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COMING EFFECTS OF CURRENT EVENTS

Wanted: Lower Prices to Help Restore Prosperity

The automobile industry grew from its infant status among the Nation's industries to its present giant proportions in large part by taking advantage of what economists call a highly elastic demand. However, to judge by recent actions of some of the principal manufacturers, those companies now are managed by men who never heard of the principle on which earlier successes were in large part based. We refer to recent news reports to the effect that dealers are being threatened with loss of their franchises if they presume to sell new cars at a low margin of profit to other dealers who are selling new cars at cut prices.

One might think that the top-management teams in Detroit had not yet heard the news that you can walk into the showroom of practically any dealer in any make of car and obtain a 10- or 15-percent or larger discount for cash. In any event, when top management attempts, as now seems to be the situation, to avoid sharp price competition, especially during a recession, they not only appear to have adopted an ostrich-like stance but also appear to have forgotten some lessons the industry learned in its youth.

The economists' notion of elastic demand is neither highly technical nor difficult to understand. Briefly, if a price reduction resulted in an increase in the dollar total of sales, the economists would say that demand was elastic. If, on the other hand, a price reduction resulted in a lesser dollar total of sales, demand would be classified as inelastic. Similarly, if the dollar sales total increased in spite of a price increase, demand would be considered inelastic, and vice versa.

For many years, in fact almost since the beginning of the automobile industry, there has been ample reason to believe that demand for automobiles has been highly elastic. Of course, a similar situation has prevailed for numerous other, perhaps for nearly all, American products manufactured for individual consumers.

Time and again, the automobile manufacturers found that price reductions so greatly stimulated demand as to make possible more efficient production followed by further price reductions, etc. For many years there appeared to be no limit to the operation of this simple principle. We assume that the great inflation of the past decade with the resulting huge volume of dollars chasing goods accounts for the fact that rising prices in re-

cent years had not earlier reduced the total demand for cars.

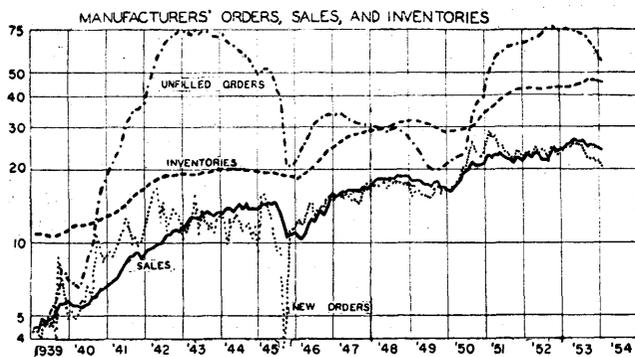
Now that the materials shortages of the World War II and Korean War periods have been largely overcome and now that inflation has been retarded even if not yet stopped or reversed, it would seem to be time for application again of the lessons learned earlier. We suspect that a manufacturer of automobiles, for example, would find himself better off in the long run if he continued production at or near his most efficient rate and sold his product for what he could get. Curtailing operations every other week or reducing to 3-day weeks can be very costly. Only the immediate out-of-pocket costs of materials and wages are saved; the overhead costs incidental to the large capital equipment continue. With increasing automation and the resulting larger capital investments involved, overhead costs become a larger portion of the total.

Lost also is the future business that would result from a larger number of owners to buy parts in later years and the larger number of prospects for the cars of a particular company at a later date. Satisfied owners have long been the best prospects for practically all makes of cars.

The precise savings versus losses that would result for any particular company could be estimated only by detailed studies; but, for the automobile industry as a whole, approximate figures are available. In recent years the portion of the industry's sales dollar paid to production employees (as distinguished from clerical and other overhead employees) has been about 20 percent. Apparently, expenditures for raw materials have been on the order of 20 to 25 percent of each dollar received from sales. Therefore, it would appear that less than half of the industry's costs are saved during sporadic shutdowns.

A simple example will illustrate the point made here. We assume that costs totaling \$100,000 in a week result in the production of 60 passenger cars sold to dealers at \$2,000 each for a total of \$120,000. By curtailing to a 4-day week, the company would save about one-half of one-fifth of \$100,000, or \$10,000. Presumably, 48 cars would be produced and sold for \$96,000, yielding a gross profit of \$6,000 instead of the \$20,000 previously obtained.

Now the demand for cars may be sufficiently elastic so that a price reduction of, say, 10 percent would result in an increase of from 12 to 13 percent in the dollar total of sales. In that event, the company would sell 60 cars,



earlier. Manufacturers' new orders during January were nearly 30 percent below the record total reached in January 1951.

The seasonally adjusted dollar value of new orders for durable goods (one of the eight "leading" statistical indicators of business-cycle changes chosen by the National Bureau of Economic Research) decreased nearly 17 percent during January to a level 36 percent below that of January 1953. The decline was a sharp break from the gradual decline since August 1953. The seasonally adjusted dollar value of new orders for nondurable goods decreased 2 percent during January.

The seasonally adjusted dollar value of manufacturers' sales, which decreased nearly 1 percent during December, decreased nearly 2 percent during January to \$23,700,000,000. The January figure was 10 percent less than that for April 1953, when the record for a single month was established. The January decrease was of about the same order of magnitude in both the durable-goods and nondurable-goods industries.

Unfilled orders (not adjusted for seasonal variations), which have been decreasing since their alltime high was reached in September 1952, decreased 4 percent further during January. Unfilled orders for durable goods decreased something more than 4 percent; unfilled orders for nondurable goods increased slightly.

The seasonally adjusted dollar value of manufacturers' inventories, which have been decreasing since September 1953, continued their decline through January. The January decrease was somewhat greater than that for December but still was less than 1 percent for both durable and nondurable goods.

According to our revised series on manufacturers' inventories and sales, the ratio of manufacturers' inventories to sales, which had been increasing since April 1953, rose 1 percent further during January to a level 8 per-

cent above that of a year earlier. The January figure was 2 percent below that of December 1951, when an all-time high was reached; but it exceeded by 8 percent that of May 1949, when the ratio reached a peak during the 1949 recession. The rising trend of the ratio, in conjunction with the falling trend of manufacturers' inventories, suggests that manufacturers have not succeeded in reducing their inventories as rapidly as their sales have decreased.

Until new orders for durable goods increase, we shall not expect an early improvement in general manufacturing activity.

Ratio of Retail Inventories to Sales

Our preliminary estimates indicate that the ratio of retail inventories to sales, which increased 1 percent during January, decreased 2 percent during February. The February ratio was 1 percent below that of a year earlier, 3 percent below the average for 1953, and 9 percent below the 1953 high reached in September. The seasonally adjusted index of department-store inventories, which decreased 2 percent during January, is estimated to have been unchanged during February.

The seasonally adjusted index of department-store sales, which decreased 4 percent during January, increased 2 percent during February. Consequently, the ratio, which is derived by dividing the inventory index by the sales index, decreased 2 percent during February. February inventories were 4 percent below those of February a year earlier and 8 percent below the average for 1953.

The dollar value of new orders placed by department stores during January (later data are not available) was about 1 percent more than that during December but was nearly 3 percent less than that during January 1953. Although there has been no clear seasonal change in new orders from month to month during recent years, the increase in January may have been somewhat smaller than usual.

The dollar value of outstanding orders increased 28 percent during January. However, outstanding orders at the end of January were 19 percent less than those of January a year earlier.

The dollar value of goods received by department stores during January decreased 36 percent, compared with a decrease of 17 percent during January 1953.

The continued caution of buyers in placing new orders suggests that a further decrease in the ratio of inventories to sales during the next few months is probable unless an unexpectedly large decrease in sales occurs.

