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RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

The Defense Production Act of 1950

In "The Dangers of Wartime Controls" (*Research Reports,* July 17, 1950) we discussed the possibility that the "pendulum will now swing to the other extreme. In the place of studied nonchalance, we may soon see an exhibition of frantic overzealous endeavor as inappropriate to the actual situation as was the original attitude." We feared "that price, wage, and other controls will be undertaken when they will do far more harm that good to the Nation's economic system and thus to the national defense."

In his special message to Congress on July 19, Mr. Truman requested authority to control credit, allocate strategic materials and facilities, establish priorities, control inventories, control commodity speculation, and make loans to industry. At first, Congress seemed to be willing to grant the authority requested with only minor modifications. However, a change of attitude soon became apparent. Even Mr. Truman, in spite of his earlier stand, agreed to accept a bill granting him stand-by authority for more widespread and stringent controls. The final act, the provisions of which are summarized below, authorizes far more extensive controls than those the President originally requested.

Establishment of priorities and allocation of materials deemed "necessary * * * to promote the national defense" are authorized. The pertinent provisions seem to be sufficiently broad so that the President may ration consumer goods as well as allocate essential raw materials. Accumulation of scarce materials "in excess of the reasonable and normal demands of business or personal or home consumption" is prohibited, and violators are subject to severe penalties.

Any "equipment, supplies, * * * or material or facilities * * * needed for the national defense" may be requisitioned.

Direct loans to business and the guarantee of loans made by public or private financial institutions in the interests of national defense are authorized. This subsection also permits the President to "install Government owned equipment, facilities, processes, or improvements to plants, factories, and other industrial facilities now owned by the United States Government or by private persons."

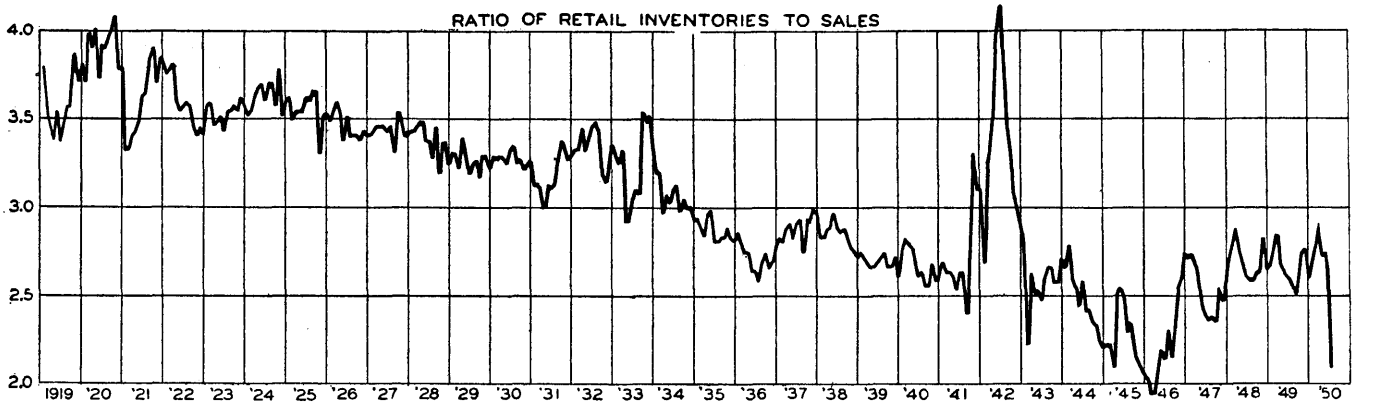
Price controls when the "price of the material or service has risen or threatens to rise unreasonably above the price prevailing during the period from May 24, 1950, to June 24, 1950" may be imposed. (The President is authorized to encourage voluntary action by "business, agriculture, labor and consumers" before imposing direct controls.) Establishment of such controls may be selective; and, "whenever a ceiling has been imposed with respect to a particular material or service, the President shall stabilize wages, salaries and other compensation in the industry or business producing the material * * * ." However, if "ceilings on prices have been established on materials * * * comprising a substantial part of sales at retail and materially affecting the cost of living, the President *shall* impose ceilings on prices * * * generally, and *shall* stabilize wages * * * generally." [Italics supplied.] No ceiling is to be established for any agricultural commodity below the highest of either the parity price or the highest price received for the commodity involved during the period May 24 to June 24, 1950. Prices of rentals for real property, professional services, and books and other published material are exempt from the provisions of the act. Furthermore, special dispensations and adjustments are authorized in special instances at the discretion of the President. Regulation of consumer credit by the Federal Reserve Board in accordance with the Executive Order 8843 issued in 1941 is authorized, as is regulation by the Government of private real-estate credit on all new construction started after August 3, 1950.

A "watch dog" committee, members of which are to be appointed from both houses of Congress, is to be established. The expiration date of the provisions relating to priorities and allocations, requisitioning of materials, and expansion of productive capacity is June 30, 1952. Controls over prices and wages, labor, and consumer and real-estate credit will expire on June 30, 1951.

Effects

Restrictions on consumer credit probably will be imposed immediately by the Federal Reserve authorities. The new regulation presumably will be similar to the wartime Regulation W.

To Subscribers: The response by readers of our special bulletin dated August 28, "The Counterrevolution and American Foreign and Domestic Policy" has been extraordinary. So many readers have requested additional copies for their Congressmen, friends, and business associates that we have decided to reprint this bulletin. By the time you receive this notice, additional copies will be available. If a large number of additional requests are received, we shall make plans to distribute this bulletin even more broadly and shall inform you regarding such plans as soon as they are made.



The Government is expected to call for reports from industry on the amount and types of inventories carried. Wholesalers and retailers may be affected later. Those industries in which aluminum, cement, copper, lead, leather, lumber, paper, rubber, steel, wool, and zinc are important probably will be the first to feel the effects of the priority, allocation, and requisitioning powers. These may be used to an increasing extent as war contracts are issued in the next several months.

In view of the President's repeated assertions that price and wage controls are not needed, such controls probably will not be imposed before the coming elections, at least. Fortunately, the early termination date for these controls (June 30, 1951) lessens the probability that they will be used.

Are Controls Needed?

Priority, allocation, rationing, and requisitioning apparently will be needed only to a small extent unless the situation changes markedly. Defense Secretary Johnson told a House subcommittee that the amount of additional steel required would be only about 4 percent of the Nation's productive capacity; additional copper, 7 percent; and aluminum, 14 percent of productive capacity. Only a relatively small portion of the total output of most industries will be needed, and industry officials have indicated their eagerness to cooperate in the war effort by voluntarily giving priority to all war contracts and expediting the production of war materials.

Price and wage controls are a means of appearing to cope with the effects (rising prices and wages) of inflation. Inflation seems to be the politically expedient way of financing a war because of the "illusion effect" of monetary inflation. However, if the war is financed by other than inflationary means, price and wage controls will not even seem to be necessary.

Fortunately, the Federal Reserve Board seems to be alert to the inflation danger and determined to act effectively. If curtailment of consumer and real-estate credit, together with higher taxes, force some deflation between now and the end of March 1951, the rise in prices may be reversed, at least temporarily. In that event, the more drastic controls that have been authorized may never be used.

The maze of language used in setting forth the provisions of the control act should be sufficient warning of the dangers inherent in such controls. The President is required to be "fair," "reasonable," give "due consideration to relevent factors" almost innumerable, to "prevent or correct hardships or inequities," to "further the American system of competitive interprise," and to "maintain the American way of life" (meaning standard of living?). Therefore, repetition of an earlier comment seems to be warranted.

The danger of elaborate economic controls is twofold. In addition to their harsh interference with the intricate and delicate relationships of a highly complex industrial civilization, they indirectly encourage inflation which in turn augments the apparent need for more controls. The end result in the long run would almost certainly be a serious reduction in the efficiency of the Nation's productive effort. This we cannot afford in a war that may extend over much of the globe and may continue for many years.

SUPPLY

Industrial Production

Steel-ingot production, scheduled at 98 percent of capacity for the week ended September 9, 1950, was 1 percent more than that in the preceding week and was 14 percent more than that in the corresponding week last year. Ordinarily, steel production decreases in the week that includes the Labor Day holiday; but most mills maintained operations at near-capacity levels through the holiday last week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Percent of Capacity†	88	15	73	45	84	98p
Weekly Cap. (Million Tons)	1.38	1.52	1.51	1.54	1.84	1.93
Production (Million Tons)	1.21	.23	1.10	.69	1.55	1.89

Automobile and truck production during the week ended September 2, 1950, in the United States and Canada was estimated at 188,264 vehicles, compared with a revised total of 179,042 vehicles for the previous week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Vehicles (000 omitted)†	109	23	64	22	146	188p

Electric-power production in the week ended September 2, 1950, increased to 6,459,386,000 kilowatt-hours from 6,345,503,000 kilowatt-hours in the previous week.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
Billion Kilowatt-Hours†	1.67	1.46	2.32	2.15	5.54	6.46

Lumber production in the week ended August 26, 1950 increased. *The New York Times* seasonally adjusted index was 1.4 points above that for the preceding week and was 20 points above that for the corresponding week last year. The rail-car shortage in the far West has resulted in shipments lagging production by as much as 10 percent. Production curtailments are already being made in some instances.

	1929	*1932*	*1937*	*1938*	*1949*	*1950*
The New York Times Index†	135	35	83	100	95	115

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

Ratio of Retail Inventories to Sales

The ratio of retail inventories to sales decreased 20 percent during July to within 7 percent of the all-time low reached in February and March 1946. The decrease was the largest single-month decline on record.

Most of the change in the ratio was attributable to the unusually great increase in sales during July; the Federal Reserve Board's seasonally adjusted index of department-store sales increased 22 percent, the index of stocks decreased only 3 percent.

Much the same situation occurred during the first month following the entry of the United States into World War II. In January 1942 department-store sales increased more than 13 percent, and department-store inventories decreased slightly. During the period following the beginning of war, department-store new orders nearly doubled in January, increased further during February, decreased only slightly during March, and remained at a high level in April. Although no precise adjustment for seasonal variations has been made, these changes indicate that demand for goods by department-store buyers increased substantially during these 4 months. Shipments of goods to department stores, however, did not reach a peak until March and continued at a high level through June. From the end of January through June, stocks increased 34 percent and sales decreased 12 percent; the ratio of retail inventories to sales rose 54 percent.

The relatively small decrease in inventories during July, in spite of the great increase in sales, suggests that department stores not only increased their orders substantially but that deliveries were quickly made by manufacturers and wholesalers. However, there is no indication thus far that department-store buyers have become overoptimistic. In 1941 there was little question that the war would be long and that there would be a substantial curtailment of consumer-goods production; consequently, department stores accumulated substantial inventories. In 1950 business analysts have stressed the fact that no great decrease in consumer-goods production should be expected as a result of the Korean War. If this opinion prevails among department-store buyers, a repetition of buying on the scale that occurred early in 1942 does not seem probable.

In view of the large consumer purchases based on credit (see "Purchasing Media" in this bulletin), the Federal Reserve Board's credit restrictions may cause a substantial curtailment of sales during the next few months. Of course, such a development would tend to raise the ratio of inventories to sales. On the other hand, there is a slight probability that hoarders of currency and demand deposits may choose to hoard goods instead. Even a relatively minor "flight from the dollar" probably would sustain sales at high levels for some time.

On the basis of our preliminary estimate of sales during August, a 15-percent increase in inventories would have been necessary to raise the ratio to the June level. In view of the fact that such a gain in inventories probably did not occur during August, the July decrease in the ratio presumably was not entirely counterbalanced last month. Moreover, if department-store buyers have not repeated the large-scale buying that occurred during the first half of 1942, the ratio of inventories to sales probably will not rise to the peak levels of 1942.

DEMAND

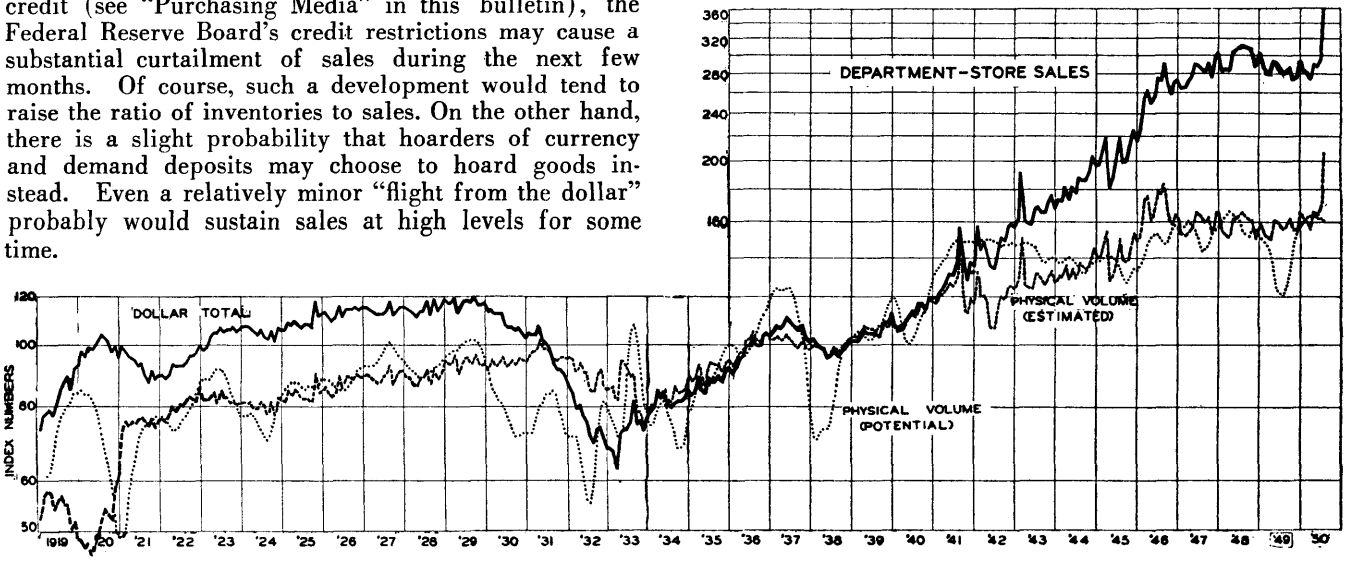
Department-Store Sales

The seasonally adjusted department-store sales index (based on dollar value) increased 22 percent during July, the largest single-month increase on record. The sales index was 29 percent above that for July last year and was 16 percent above the previous all-time high reached in July 1948.

Similarly, the estimated physical volume of department-store sales reached a new high in July. Although prices of goods sold in department stores increased slightly, the estimated physical volume was 21 percent above that for June and was 31 percent above that for July 1949.

Our index of the potential physical volume of department-store sales (based on the production of goods usually sold in department stores) decreased 1 percent during July. Of course, the gap between the estimated and potential sales series increased greatly, which would usually indicate that department-store inventories decreased markedly. However, department-store orders apparently were filled almost immediately from inventories of wholesalers and manufacturers; consequently, department-store inventories decreased only 3 percent during July.

Of interest is the fact that the dollar value of sales (before seasonal adjustment) actually decreased slightly during the month. However, because the Federal Reserve Board's seasonal adjustment allows for approximately a 17-percent decrease in July sales from the June total, the seasonally adjusted index of sales increased substantially during July.



In view of the probable curtailment of buying as a result of consumer-credit restrictions and increased taxes and the possibility that many consumers have anticipated their near-future needs, further decreases in department-store sales (after seasonal allowances are made) in the next few months would not be surprising.

Latest Weekly Data

Department-store sales for the week ended September 2, 1950, were 8 percent more than sales for the previous week and were 5 percent more than sales in the corresponding week last year.

Purchasing Media

The amount of purchasing media in circulation increased $1,105,000,000 during August to $98,417,000,000 from the revised July figure of $97,312,000,000. The August total equaled the all-time high reached in December 1947 and was 4 percent more than that reported in August last year. Since the March low the amount of purchasing media in circulation has increased $4,528,000,000, nearly 5 percent. The increase has been attributable primarily to increases in purchasing media derived from the second and fourth sources.

Purchasing media derived from the money commodity, gold, decreased during August to $22,711,000,000, the lowest level since August 1948. Since the high reached in August 1949, the purchasing media derived from this noninflationary source have decreased $849,000,000, nearly 4 percent. During the week ended August 23, gold holdings decreased $144,000,000, one of the largest weekly decreases in recent years. The change resulted from the conversion of dollar holdings into gold by foreign central banks.

For the third consecutive month purchasing media derived from the second source (commercial, industrial, and agricultural loans, which are noninflationary) increased. The 4-percent gain of $871,000,000 was the largest monthly increase since October 1947. Since the 1950 low was reached in May, the purchasing media derived from these loans have increased $1,671,000,000, nearly 9 percent.

Purchasing media derived from the last two sources combined, both of which are inflationary, increased during August. Purchasing media derived from the third source increased $754,000,000, and the amount derived from the fourth source increased $42,000,000. (As a result of the changes described above, the Harwood Index of Inflation leveled off in August. Our preliminary figures reported 2 weeks ago had indicated a small gain.)

Since March, loans on real estate, securities, and other loans (all of which create inflationary purchasing media unless balanced by new savings) have increased $1,289,000,000, $56,000,000, and $1,766,000,000 respectively; the combined total gain exceeds $3,000,000,000.

There have been no new developments in the battle between the Treasury and the Federal Reserve Board since publication of our article "The Harwood Index of Inflation" in the August monthly bulletin. Although the Federal Reserve Board apparently is cooperating with the Treasury in the latter's refunding operations and will continue to support the Government short-term security market, the Board presumably has not abandoned its efforts to force some deflation.

In spite of the war, no great increase in Government expenditures is expected immediately. The cash surplus of the Treasury is expected to be even greater this September than it was in September 1949; consequently, the decrease in purchasing media available during September may be even greater than that during the corresponding month last year. Moreover, if the Federal Reserve Board's new restrictions (on installment and other lending) are sufficiently stringent, the purchasing-media total may not increase in October. After that month, increases in individual's withholding taxes and quarterly tax payments of corporations may be more than counterbalanced by increased expenditures for national defense; consequently, the seasonal increase in purchasing media to an annual peak in December may occur again this year.

PRICES

Commodities at Wholesale

(August 1939=100)	*1949* *Sept. 7*	*1950* *Aug. 31*	*1950* *Sept. 7*
Spot-Market Prices (28 basic raw materials)	251	320	326
Commodity Futures Prices (Dow-Jones Daily Index)	272	388	396