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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Progress of the Korean War

An estimate of the military situation in Korea is a prerequisite to judging the desirability and probable effectiveness of the courses of action having economic significance that have been proposed by the President. Therefore, with the aid of such expert military advice as is available to us, we have estimated the military situation and present below a summary of our conclusions.

The Military Situation

Although the news from the front has been discouraging for more than 3 weeks, we are convinced that a fundamental and marked change for the better has occurred. No longer is there a real danger that the American forces will be driven from Korea, unless Russia decides to use sea, air, and ground forces available in Asia. Even then, we doubt that the American forces could be forced out if the United States chooses to keep them there. (The communique from General MacArthur's headquarters published within 24 hours after the foregoing was written confirms this analysis.)

Earlier reports of the ineffectiveness of American troops should be discounted. Platoons and companies were not expected to win battles against regiments and divisions. When the American ground forces have been grouped in sufficient numbers to form infantry-artillery combat teams, their effectiveness has been apparent and decisive.

The terrain east and south of Taejon to the port of Pusan is vastly more favorable to the defense than were the relatively flat and open fields north of Taejon. In mountainous areas the South Korean forces have been, and probably will continue to be, effective on the defense; and, through the principal passes in the mountain barriers, American forces can be expected to conduct successful offensive operations.

We do not mean to imply that the war in Korea is virtually over or that no reverses are ahead. Months may be required to destroy the principal armed forces of the enemy. However, the troops under General MacArthur now are, or soon will be, in a position to attack. We confidently expect the military operations during the next few weeks and months to be much more encouraging to the American public than those of the past 3 weeks.

The President's Proposals

The President has recommended to Congress legisla-

tion intended to aid the war effort. His requests were in general accordance with the expectations of legislators and the public, but some of the specific recommendations were surprising.

Mr. Truman's accompanying comments revealed awareness of the fact that armed attack may occur in any part of the world, and the statement as a whole indicated that the "unpleasant potential facts of the future" now are being faced. Furthermore, the danger mentioned in last week's bulletin, frantic overzealous endeavors inappropriate to the actual situation, apparently is being avoided except in a few specific instances mentioned in the paragraphs that follow.

Military Manpower and Funds

The President recommended that all limitations on military manpower be removed. He also requested authority to call such members of the National Guard and reserves as may be needed in the war effort. The wisdom of giving the President authority to expand the personnel of the armed forces as much or as little as he sees fit is questionable. Only 3 weeks ago Mr. Truman was assuring the American people that ground forces would not be needed in Korea. We see no reason to believe that equally serious underestimation of future needs may not be made, nor is there any assurance that those who have blundered so greatly at one extreme will not blunder in the direction of the other extreme as well. Would it not be better to have Congress investigate the requirements and fix new minimum and maximum limits for military manpower and, in the meantime, authorize such temporary increases as may be advisable?

Equally important is careful Congressional scrutiny of the \$10,000,000,000 additional expenditures suggested. Even in World War II, various elements of the armed services engaged in virtually unrestrained campaigns of "empire building," with results definitely harmful to the war effort. Experience indicates that the Nation will get the most for its defense money only if there is thorough and continuing scrutiny of the expenditures by the appropriate Congressional committees. We believe that authority to spend without limit should be temporary for a stated period, during which the actual requirements presumably can be more accurately ascertained.

Other Recommendations

Authority to establish priorities for and to allocate essential materials was requested. Such controls presumably are necessary and should be authorized. However, the additional request for authority to control the

use of essential materials otherwise than for war needs is not essential to the war effort and does not seem wise. As we suggested in our discussion of wartime controls last week, supply and demand in the market places probably will provide a more effective allocation of materials for civilian use than can Government-imposed regulations.

Limitations on credit expansion also were sought. This request indicates that one source of inflation is recognized. Although the means chosen for limiting credit expansion is not so satisfactory, in our opinion, as that already available to the authorities, further inflationary expansion of credit certainly should be minimized. There is a possibility that the restrictions on consumer and real-estate credit will be sufficient to force some deflation and thus counterbalance some of the inflation resulting from the Government's borrowing from the commercial-banking system. Already, the President has exercised the authority available to him in order to curb real-estate loans.

In addition, the President requested that action be taken that would prevent inventory hoarding. He also recommended legislation that would provide loans to business in order to facilitate production of military goods.

Although specific measures were not presented, the President emphasized the need for increased taxes and promised to submit definite proposals shortly. He correctly asserted that paying the increased costs of national defense by means of avoiding or postponing other expenditures and by increasing taxes are the most effective means of avoiding further inflation. His emphasis on new taxation as a means of preventing profiteering suggests that revival of the so-called "excess profits taxes" may be contemplated; but elsewhere in his message he said, "* * * we must make sure that the economic strength, which is at the base of our security, is not impaired but continues to grow." Taxes penalizing the more successful corporations are a most effective means of preventing the Nation's economic growth. This fact should be remembered when the new taxes are levied.

Price and wage controls were not recommended, and we see no reason to believe that they could be helpful. The recent flurry of hoarding will quickly die down if markets are left free. Some marked price increases may occur, but they will not last long except in those instances where higher prices are essential in order to stimulate additional production that is really needed.

In this connection, we consider threats of rationing and other controls most unwise. One way to force a

bank to close its doors is to announce to depositors that, if they don't stop asking for their money, they will get only a rationed portion of their deposits; on the other hand, the way to stop a "run" on a bank is to pile currency on the counters and invite all depositors to come and get their money if they want it. Surely we have enough foodstuffs in the Government's bins and caves and enough sugar piled on the island of Cuba so that the Government could simply announce, "Come and get all you want, if you are foolish enough to pay hoarders' prices." Perhaps that would reduce slightly the surpluses that have become such a burden in recent years.

Conclusions

On the whole, we consider the President's initial recommendations sound. Whether the subsequent detailed legislation proposed will be equally sound remains to be seen, but at last Mr. Truman seems to be more aware of the grave potential dangers involved, especially those involving the strength and future growth of the domestic economy.

SUPPLY

Industrial Production

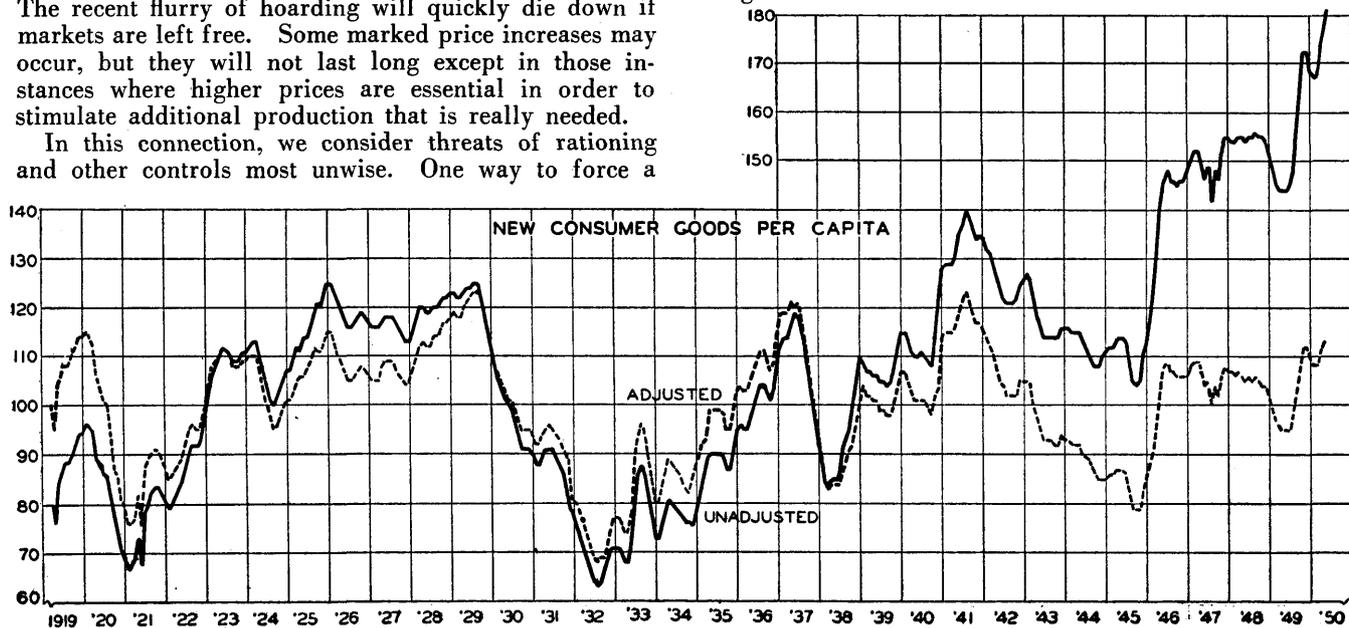
Steel-ingot production, scheduled at 99.4 percent of capacity for the week ended July 22, 1950, was 3 percent more than that in the preceding week and was 31 percent more than that in the corresponding week last year.

	1929	1932	1937	1938	1949	1950
Percent of Capacity†	95	16	83	37	78	99p
Weekly Cap. (Million Tons)	1.38	1.52	1.51	1.54	1.84	1.91
Production (Million Tons)	1.31	.24	1.25	.57	1.44	1.89

Automobile and truck production during the week ended July 15, 1950, in the United States and Canada, was estimated at 202,594 vehicles, compared with a revised total of 137,730 vehicles for the holiday week preceding.

	1929	1932	1937	1938	1949	1950
Vehicles (000 omitted)†	115	46	115	42	156	203p

Electric-power production in the week ended July 15, 1950, increased to 6,006,345,000 kilowatt-hours from 5,379,924,000 kilowatt-hours in the holiday week preceding.



	1929	1932	1937	1938	1949	1950
Billion Kilowatt-Hours†	1.73	1.42	2.30	2.08	5.34	6.01

Lumber production in the holiday week ended July 8, 1950, decreased. *The New York Times* seasonally adjusted index was 10 points below that for the previous week but was 15 points above that for the corresponding week last year.

	1929	1932	1937	1938	1949	1950
<i>The New York Times</i> Index†	135	42*	97*	73*	65*	80*

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

New Consumer Goods Per Capita

Our 3-month moving average reflecting the production of new consumer goods per capita, unadjusted for long-term trend, increased more than 2 percent during May to an all-time high. The index exceeded the previous peak reached in November 1949 for the second consecutive month and in May was 26 percent greater than that of May 1949. The increase since the low reached in May 1949 has been one of the most rapid in the history of the series.

The index adjusted for long-term trend was nearly 2 percent above that for April and exceeded the earlier postwar high reached in November 1949 by nearly 3 percent. Although the increase since the low reached in the spring of 1949 has been 21 percent, the index is still 7 percent below the peaks reached in 1929, 1937, and 1941.

Production of the consumer goods on which our indexes are based increased 3 percent in May. The components that contributed most to the increase in the over-all figure during the month were the 25-percent increase in automobile production and the 12-percent increase in tobacco output. Residential construction and textile production increased slightly during May, and the manufactured-foods component was unchanged. Furniture production decreased 2 percent.

The increase in automobile production during May was followed by a further increase of 19 percent in June. Although output is expected to decrease slightly during July because of a shorter number of working days, plans for August suggest that the June total will be exceeded in that month.

According to the preliminary estimate, residential contract awards reported by F. W. Dodge for the 3 months, April, May, and June, increased slightly. There is some reason to believe, however, that this estimate may be low. In view of the greater-than-seasonal increase in the value of private residential construction during June (reported by the Department of Commerce) and in view of the record number of housing starts, we should have expected the 3-month moving average of residential contract awards for May, in which June data replaced the relatively low March data, to have increased substantially during that period. This expectation may be substantiated by revised data.

Because of the increase in building costs during May, the 3-month moving average of the physical volume of construction apparently decreased. The physical volume is still 18 percent below the all-time peak reached in 1925.

Thus far in 1950 the increase in the index of new consumer goods per capita has been attributable primarily to the 95-percent increase in automobile output and the 17-percent gain in residential construction. Other com-

ponents such as furniture production and food production have remained relatively unchanged. Shoes and tobacco have increased 12 and 21 percent respectively, but neither of these components is heavily weighted in the calculation of the combined index.

Because of the Korean War, further substantial increases in the production of new consumer goods probably will not occur. However, if the war remains a relatively minor effort and is not greatly prolonged, decreases in the production of consumer goods may be small.

DEMAND

Retail Sales

Total retail sales have increased nearly 8 percent from the low reached in February.¹ During May the seasonally adjusted index of the dollar value of sales increased more than 2 percent to a level 5 percent above that of May 1949.

Most of the gain during recent months has been attributable to increased sales of durable goods. More than 90 percent of the gain thus far this year resulted from increased sales of durable goods and only 10 percent from larger sales of nondurable goods. Since May 1949, retail sales of durable goods have increased nearly 17 percent; sales of nondurable goods, on the other hand, have remained almost unchanged.

The National Bureau of Economic Research selected total retail sales as one of the 21 most important statistical indicators of business-cycle changes. However, the series usually lags during both recessions and revivals; consequently, the series is of more value in substantiating peaks or troughs that have already occurred than in forecasting cyclical movements.

If consumer durable-goods production is curtailed substantially during the next several months in order to facilitate rearmament, retail sales may be curtailed. During the first 2 years of World War II the dollar value of durable goods sold at retail decreased nearly 50 percent; on the other hand, the dollar value of nondurable goods sold increased throughout the war. Present indications are that curtailment of durable-goods sales comparable to that from 1941 to 1943 is not probable, unless the war becomes a major one involving Russia.

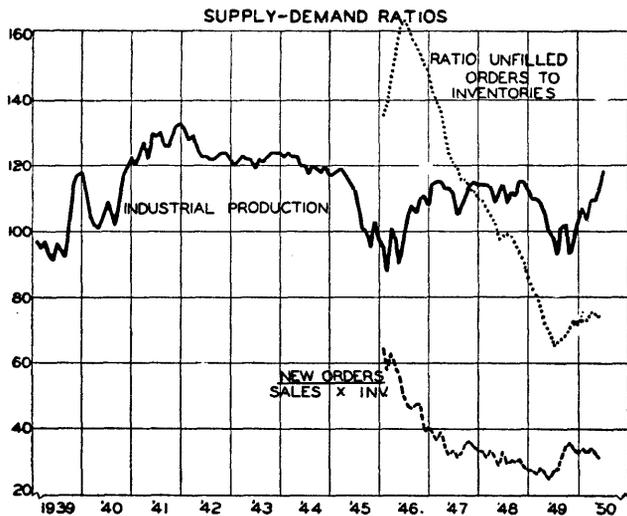
Department-Store Sales

Department-store sales for the week ended July 10, 1950, were 21 percent more than sales for the previous week and were 24 percent more than sales in the corresponding week last year.

Mail-Order and Chain-Store Retail Sales

Sales in the Nation's leading mail-order and chain stores during June were 7 percent more than sales in the corresponding month last year. Automotive chains reported the largest percentage increase followed by the mail-order companies. The data compiled by *The New York Times* are summarized below.

¹The usual chart of retail sales has not been published because revisions are being made in the data. As soon as we have received the revised data, the chart will be brought up to date and published.



Percent Change in Retail Sales for June 1950 vs. June 1949

Mail order	+12
Grocery	+ 3
Variety	+ 3
General merchandise	+ 7
Apparel	+ 1
Automotive variety	+22
Shoes	+ 5
Drugs	+ 2
Men's wear	+ 9

Note: The classes are given in the order of magnitude of dollar sales.

PRICES

Commodities at Wholesale

	1949	1950	
(August 1939=100)	July 20	July 13	July 20
Spot-Market Prices (28 basic raw materials)	236	284	291
Commodity Futures Prices (Dow-Jones Daily Index)	287	337	358

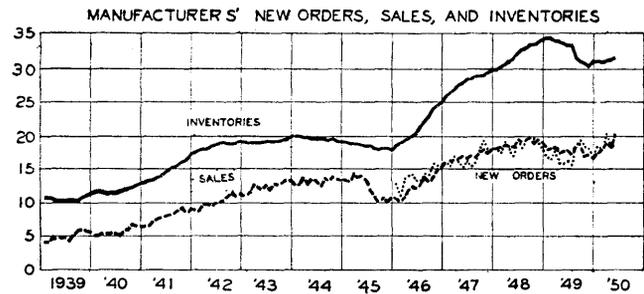
BUSINESS

Manufacturers' New Orders, Sales, and Inventories

Manufacturers' new orders increased nearly 8 percent during May to a level only slightly less than the previous peak reached in March. The dollar value of manufacturers' new orders in May was \$20,000,000,000, compared with \$15,734,000,000 reported in May last year. Although marked fluctuations have occurred during the past several months, the trend of manufacturers' new orders has been upward since last December.

Manufacturers' sales increased during May to a new high. Except for the interruption in April, a continuous increase in sales has occurred since December 1949. The dollar value of sales (seasonally adjusted) for May was \$20,400,000,000, 10 percent more than sales in April and 15 percent more than sales in May last year.

Inventories have been increasing since November 1949 and in May increased nearly 1 percent, the largest increase that has occurred this year. In spite of the moderate increase during the past several months, manufacturers' inventories in May were still 9 percent less than those reported in January 1949, when an all-time high



was reached. The inventory data shown on the accompanying chart include manufacturers' raw materials, goods in process, and finished goods. Although the gap between the sales and inventory series shown on the chart has widened considerably since the end of the war, the present inventory-sales relationship is not unusual. In 1939 inventories ranged from slightly less than twice sales to almost 3 times sales. At present inventories are only 1.6 times sales; and even at the high reached in January 1949, inventories were slightly less than twice sales.

As might be expected, changes in manufacturers' new orders appear to lead changes in many other important statistical indicators. The National Bureau of Economic Research has included the series of new orders for durable-goods industries in its "leading group" of statistical indicators of cyclical changes.² Analyses made by members of the Econometric Institute reveal that manufacturers' new orders for consumers' nondurable goods also lead other cyclical changes. This organization was particularly interested in the movements of such new orders in relation to stock-market trends. The president of the organization stated recently that a "little investigation showed that many of the manufacturers in this field [nondurable-goods industries] were active stock market operators, and that the average small merchant or public investor around the country was apt to appraise the business outlook in terms of his outlook for those goods."

As we have mentioned in previous discussions, the ratio of new orders to sales times inventories appears to have led the revival of industrial production last year by at least 2 months. Since the latter part of 1949 the trend of the ratio of manufacturers' new orders to sales times inventories has been downward. In May the ratio decreased for the second consecutive month.

Changes in the ratio of unfilled orders to inventories also appear to have led changes in industrial activity by several months. This ratio likewise decreased for the second consecutive month in May. However, until the trends of other statistical indicators confirm the movements reflected in the two ratios here discussed, one should not assume that the recent downward trends of the ratios forecast a cyclical business recession.

The increases in manufacturers' new orders in recent months and the probable further increases because of the war suggest that manufacturers' sales will increase further. Consequently, we now expect the trends of the two ratios to turn upward again, at least for a few months.

²See our discussion of the National Bureau's study in the May 15 and June 19 issues of the *Research Reports*. The analysis made revealed that this indicator consistently led business-cycle movements by from 4.7 to 6.9 months.