke of his pen gave certain ancestors of these persons authority to hold that land forever. To the extent that special privileges of this type are perpetuated, some degree of economic freedom is denied to those who produce wealth on these lands and share it with the holders of the monopoly privileges. Moreover, the retarding effects on industrial progress are substantial. In the first place, the potential labor of those persons who live on the bounty provided by special privilege is lost, thereby reducing the Nation's output of goods and services. In the second place, those persons who have no special privileges but who do contribute labor or capital are forced to give part of what they produce without any return; consequently, the incentive to produce is not so great as it might otherwise be.

Government Policies

Do tariffs lessen economic freedom? The so-called "protective tariffs" have long reduced the degree of economic freedom. In an effort to protect certain domestic industries from the competition of more efficient foreign industries, tariffs have been placed on incoming goods. One effect of "protecting" domestic industry is to perpetuate relatively inefficient uses of land, labor, and capital. Not only are land, labor, and capital thus wasted but also their use in new or more efficient industries is prevented or delayed.

Are high taxes promoting economic freedom? There is little question that high taxes prevent the producer from receiving his production or its equivalent in value. Consequently, the expansion of production and productive facilities is discouraged. Moreover, to the extent that the Government uses the funds unwisely (for example, in making loans to such organizations as the Lustron Corporation), there is a misuse of savings that prevents the most effective expansion of the Nation's capital plant and equipment.

Does the farm-price support program lessen economic freedom? The support program lessens economic freedom in three ways. First, free markets are distorted as demand is artificially and arbitrarily influenced by Government funds. Second, the farmer is singled out to receive special privileges. Third, the distortion of market relationships makes the measurement of values difficult, with resulting misapplication of land, labor, and capital.

Do the monetary, credit, and fiscal policies of the Government lessen economic freedom? The amount of inflationary purchasing media in circulation at present as a result of the Government's monetary, credit, and fiscal policies exceeds $40,000,000,000. Moreover, changes in the amount of inflationary purchasing media are occurring from month to month. That this inflationary purchasing media have distorted market relationships can be seen in the great increases during the past few years in dollar wages, dollar prices, dollar profits, dollar value of construction, etc. The effects of these distortions in a capitalistic economy are far reaching. The Nation may be dissipating its capital plant and equipment without any realization of the fact by the great majority of its citizens. Even trained statisticians are forced to question their calculations of the physical volume of construction and other production activities that are measured in dollars.

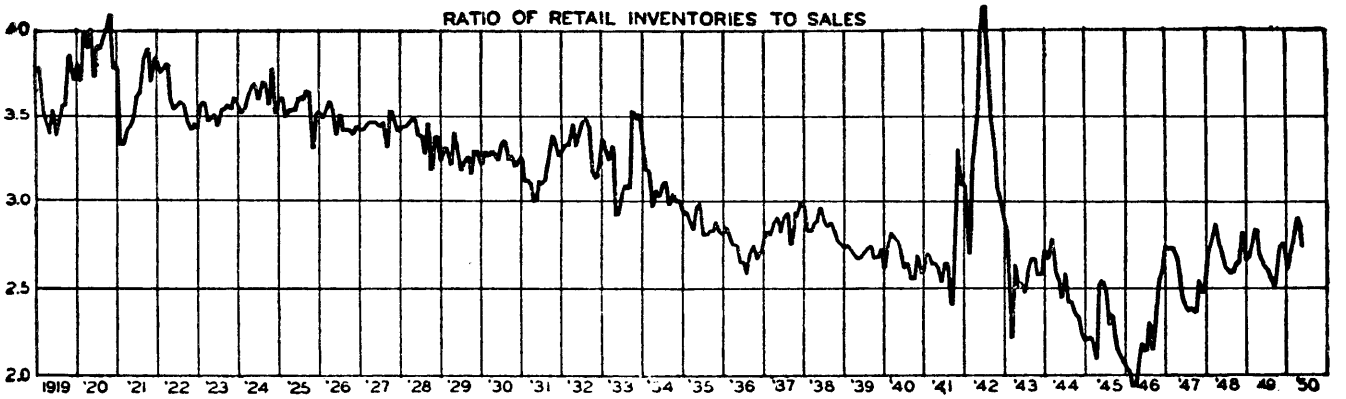
When the President speaks of the great gains in gross national product and in national income and explains that he is not speaking in terms of dollars but in terms of real product and real income, the Nation's citizens should give the situation some serious thought. In the first place, the assurance with which Mr. Truman accepts these estimates of real product and real income is unwarranted. One might think that translating dollar values into physical volume was a simple matter of grade-school arithmetic. Unfortunately, such is not the case, and such translations may be especially misleading with respect to the condition of the Nation's plant and equipment as well as its annual production of goods and services. But of even greater significance is the fact that the President finds necessary the translation of these dollar values into real product and income. When the basic measure of a nation's goods and services (in the United States this measure is the dollar, one thirty-fifth of an ounce of gold) can no longer be used to measure the value of its goods and services, the time has come for that nation "to put its house in order" if disaster is to be avoided.

Conclusion

We are convinced that the greatest threat to the security of the United States is the retardation of industrial progress. Continued divergence from the principles and circumstances that have made possible the vast industrial development of the United States will retard progress here as the technological advance has been retarded in France by four decades of inflation and monetary depression and in England by monopoly and "creeping socialism."

The United States already has diverged so far from the path toward economic freedom that vast amounts of land, labor, and capital have been and are being wasted. Further divergence from freedom toward socialism may so lessen the Nation's industrial superiority as to invite attack from Russia and her satellites.

In order to preserve and defend the United States during the foreseeable future, the path toward economic freedom must be regained. Public attention should be focussed on the ways and means of restoring and preserving the circumstances that have made this country great. Much effort will be required, hard work, clear thinking, and accurate scientific analysis. The task will



not be done in one year or ten; but, unless it is done, a succession of Marshall Plans and other aid programs will hasten rather than delay our ultimate defeat. If Western civilization, the hope of mankind, is to be saved, it will be saved not by our bounty but by our example. Our first problem is to save ourselves from the consequences of numerous past and present follies, and on that aspect of our defense problem the work has barely begun.

SUPPLY

Industrial Production

Steel-ingot production, scheduled at 101.3 percent of capacity for the week ended June 10, 1950, was slightly less than that in the preceding week but was 13 percent more than that in the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Percent of Capacity†	95	20	75	27	89	101p
Weekly Cap (Million Tons)	1.38	1.52	1.51	1.54	1.84	1.91
Production (Million Tons)	1.31	.30	1.13	.42	1.64	1.93

Automobile and truck production in the week ended June 5, 1950, in the United States and Canada was estimated at 139,061 vehicles, compared with a revised total of 179,963 vehicles for the previous week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Vehicles (000 omitted)†	125*	50*	103*	27*	98*	139*p

Electric-power production in the week ended June 3, 1950, decreased to 5,631,934,000 kilowatt-hours from 5,893,782,000 kilowatt-hours in the previous week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Billion Kilowatt-Hours†	1.70*	1.38*	2.13*	1.88*	5.02*	5.63*

Lumber production in the week ended May 27, 1950, decreased. *The New York Times* seasonally adjusted index was slightly less than the revised figure for the previous week but was 17 points more than that for the corresponding week last year.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
The New York Times Index†	130	39	96	79	88	105

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

Ratio of Retail Inventories to Sales

The ratio of retail inventories to sales decreased nearly 6 percent during April from the postwar high reached during March. The change was similar to those that occurred during April in each of the preceding 3 years.

The decrease resulted primarily from the unusually large increase in the dollar value of department-store sales (seasonally adjusted) during the month. According to the Federal Reserve Board, the index of department-store sales rose nearly 7 percent during April.[1] The dollar value of department-store inventories (also seasonally adjusted) increased nearly 1 percent during April.

A study of our series of department-store new orders reveals a seasonal pattern that may be helpful in analyzing the over-all department-store situation. The ordering of goods by department stores usually leads the seasonal increases in sales by a few months; consequently, a greater than seasonal increase in new orders suggests that department-store buyers are optimistic with respect to future sales or are endeavoring to accumulate inventories.

We have estimated that the dollar value of sales decreased slightly during May, but there is no indication whether inventories increased or decreased during the month. However, in view of the high level of sales, there is little reason to expect any great change in the ratio during May. Since January, sales and inventories have been at about the same levels as they were in corresponding months of 1949. In view of the unusually great amount of new orders in March, the ratio may not decrease so rapidly this year as it did in the corresponding months of 1949.

DEMAND

Purchasing Media

For the second consecutive month the amount of purchasing media in circulation has increased. At $96,592,000,000 the total in circulation at the end of May was nearly $870,000,000 more than that outstanding at the end of April and was more than $2,700,000,000 ity, gold, decreased $38,000,000 during May, thereby resuming the downward trend that began in September greater than the total last March, when a low for the year was reached. Although the amount in circulation was still $550,000,000 less than the high reached last December, the May figure was $3,000,000,000 more than that reported in May last year and was an all-time high for that particular month.

Purchasing media derived from the money commod- last year. Since the high reached last August, the monetized portion of the Nation's gold stocks has de-

[1]For the fourth year since the war the ratio has reached a high in the early months of the year. Consequently, there is some question whether this consistent pattern reflects a new seasonal pattern of department-store ordering with respect to sales. Prior to the revisions made in mid-1949 the inadequacy of the seasonal adjustments was obvious. Moreover, although the revisions somewhat reduced the extent of the changes shown, the regular timing of the principal fluctuations suggests that the seasonal influence may not have been eliminated. Further revisions are being made at present by the Federal Reserve Board's statisticians, but thus far the changes have not been of great significance.

creased nearly $400,000,000. Except for the slight increases that occurred last January and again in April, the decrease since the August high has been continuous.

Purchasing media derived from the second source, commercial and agricultural loans, decreased for the fifth consecutive month. Commercial and agricultural loans outstanding decreased $200,000,000 during May and were nearly $230,000,000 less than the total reported in May 1949, when business activity was receding.

The seasonal decrease in commercial and agricultural credit has not been so great this year as that which occurred last year. Since the high reached in December 1949, such loans have decreased $750,000,000, compared with a decrease of $2,245,000,000 during the corresponding period of 1949. Presumably the seasonal decrease will be halted in the next few weeks, when harvesting of agricultural products is expected to increase and commercial interests begin making commitments for late-summer and fall goods.

Purchasing media derived from the last two sources, both of which are inflationary, increased during May. Purchasing media derived from the third source increased $100,000,000 and those derived from the fourth or "printing press" source increased more than $1,000,000,000. Thus the gain in total purchasing media during May resulted entirely from the increased amount of inflationary purchasing media placed in circulation.

During May, loans on real estate increased $220,000,000, and other loans (including installment credit) increased $350,000,000. Loans on securities were unchanged during the month.

The net change in the security holdings of the commercial-banking system during May was an increase of more than $500,000,000. An increase of $860,000,000 in the holdings of the other commercial banks more than counterbalanced a $350,000,000 decrease in the Federal Reserve Banks' holdings. May was the first month since January in which the security investments of the commercial banks have increased.

On the other hand, the Federal Reserve banks sold more Government securities during May. As a result, these banks have reduced their holdings approximately $1,600,000,000 since the first of the year.

One recent financial report indicated that as a result of the policy adopted by the Federal Reserve Board, the excess reserves of the commercial banks had been "mopped up." Actually more than $500,000,000 of excess reserves were still available to the banking system in May. On the basis of such excess reserves, a credit expansion of more than $2,500,000,000 would be possible. The banking system as a whole has not yet been forced to liquidate large amounts of investment-type assets in order to expand commercial loans. Furthermore, important credit restrictions such as higher interest rates, increased collateral valuation, etc. have not been imposed to any great extent.

Apparently, the Federal Reserve Board's actions thus far have been intended to counteract the inflationary expansion resulting from increases in real-estate and installment lending and the borrowing from the commercial banks by the Treasury that has occurred. In other words, the Federal Reserve Board has not yet forced the commercial banks to discourage the expansion of bank credit.

Conclusion

During the first half of June, when quarterly tax payments will be due, total purchasing media probably will decrease. (Deposits of individuals and corporations will decrease and the Government's idle demand deposits will increase temporarily.) However, increased amounts of inflationary purchasing media created by the further expansion of real-estate, consumer-installment, and other loans will offset the temporary withdrawal of other purchasing media to some extent. During the last half of the year seasonal increases in commercial and agricultural credit and the expansion of other loans, together with some Government borrowing from the commercial-banking system, are expected to increase the amount of purchasing media in circulation perhaps to an all-time peak.

PRICES

Commodities at Wholesale

(August 1939=100)	*1949 June 8*	*1950 June 1*	*1950 June 8*
Spot-Market Prices (28 basic raw materials)	233	267	269
Commodity Futures Prices (Dow-Jones Daily Index)	258	307	311