AMERICAN INSTITUTE for ECONOMIC RESEARCH

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WEEKLY BULLETIN

June 5 1944

RESEARCH REPORTS

COMING EFFECTS OF CURRENT EVENTS

Wall Street and the War

The trend of the stock-price averages presumably reflects the combined opinion of speculators and investors regarding the factors shaping the value of common-stock shares. The two major influences determining stock-market levels are corporate earnings, present and in prospect, and the public's buying power, which can generally be measured by the volume of purchasing media available. It is conclusively shown (see the Institute's chart "Sources of Purchasing Media," May 15, 1944 bulletin, page 79) that the latter condition is favorable for active speculation. The first influence is dependent on the course of the war.

During the month of May, when the threat of invasion was being held over Germany by the United Nations, average prices of issues listed on the New York Stock Exchange moved upward, although there was no evidence of active speculation. Inasmuch as it was not a speculative movement, it was probably not primarily motivated by existing inflation. The market's behavior is subject to more than one interpretation, but the most probable one appears to have favorable implications. If the consensus of opinion anticipated unsuccessful not to say disastrous attempts to breach Hitler's fortress, this conclusion could not by any stretch of the imagination be viewed as helpful for stock values. The action of the market clearly reflects confidence in our ability to win, although less light is cast on the probable duration of the struggle.

The war has now lasted so long that the effects of the sudden establishment of peace in Europe would be greeted more favorably than it would have been a year or more ago when there were occasional "peace scares" in the stock market. There is a growing realization that a war is not a bonanza that will make and keep everyone wealthy. Stock-market strength now is more likely to indicate belief in the early success of our armed forces, rather than in an extended stalemate.

If this interpretation of stock-market behavior is well-founded, it is evident that confidence in an early victory is stronger in England than it is here. The London market has exhibited a stronger tone than has the New York market during the past month. After nearly five years of war, the British are more inclined to look on victory as a favorable development than we are. Of course, it may be that English investors are so impressed with the weight of material and personnel assembled on their island for the European onslaught that they have acquired an exaggerated idea of its invincibility. However, stock-market strength in New York and London in some measure supports the hope that Germany is nearer defeat than responsible military leaders are willing to admit.

The Individual Income-Tax Amendments

If the tax experts, whose professional assistance was in heavy demand last March to straighten out the confusion of laymen making individual returns, anticipated the substantial loss of this business, they have no doubt been reassured after studying the 1944 amendments. The process of dealing with the Federal tax collector remains difficult for all individuals having incomes exceeding $5,000 per year and for those whose incomes from "sources other than wages subject to withholding" exceed the extremely modest amount of $100. In fact, income taxpayers falling within these classifications will have a new puzzle to solve, only slightly less complicated than the one over which they may have achieved some degree of mastery early this year.

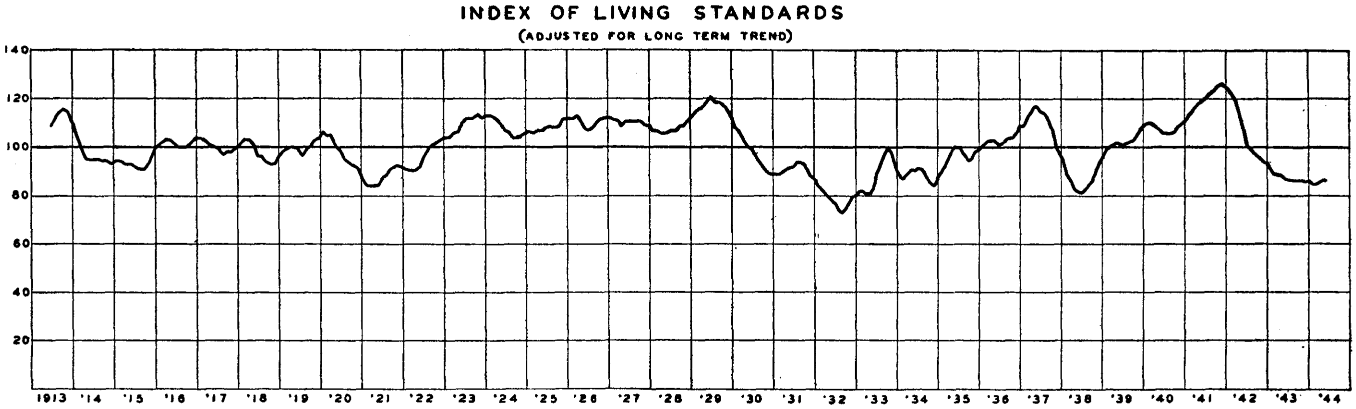
The extent to which the new individual income-tax amendments will affect middle-class taxpayers can be determined only after an extended process of analysis, but a few examples indicate that payments by the majority within this group will be increased as a result of the 1944 Act. The chief beneficiaries of the amendments appear to be wage earners claiming numerous dependents.

BUSINESS

Index of Living Standards

The Institute's index of living standards, shown in the chart on page 90, reflects changes in the per capita volume of consumer goods produced in the United States. It is a six months' moving average plotted at the sixth month to allow for the normal time required for such goods to reach the hands of consumers. It is adjusted for long-term trend by adapting "weights" given to the component series of the index each year, so that each item has an influence proportional to the value of the year's production.

The index for May is 87.9 per cent of estimated normal. This represents an extremely small advance from the April index, which was 87.8. However, the index in May was a full point higher than it was in February this year, when the lowest level for the war period was reached.



Following our entrance into the conflict, the production of consumer durable goods was reduced by war conditions below the levels existing during the lowest point of the industrial depressions of 1921, 1932–33, and 1938. After more than two years, during which time the civilian population has been deprived of most durable goods, the effect of the deterioration of existing equipment is becoming more pronounced. No substantial relief can be expected while the European conflict is in its present phase, and the public will experience difficulty in maintaining existing facilities in service.

The production of consumer nondurable goods has been maintained at a level somewhat above estimated normal during the past two and a half years. However, as the domestic civilian population knows, only a portion of this production is available to civilians. Requirements of our armed forces for food, clothing, and other nondurable goods are greatly in excess of the amounts required for the same number of civilians. Apparently, substantial quantities of nondurable goods are being shipped to associated nations in the form of lend-lease aid. At the present time, the supply situation for cotton textiles has become more unfavorable, and shortages of this important class of nondurable goods appear to be inevitable during the next few months.

The rise in the index of living standards during the past three months should probably be considered evidence of stabilization rather than of the beginning of a strong upturn. The latter movement can be made possible only by the collapse of one of our two major enemies. Even if Germany is defeated during the next few months, the index of living standards may remain not far from its present level during a period when industry is adjusting itself to the new conditions that will follow the defeat of one of our antagonists.

THE FUNDAMENTALS

Supply

It is estimated that the steel-ingot production rate remained unchanged last week at the preceding week's rate of 97½ per cent of theoretical capacity. *The Iron Age* stated: "Although there appeared to be some hesitancy in steel buying during the past week, this factor was by no means taken as an indication of a basic slowing up in order volume. More properly it was being interpreted as a slight reluctance on the part of steel buyers to make further commitments until the military situation became more clarified. Order volume on the whole was still close to actual shipments in the past week, and any decline in total backlogs was said to be slight or of no consequence. Some steel centers were still complaining that carry-overs will represent one of their major troubles in months to come. This was particularly true, it was said, on plates, shapes, and semi-finished steel."

	1929	*1932*	*1937*	*1938*	*1943*	*1944*
Per Cent of Capacity	96.5	22.0	75.0	26.0	97.0	97.5

(Latest 1944 weekly data; corresponding week earlier years.)

The increase of 7.6 per cent in electric-power output last week, compared with production in the corresponding week of 1943, was slightly more favorable than the record for recent preceding weeks. The rate of increase in power generation has moderated this year, but the industry is now producing 85 per cent more power than it was prior to the outbreak of war in 1939.

	1929	*1932*	*1937*	*1938*	*1943*	*1944*
Billion Kilowatt-Hours	1.69	1.31	2.13	1.88	3.99	4.29

Lumber production increased contraseasonally last week, and the adjusted index advanced from 106.6 to 107.5 per cent of the 1935–1939 monthly average. The industry is expected to make special efforts to avoid seasonal curtailments this year in order to meet the Government demand for lumber.

	1929	*1932*	*1937*	*1938*	*1943*	*1944*
New York Times Index	122.5	39.9	95.9	62.1	111.7	107.5

Demand

Judging by the past performance of the comprehensive index of retail sales compiled by the United States Department of Commerce, periodic War Bond campaigns have no appreciable effects on public spending. It therefore seems reasonable to anticipate that demand for consumer goods by the civilian population will remain strong this month when the Treasury launches its campaign to sell $16,000,000,000 of new public debt. On the other hand, the initiation of a major attack on Europe from British bases would probably result in some temporary slackening in retail sales.

Prices

The sensitive wholesale commodity price indexes moved within a narrow range last week. Moody's

Spot Commodity Price Index was 250.7 on May 25 and was 250.9 on June 1. The Dow-Jones Index of Commodity Futures closed at 95.13 on May 25 and at 95.71 on June 1.

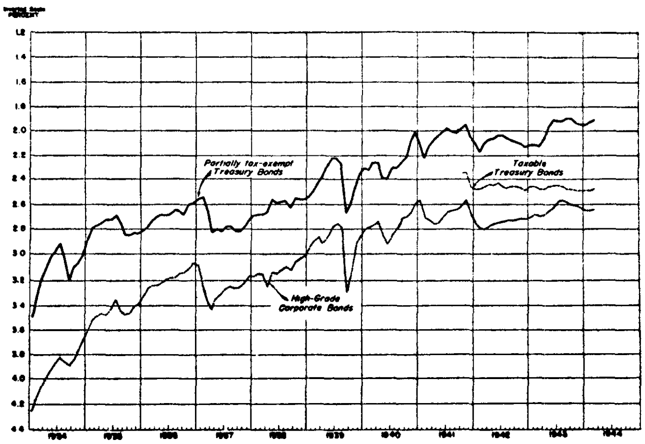
FINANCE

The Trend of High-Grade Bond Yields

The easy-money policy that the Government has pursued throughout most of the past decade has resulted in depressing yields on high-grade bond issues to extremely low levels. High-grade corporate bonds early in 1934 could be obtained that would yield about four per cent, and equivalent issues now can be obtained to yield only about 2½ per cent. Average yields on United States Government issues have been reduced from about 3½ per cent to two per cent during this period.

The effect on dividends paid by savings institutions has of course been drastic. Interest on savings-bank deposits has been reduced to one-half to one-third of the rate that prevailed ten years ago. Dividends declared on insurance premiums have been reduced drastically. The reduction in bond yields has been reflected in lower mortgage rates, and this development has benefited some property owners, while it has reduced the return on investments of savings institutions and of individual investors.

HIGH-GRADE BOND YIELDS



The accompanying chart, that was prepared by statisticians of the Board of Governors of the Federal Reserve System, shows the yield on high-grade bonds presented as an average in inverted scale. The chart shows the trend of high-grade corporate bonds during the past decade and the trend of Government issues during the same period. The yield on fully taxable treasury bonds is shown since these were first issued.

Subject to minor fluctuations, the general trend of the chart has been upward during the past ten years, with the exception of declines that occurred in 1937 and in 1939. The first decline in 1937 was occasioned by the Government's deflationary policy of raising reserve requirements that was instituted in 1936 but that did not take full effect until early in the next year. This policy was reversed in 1937, and high-grade bond yields declined until the outbreak of war in Europe in 1939. The initial response to the war was a relatively sharp advance in high-grade bond yields, but this was short-lived, and the average made a new high level (on the inverted scale) within a reasonably short period, exceeding the 1939 high point in 1940.

During the past two years, yields on high-grade bond issues have been generally steady, although there was a decline in the curve on the inverted scale early in 1942 that was recovered after a period of more than one year. The course of bond yields during the war period is less interesting than the probable course that will be taken during the next few years.

Institutional and individual savings investors now hold high-grade bonds, either purchased at a high level or that are currently selling at a high level. Low returns are being accepted because of market conditions. If a drastic change in interest rates is in early prospect, it is obvious that high-grade bond issues should be liquidated, inasmuch as the return is now at an extremely low level in relation to the long-term (measured by centuries) rate. During the past two years, the yield on high-grade bond issues has either stopped advancing or has reached a level where approximate stabilization may be expected. Ultimately, the curve of high-grade bond yields will probably be reversed. However, this should not be considered as being imminent, because it is essential for the Treasury to maintain low yields on high-grade bonds as long as the Federal debt continues to increase.

It is virtually certain that the great powers of the Federal Government over interest rates will be exerted in the direction of low returns for the next few years. Short-term money rates will undoubtedly be maintained at an extremely low level, and long-term bond rates will rise only slowly. The prospects for the next few years are therefore for a plateau in high-grade bond yields, subject to only intermediate fluctuations, such as have occurred since early in 1941.

NOTE: Last week, the following letter was received by the editor of Research Reports, together with the two letters to which reference is made. Because of space limitations, we are publishing only one of the accompanying letters in this bulletin. The other letter will be reproduced in a subsequent issue.

Somewhere in New Guinea
15 May 1944

The Editor, "Research Reports"
American Institute for Economic Research
54 Dunster Street, Cambridge, Mass.

Dear Sir:

In the March "Scientific Monthly" there appear two articles purporting to be of economic significance. The first attempts to show that the undernourishment of a major portion of the human race is attributable to the niggardliness of nature and the backwardness of scientific progress in agriculture. The second article asserts that "free enterprise tends to pass over into plutocracies, dictatorships, or militaristic empires," and implies that the salvation of the United States depends on our acceptance of the totalitarian system now existing in Russia.

Because of the high standing of the "Scientific

Monthly," it is inevitable that these articles will be given much weight by persons unfamiliar with the scientific method. They naturally will assume that the mere inclusion of an article in the "Monthly" is to some extent a guarantee that the scientific method has been successfully applied by the author.

As I have pointed out in the accompanying letters to the Editor of the "Scientific Monthly," the two articles provide little better than gross caricatures of the scientific method. Each is clearly fallacious and most unscientific in character. It is not too much to say that work of the character found in these articles is one of the most compelling reasons that many scientists even doubt the applicability of the scientific method to the social sciences.

However, the real difficulty is not the inapplicability of the scientific method, but the ignorance of its processes so prevalent among the many pseudoscientists who have long taken advantage of the immaturity of the social sciences, just as all manner of quacks, including many who deceive themselves no less than others, were far more prevalent in the field of medicine when that science was young.

It seems to me that there is an obligation borne by organizations such as the American Institute for Economic Research to expose the "quacks" in the social sciences, especially in the field of economics. I therefore hope that you can find room for the inclosed letters in the Research Reports.

Inasmuch as I do not desire personal publicity, I ask that my name not be used except as you find desirable in connection with these letters.

Sincerely,

(Signed) E. C. Harwood, Colonel, C. E.

Somewhere in New Guinea
15 May 1944

The Editor, "The Scientific Monthly"
Smithsonian Institute Building
Washington 25, D.C.

Dear Sir:

The March "Scientific Monthly" includes an article, "The New Henry George," by Dr. G. R. Davies. I realize that the Editor may have published this article in order to present a striking example of the absurd conclusions often reached by those unfamiliar with the scientific method, especially in the social sciences. However, I cannot but feel that this intent, if such it was, may not be recognized by many of your readers who are not themselves thoroughly familiar with the methods of science.

In the second paragraph of the article, Dr. Davies says, "When the Russians adopted modern cost accounting methods for their ambitious corporate system, they made the simple discovery that the cost of human services — wages of management and labor — by no means equaled the value of produced income." (I assume that the phrase "value of produced income" refers to the value of the resulting goods and services.)

It is well-known that the "cost of human services," that is to say, the wages and salaries paid by the state as the employer in Russia, are determined by the state. One works at the rate established by the government, or starves. It is also well-known that the selling prices of goods and services (such as train fares), are also determined by the state. In view of this situation, what possible scientific value can there be in the "discovery" that total wages and salaries paid are less than the aggregate selling price of the product? By lowering wages, or by increasing prices, or by a combination of both, the state can keep for its own uses any portion of the total product desired, short of that needed to induce the human beings involved to reproduce their kind and continue the process.

In view of these elementary, and I think obvious, relationships, the "discovery" described by Dr. Davies should hardly be considered a discovery in the scientific sense of the word. Surely, the fact that a totalitarian state chooses to retain for its own uses some of the products of its mines, farms, and factories does not add anything new to our knowledge; every high-school student must have been aware of this simple fact.

In view of the weakness of the article's foundation, the remainder of it does not warrant further serious consideration as a scientific analysis, which I assume the author intended it to be. However, it is desirable to point out that Dr. Davies has lumped together as "capital equipment" both "real estate and machines." Real estate of course includes both land and the buildings erected on it. Thus, he includes land as part of "capital equipment," although this fallacy (which embodies a contradiction of terms) was perhaps more clearly exposed by Henry George than by any other writer before or since. This, together with comment in the article referring specifically to the views of Henry George, suggests that Dr. Davies has not troubled to read Henry George's writings, but has gained only a second-hand and I fear a distorted knowledge of the views of that eminent social scientist.

The sentence, "But at least it ('the taxing power of capital') emphasizes the truth of the traditional religious principle that wealth is a trust fund" seems to be a wide departure from scientific analysis. Is, then, the large income received by a Mary Pickford, for example (which I assume Dr. Davies would classify as "wealth"), to be regarded as a "trust fund"? If so, "the taxing power of capital" does not account for it.

As final evidence of the inconsistencies that inevitably result from failure to apply the scientific method, it may be noted that in the fourth-from-the-last paragraph Dr. Davies correlates "diminishing investment returns" with "depressions common and extreme," and two paragraphs later "enlarged investment returns" are found to be a cause of "paralysis of enterprise."

In spite of the foregoing comments, Dr. Davies deserves much credit for his last sentence, "If modern democracies are to escape the historical fate of free-enterprise systems, there must be an advance in social science comparable to that which has occurred in the natural sciences." I think that he has conclusively proved his point, although his understanding of the "free enterprise system" appears to be somewhat limited.

Sincerely,

(Signed) E. C. Harwood, Colonel, C. E.
