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# BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO



# The Farmer as a Customer

## Many Factors Involved in His Purchasing Power

Quite often it is said mistakenly that a prosperous agriculture results in a prosperous economy. It is argued by those who hold this view that all that is needed is to make the farmer prosperous and that everyone else will then do well as a consequence. This is quite misleading. The farm population of the nation is scarcely 20 per cent of the total. Yet the farm depends for its prosperity upon the demand for its products not only from the other 80 per cent, but from the entire population in some respects.

It is sometimes argued that the farmer is *the* basic producer, and that therefore his prosperity is "basic." If by this it is meant that the farmer, as the primary producer of food and fibre, is indispensable to life, it would, of course, be readily and widely admitted. But in a highly integrated and specialized economy such as ours, mining, manufacturing, transportation, commerce, and service trades are likewise "basic" in that they are indispensable.

### FARM INCOME HIGHLY VARIABLE

In terms of net income to agriculture, farming contributes from 7 to 10 per cent to the total of national income. It was 7.5 per cent of the total in 1932 and about 10.5 per

cent of the total during the past two years. An important factor in this variation in the proportion contributed is that prices paid by farmers tend to lag considerably behind prices received by farmers as the price level fluctuates.

But this contribution to national income is based upon *net* income to agriculture. It is useful in appraising the farmer as a customer only to those who sell to and service farmers primarily as family consumers. Measurement of the farmer's total capacity as a customer requires that *gross* income and expense be considered. Gross cash farm income in recent years has varied between the low of \$4.7 billion in 1932 and the high of around \$20 billion in 1943 and 1944. These estimates represent the cash receipts from the sale of products and Government benefit payments. On a per-farm basis this would be a range from about \$725 in 1932 to roughly \$3,400 for the last two years.

Gross farm income is somewhat larger than these figures, however, when the value of home-consumed products and the rental value of the farm home are added. Computed on this basis the gross farm income for the nation is estimated at \$6.4 billion in 1932 and nearly \$23 billion for the last two years, or roughly \$1,000 and \$3,900, respectively, on a per-farm basis. From the gross income, expense deductions (not including hired labor) of \$700 per farm in 1932 and \$1,800 in 1943-44 give an estimated net income per farm to persons on farms of roughly \$300 in 1932 and about \$2,100 for the recent high years.

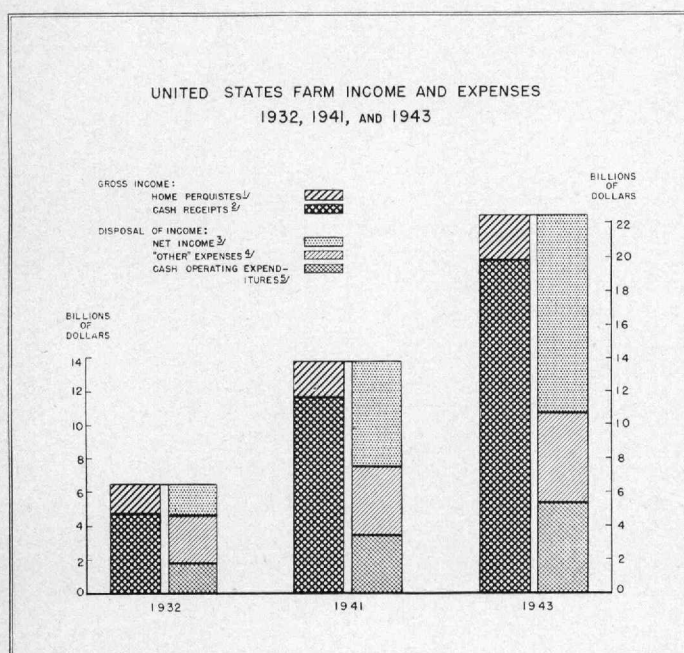
Thus, while there was roughly a four-fold increase in gross income in 1943 and 1944 when compared with 1932, the net income was seven times as large in these two years as it was in 1932.

### HOME-PRODUCED CONSUMPTION IMPORTANT

In appraising the farmer as a customer it is often overlooked that he is an important supplier of his own needs. Nationally from 10 to 15 per cent of cash value of farm products is home-produced and home-consumed. The proportion is around 10 per cent in years when crops are excellent and prices are relatively high, and it mounts above 15 per cent when crops are short or prices are relatively low. In 1935, a year affected by the 1934 drouth, and a year of low prices, the proportion was 16 per cent, while in 1944 it was less than 10 per cent.

The year-to-year fluctuations in these proportions in relation to the condition and size of the crops is partly due to the fact that when crops are good there is naturally a larger marketable "surplus" above family subsistence needs than when crops are short. This same principle largely explains the variations among states and regions of the country in the proportion of the value of products that

(Continued on Page 8)



<sup>1</sup> Value of products consumed on farm where produced, plus rental value of farm homes.

<sup>2</sup> Includes, in addition to receipts from marketings, government payments of \$586 million in 1941 and \$672 million in 1943.

<sup>3</sup> Net income of farm operators from farming.

<sup>4</sup> Includes building and machinery maintenance, taxes, interest, wages to hired labor, and rents to non-farm landlords.

<sup>5</sup> Includes feed and livestock purchased, lime and fertilizer, cost of motor vehicle operation, and other cash expenditures.

SOURCE: "Agricultural Statistics," 1944, pp. 424-426.

# Property Tax Reform in Illinois

## *Valuations Raised to 100 Per Cent—Tax-Rate Limits Revised*

Legislation recently adopted by the Illinois General Assembly proposes the solution of troublesome property tax problems that have existed in Illinois for over a half-century and are common to other states throughout the union.

The laws passed by the Illinois legislature emanate from a program formulated by The Joint Legislative Committee to Investigate Tax Problems (called the Butler Committee), a committee appointed by Governor Green to investigate the consequences of a radical change in the level of assessment in Cook County which was introduced by the assessor of that county for the year 1943. The Committee's report embraced a program that sought an end to the extreme differences in the bases of assessment among Illinois counties, greater uniformity of assessment within individual counties as among townships and among classes of property, the adjustment of legislative controls over local taxation and borrowing, and a consistent criterion for granting state financial aid to local governments.<sup>1</sup>

The portions of this program enacted into law charge the Illinois Department of Revenue with the responsibility of establishing the level of assessment throughout the state at 100 per cent of fair cash value, set new qualifications for state grants, and adjust tax-rate limits over a period of five years to a new basis that takes account of full-value assessments. An additional measure designed to strengthen local assessment administration by requiring the adoption of standardized appraisal systems and the employment of full time assessment personnel failed of enactment.<sup>2</sup>

The amendments to the Illinois Revenue Act have raised questions regarding their effect upon levels of property taxation in that state. Accurate appraisal of these reforms requires an understanding of the nature of the property tax and certain technical aspects of its operation.

While it is commonly recognized that the property tax is a major source of local revenue, it is less often appreciated that this tax is more important than any other single Federal, state, or local revenue excepting Federal personal and corporate income taxes and for a long period of years was more important than these. In the combined state and local tax systems of the Seventh District states, the property tax accounts for approximately 50 per cent of the total revenue; its economic effects are important to the business community as well as to citizens generally.

### PROPERTY TAX RATES

The property tax differs from most other taxes in that

<sup>1</sup> Report of The Joint Legislative Committee to Investigate Tax Problems, March 2, 1945.

<sup>2</sup> Thus, of the three key measures in the program, two were enacted (Senate Bills 229 and 314) and one defeated (Senate Bill 208). Eighty-nine additional laws were passed to amend the limitations on levying powers of the 15,000 local governments in Illinois. Effective date of the new acts is January 1, 1946, so assessments, levies, and rates for the year 1946 will be the first to be affected by the program.

the rate of taxation is not ordinarily fixed by legislative act as a specific proportion which remains unchanged until modified by subsequent legislative process, as in the case of motor fuel, net income, liquor, tobacco, sales, and virtually all other taxes in common use. The property tax rate is a variable amount depending upon two factors: (1) the revenues required by local governments to meet their expenditure programs, and (2) the valuation of property within the boundaries of each of the several governments.

Typically a tax rate is expressed as a percentage of assessed value, a millage on the dollar of valuation, or a dollar-and-cents rate on the \$100 or \$1,000 assessed valuation. Arithmetically it is the quotient of the amount required, or the levy, divided by the total valuation to be taxed. The rate then is applied to each individual assessment to produce the tax billings or extensions. In theory, the levy and the assessment are independently determined; in fact, the latter is often affected by the former, largely because the control of local expenditure has often been attempted by statutory restrictions on tax rates.

### PROPERTY TAX LEVIES

In the states of the Seventh Federal Reserve District there are over 43,000 local governments whose corporate authorities annually determine the revenues that will be required from levies on property. Each one typically estimates the cost of the current services it plans to render, requirements for debt service, and the portion of capital outlays to be financed from current revenue. These estimates inevitably reflect the corporate authorities' balancing of the cost of services that the community wants and its willingness to pay the taxes to provide them. Such judgments are the fundamental factors determining the level of taxation in each community.

Certain types of local units, particularly the cities and villages, have long been able to raise revenue from sources other than the property tax. The earnings from water departments and parking meters, wheel taxes, business licenses, and the like, lessen the dependence of these units on the property tax. Other local governments, notably school districts and units that have street or highway functions, receive substantial amounts of state aid for these programs that also are offset against property tax requirements. In any case, the size of the expenditure program of a given unit, modified by any other sources of income—whether taxes, earnings from municipal enterprise, or grants—fixes the amount to be raised by property taxes.

### CONTROL OF LOCAL EXPENDITURE

The fact that local government generally is closer to the



citizenry than either state or Federal government suggests that local officials might properly be entrusted with a large measure of responsibility for making decisions affecting local taxation and expenditure and that such decisions could be presumed reasonable determinations of the wishes of the majority of taxpayers and citizens.

In addition to this direct responsibility, however, there have been numerous restrictions imposed from the state level. These are of two types, depending upon the governmental philosophy which they reflect. One builds upon the principle of local fiscal responsibility, relying upon taxpayers and citizens in each community to reach a proper level of local expenditure, but materially aids in the implementation of citizen controls by prescribing standards for local financial accounts, audits, budgetary procedures, and reports of governmental transactions. The rationale behind this type of control is that if the citizenry are fully apprised of the financial plans and operations of their governments, they can be depended upon to establish the most desirable level of expenditure and taxation.

Some states have made these budgeting and accounting controls more effective by requiring a state agency to assist local units in installation and maintenance of accounting and budgetary systems, to audit their accounts, and to publish comparative statements of expenditure. State prescribed standards and procedures for local financial operations are found in all Seventh District states but are most effectively used in Wisconsin, Indiana, and Iowa. They are least effective in Illinois, where they are limited to recommendations of budget forms and procedures for school districts, townships, and special districts, and to accounting and reporting requirements for school districts.

#### TAX-RATE LIMITS

The other type of state control over local units operates on the hypothesis that governmental expenditures can be sufficiently and properly limited only by restricting the productivity of the revenues which support such expenditure or, in a more limited sense, by restricting the revenues from a particular tax source—in this instance, the property tax. There are several devices of limitation in use in the United States, but the majority and the types common in the Seventh District states restrict local revenue by fixing maximum rates of taxation. These maxima may be applied to limit the total tax rate applicable to any single parcel of property (the over-all limit), or they may apply to the sum of the rates that a particular type of government can levy for all purposes, or they may apply to each of the several funds used by a given unit.

Illinois has had experience with each of these methods of limitation; at the present time, however, the limit on specific funds is used almost exclusively, the only variation being a constitutional restriction on the total rate for all county levies. The limitation of specific funds used in Illinois, because of the variety of types of taxing districts and the particularity with which the Illinois General Assembly has delineated and specified the powers of local government, is manifested in about 150 separate statutory

provisions. As these limits are expressed as percentages of assessed valuation, they relate to nominal tax rates rather than to those based upon actual valuation. Because bases of assessed valuation differ from county to county, such limitations do not have a uniform application but are restrictive in inverse proportion to the level of assessment, a factor which in turn is subject to the arbitrary decision of assessment authorities. For, if an assessor disregards a statute which requires him to assess property at its full, fair cash value, he may adopt any other reasonable level of assessment. Thus, wherever statutory limits apply or can be made to apply by reducing the level of assessment, the assessor may well become responsible not only for the distribution of taxes among property owners but also for fixing the level of taxation.

#### PROPERTY TAX ADMINISTRATION

The distribution of property taxes among individuals and businesses is effected through appraisal by the assessor of the value of each holding of taxable property. These valuations in Illinois are made annually for personal property and every four years for real estate.

The very nature of real and personal property makes the task of their periodic valuation one of the most difficult undertakings in connection with the administration of any tax used by Federal, state, or local government. The endless variety of property renders it difficult to attain uniformity of treatment even under the most favorable conditions. Long-lived and specialized improvements on real estate and the value of the land itself are a constant challenge to the best equipped appraisers. Property valuation on a wholesale scale—the task of assessment officials—requires a very high order of competence and integrity.

Assessment organization in Illinois, as well as in other Seventh District states, is inherited from the earliest days of the property tax and reflects the early establishment of the township form of government in this area. There are township assessors in all five states, although Illinois has county assessors in the 17 of its 102 counties not organized into townships, and a county assessor in Cook County and a board of assessors in St. Clair County in addition to township assessors. Most of these assessment authorities are elected, part-time officials who work for a period of from three to four months annually at relatively low rates of compensation.

In the Seventh District states certain types of property are not locally assessed but are valued by a state assessment agency. This is true of the bulk of railroad property in all states and of property of other utilities in Michigan, Wisconsin, Iowa, Indiana, and, to a minor extent, in Illinois. In three of the states—Illinois, Indiana, and Iowa—the state assessment creates important difficulties because the statute requires the taxation of centrally-assessed property along with locally-assessed property and, as the same rate must be applied to both classes, it is essential that assessments be uniform. The difficulty of effecting this uniformity is one of the basic problems associated with property tax administration.



The task of the assessment officer, in theory, is limited to making an inventory and valuing all property within his jurisdiction. Laws of most states, including Illinois, require that this valuation be the full, fair cash value. So wide, however, is the discretion of the assessment authorities in their official acts, and so strong are taxpayer pressures upon assessment officials, or so heavily do the practices established by their predecessors weigh upon them, that very few assessment authorities actually make any effort to assess property at its fair cash value. On the contrary, they typically use some proportion of fair cash value as a standard of assessment. The use of these assessment ratios—a practice which is general throughout the country—is not particularly important so long as one uniform level is adopted, but once departures from full value come into use they tend to disperse further and further from uniformity at any level. In Illinois counties, for example, official findings show that the level of assessment has ranged from approximately 20 per cent of fair cash value to 75 per cent.

#### FULL-VALUE ASSESSMENTS

Any attempt on a statewide basis to provide a uniform ceiling for tax rates, a debt limitation expressed in terms of a percentage of assessed valuation, or a distribution of state aids to which a given level of local tax contribution is a prerequisite, logically requires machinery to translate non-uniformity in assessment practice into uniformity. Otherwise, the incongruities and absurdities which ensue entail a *de facto* if not a *de jure* abandonment of such legislative controls as tax-rate and debt limits. Machinery established by the Illinois legislature this year for attaining the requisite assessment uniformity provides that the Department of Revenue, the state's principal tax administering agency, shall determine on a uniform basis the average level of assessment in each county of the state and require the increase or decrease of all assessments in each county in terms of this average so as to bring them to the Department's estimate of full, fair cash value. The controls over rate limits and the grants of state aid are then linked to this uniform standard of valuation. It should be noted that the Department's responsibility for determining an average level of assessment for each county is an important one and difficult to fulfill, particularly if the quality of the assessment within a given county is low and there is considerable non-uniformity in assessed valuations from township to township and among the various classes of property. In normal times a reasonably active real estate market will provide a fair measure of the level of real estate assessments and one which is consistent and equally appropriate for all of the counties in the state. The Department has been making determinations of the level of real estate assessment in each of the Illinois counties for the past several years and presumably will be able to undertake its new responsibilities with a substantial basis of experience behind it. Furthermore, these findings have been made generally available for several years, and the level of assessment which will apply to any given county

can be approximated from these past records.

The adoption of machinery for arriving at full valuations on a uniform basis and making them the official assessment record in all counties will eliminate certain difficulties that have been a source of considerable irritation and inequality. One of these is the attainment of uniformity for taxpayers in districts that overlie county boundaries. There are some 900 such taxing districts in Illinois that lie in two or more counties. In a large number of cases the levels of assessments in counties to which such taxing districts are common are substantially different, but the tax rate applied to assessments throughout a given district always is uniform. Consequently, in the counties with the higher levels of assessment larger contributions have been exacted from taxpayers for support of the overlapping district than in the counties with the lower levels of assessment. Instances are not uncommon in Illinois where the level of assessment in one of two adjoining counties is twice that of the other. A taxing unit such as a school district or municipality extending into both counties collects twice as much from property having the same actual value in one county as from the other because such property happens to be located in a county with a high assessment ratio. Raising the level of assessment in every county to full value will eliminate such discrimination.

The operating properties of railroad companies and the capital stock of certain types of corporations are assessed by a state agency and, under a decision of the Supreme Court of Illinois, equalized for local taxation at the average level of assessment throughout the state. This has been productive of another type of discrimination which has also contributed to the dissatisfaction with the operation of property tax in recent years. Here the extreme disparity in levels of assessment is again the disturbing factor. A state average level of assessment occasions little difficulty if assessments are relatively uniform. However, the taxing of railroad property at 50 per cent of its appraised value, while adjoining homes, farms, and other property are taxed on bases varying from 20 to 75 per cent of their value reflects an intolerable situation, especially since it is not a deliberate legislative policy. Classification of property for the application of varying tax rates is common in the United States and by administrative fiat is even used for intangibles in Illinois. Such classification, however, should always rest on a considered public policy toward certain classes of property and not on purely fortuitous and variable circumstances.

Full-value assessment will eliminate this troublesome problem as the state agency of assessment will be able to place the valuations of property it assesses on a basis identical with that of the equalized local assessment.

#### UNIFORM QUALIFICATION FOR STATE AID

The granting of state aid in Illinois is contingent upon evidence that a certain degree of local tax effort has been made for relief and certain educational assistance. In the past, evidence of local effort was assumed to be the levy-



ing of taxes sufficient to meet rate limits expressed in terms of assessed values. Such a criterion was obviously a variable one dependent upon the level of assessment. School districts or townships in counties with low assessment levels could qualify for state funds with a very much smaller tax contribution in proportion to actual property values than could similar districts in counties with high levels of assessment. Far more by accident than design many wealthy units for which state school equalization funds were never intended have qualified for distributions appropriated for needy districts. Such grants are now to be placed upon a logical basis by making them contingent upon the levying of local taxes at rates expressed in full rather than assessed value.

#### ADJUSTMENTS IN RATE LIMITS

The principal discussion regarding these changes in Illinois property tax law has centered around the treatment of tax-rate limits which for a long period have been an important feature of state control over local expenditure. The Butler Committee recommended that with the change in the basis of valuation from assessment factors ranging from between 20 and 75 per cent, to a uniform 100 per cent basis, the existing rate limits be reduced by one-half. This recommendation was adopted in a series of bills which revised around 150 separate rate limits.

The possibility that this reduction in statutory limits would be insufficient to forestall tax increases in counties with low assessment ratios was anticipated by another law in the program which provides for the transition from the present haphazard system of rate limitation to one in which the limits will be on a uniform basis throughout the state. The period of transition is five years beginning January 1, 1946, and the transition measures provide stays of execution for both taxing units and taxpayers during this interval while creating referenda machinery to be used by the voters in passing final sentence.

The legislative assurance to taxing districts is contained in a provision which suspends the operation of any new rate limit (unless modified by voter action) which reduces taxes below a certain amount. For the great majority of taxing districts this amount is equivalent to the product of the effective rate they could have levied in 1942 and the current full assessed value. This provision means that if the full value of property in a particular unit remains unchanged, it would be allowed to levy for the same amount of revenue as it could have levied in 1942. But, if the value of property in the district increases because of additional construction or annexation of additional areas, or because there is an increase in the general price level, the absolute amount of taxes for the district will also be permitted to increase, though the rate of taxation may not. Similarly, if the district should decrease in size or should there be a deflation in real estate values, the district would not be allowed to levy for the same amount of money that it obtained in 1942 but only for an equivalent rate. The purpose of this provision is to provide a period of adjust-

ment for the districts in counties where the level of assessment exceeds 50 per cent.

To restrict taxes in districts where low ratios of assessment prevail and where the decrease of 50 per cent in rate limits is more than offset by increases in valuation, any increase in tax rates is limited to 15 per cent during a five-year period beginning January 1, 1946. This limitation is, however, qualified by an additional provision which restricts the amount of tax increase in any single year to 5 per cent of the amount that could have been obtained by use of the maximum rates for the year 1942. Thus, for the period of transition, tax increases are virtually restricted to those arising from higher property values and previously unused reservoirs of local taxing power.

During the period of transition referenda may be held which will enable any taxing district, either by action of its corporate authorities or by petition of its voters, to increase limits by as much as 25 per cent or to reduce them by as much as one-third. Beginning with the year 1951, it is anticipated that all taxing districts will have made the modifications in their limitations which will enable them to continue functioning satisfactorily, since it is then that the new system of rate limitation goes into effect.

#### LONG-RUN CONSIDERATIONS

Tax-rate limitations undoubtedly have been effective in holding down—at least temporarily—governmental expenditures and taxes, although they may thereby have induced more undesirable governmental practices in financial policies than higher expenditure or taxation. It seems unlikely that the tax rates under the transition measure will change appreciably during the next five years. The total amount of taxes undoubtedly will increase, particularly if higher price levels are reached and as the more sluggish items of cost in local expenditure become adjusted to the already higher level of prices. It would hardly be appropriate, however, to attribute such tax increases to any of the changes involved in this recent legislation.

In point of fact, a very large number of Illinois taxing districts are not now taxing at their limits and never have been. For these units tax-rate limits have had nothing to do with the level of taxation and expenditure. Similarly, there are many taxing districts where the advantages from a social point of view of a larger expenditure outweigh the tax savings which artificial restrictions involved in rate limits impose.

The system of rate limitation in Illinois, however, could be simplified and better adapted to the requirements of the thousands of local governments in that state. It is quite possible that during the two succeeding sessions of the legislature, which will occur before the proposals adopted at the recent session become completely effective, there will be further modifications of the method of rate limitation now in effect. It is premature to forecast these long-run consequences, therefore, until the present adjustments have come into practical operation and the more remote revisions become settled policy.



# The Seventh War Loan Drive

## *Sales to Individuals Top Previous Records*

Oversubscription to the securities offered during the Seventh War Loan was substantially greater than that which has occurred during any previous drive since the war financing program began. Sales to all classes of investors totalled 26.3 billion dollars compared with a 14 billion dollar goal and established a new record over the 21.6 billion dollars raised in the Sixth Drive. Purchases by individuals of all types of securities amounted to 8.7 billion dollars, exceeding by a substantial margin the 7 billion dollar quota. Sales of Series E bonds fell only slightly short of their goal, which was stepped up to 4 billion dollars compared with 2.5 billion dollars in the Sixth Drive. Purchases by corporations and associations reached another new high of 17.6 billion dollars and accounted for most of the tremendous oversubscription—more than 10 billion dollars in excess of the quota set for them.

Sales of all types of securities in the five Seventh District states amounted to 3 billion 759 million dollars—exceeding the combined quotas by 74 per cent and Sixth Drive totals by about 500 million dollars. All five states attained their quotas for sales to individuals, and only Michigan failed to meet its Series E bond goal. The accompanying table shows sales and quotas for the nation and for the five Seventh District states.

### FINANCING METHOD REVISED

The Treasury again emphasized the need to obtain funds to meet war financing requirements from savings of indi-

viduals rather than through creation of bank deposits and currency. Bank credit expansion in the Sixth War Loan amounted to almost 50 per cent of the proceeds of the loan—much of which resulted from sales to the banks of outstanding 2 per cent bonds at a premium and subsequent purchase by nonbank institutions at par of new issues bearing the same rate and approximately the same maturity. Attempts to curtail these operations were made not only because of the inflationary character of the new money created through bank financing but also because of the disturbance to the established pattern of interest rates which accompanies the shifting of the marketable issues from both institutional and individual purchasers to the banks.

Prior to the opening of the Seventh Drive the Treasury again requested nonbank investors to refrain from selling outstanding securities to obtain funds with which to purchase the new issues, except in connection with normal portfolio adjustments, and asked banks to cooperate in refusing to make loans to customers for speculative purchases. Banks were also instructed not to encourage subscriptions to securities which were likely to be resold after the drive or which would result in expansion of war loan accounts without being offset by a corresponding reduction in other normal deposits. In the attempt to avert such abuses, all of which had been widespread in previous drives, several changes were made in the basket of securities offered and the terms of sale.

As usual, the Series E, F, and G savings bonds, Series C savings notes,  $\frac{7}{8}$  per cent certificates of indebtedness,

**SEVENTH WAR LOAN SALES AND QUOTAS**  
**UNITED STATES AND SEVENTH DISTRICT STATES**  
(amounts in millions of dollars)

Areas	Grand Total			Individuals									Corporations and Associations		
				Total			Series E			Other Issues					
	Sales	Quota	Per Cent of Quota	Sales	Quota	Per Cent of Quota	Sales	Quota	Per Cent of Quota	Sales	Quota	Per Cent of Quota	Sales	Quota	Per Cent of Quota
U. S. total . . .	26,313	14,000	188	8,681	7,000	124	3,976	4,000	99	4,705	3,000	157	17,632	7,000	252
Illinois. . . . .	1,689	965	175	572	490	117	280	279	101	292	211	138	1,117	475	235
Indiana. . . . .	428	240	178	191	167	115	105	104	101	87	63	138	237	73	325
Iowa. . . . .	369	189	195	172	135	128	98	82	119	75	53	142	197	54	365
Michigan . . . .	747	501	149	336	333	101	203	226	90	133	107	124	411	168	245
Wisconsin. . . .	525	267	197	164	150	109	91	89	103	73	61	119	361	117	309
Five state total. . . . .	3,759	2,162	174	1,435	1,275	113	777	780	100	660	495	133	2,323	887	262



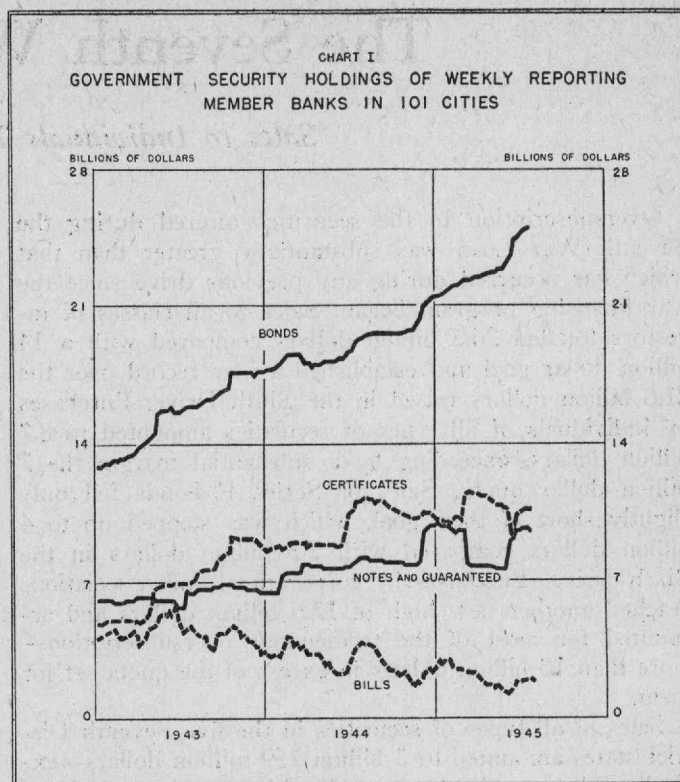
and 2½ per cent long-term bonds were included in the offering. Instead of the 1¼ per cent notes and 2 per cent medium-term bonds, which were very popular for bank investment after the Fifth and Sixth drives, the Treasury sold 1½ per cent 5½ year bonds and 2¼ per cent 14-17 year bonds. The 2¼s, like the 2½s, are ineligible for bank purchase until 10 years before maturity. The 1½s, although unrestricted as to bank ownership, were sold only to individuals. In anticipation of continued stability in the interest rate structure, banks have favored longer-term securities to a growing extent, a tendency which has been particularly marked during 1945, while lower-coupon securities are less attractive and have brought a lower premium in the market. The shift into longer-terms for the weekly reporting member banks is apparent from Chart I. Because of this preference, it was hoped that restriction of any securities with coupons over 1½ per cent would deter speculative purchases and discourage both banks and investors from shifting operations after the drive. Restriction of the higher coupon issues, moreover, will tend to reduce even further the interest charges on that portion of the public debt held by banks.

To facilitate attainment of the high quota for individuals, sales of Series E, F, and G bonds and Series C notes from April 9 through July 9 were credited to the drive, while sales of the marketable issues to individuals opened May 14, thus including a somewhat longer period than has been covered in previous drives. The goal for corporations and associations was set at the relatively small figure of 7 billion dollars, compared with 9 billion for the Sixth Drive, in hopes that reduced pressure to meet the quota would also discourage trading of outstanding issues for the drive securities by those investors among whom that practice has been most prevalent.

#### STRONG DEMAND FOR LONG-TERM ISSUES

The Treasury's efforts to curb the abuses of previous drives resulted in an altered distribution of sales by type of issue. The E bond sales of just under 4 billion dollars represented a marked improvement over the earlier drives. Among the marketable issues sales were concentrated in the restricted 2¼ and 2½ per cent bonds, particularly the latter. Proceeds of these two issues together amounted to 12.2 billion dollars, of which more than 7 billion were attributable to the longer-term issue. Sales of certificates were 4.8 billion. Sales of the 1½s, the only bonds eligible for bank purchase later, were held down to 1.7 billion dollars by the limitation of subscriptions to individuals. This amount compares with sales of 6.9 billion of 2 per cent eligible bonds and 1.5 billion of 1¼ per cent eligible notes in the Sixth Drive.

Despite the intensified efforts to prevent illegitimate subscriptions, it is apparent that a considerable portion of the huge sales volume was financed through bank credit expansion. Switching operations were most pronounced in the 2¼ and 2½ per cent categories. Insurance companies and savings banks, in particular, traded large amounts of the bank-eligible 2s acquired during the Sixth Drive for



the new longer-term issues.

This trading of outstanding securities for new issues was reflected in the growth of bank holdings of Governments. Although figures for the entire banking system are not yet available, statements of the weekly reporting member banks in 101 cities of the United States show a somewhat larger amount of bank credit expansion than in the Sixth War Loan. From May 9 through July 4, holdings of Governments other than Treasury bills of these banks rose 3.8 billion dollars compared with a 3.7 billion dollar increase for the corresponding period of the previous drive. Most of these securities were purchased in the market although limited amounts of the unrestricted issues were purchased directly from the Treasury on the basis of time deposits. Such direct purchases by all commercial banks amounted to 1.3 billion during the drive. Meanwhile, the Federal Reserve Banks increased their holdings of Governments by about one billion dollars, more than half of which represented purchases of certificates.

Loans for purchasing and carrying Government securities rose 2.5 billion dollars during the same period, of which 1.8 billion were to others than brokers and dealers. Expansion in the total of these loans, although larger than in the Sixth Drive, was smaller than that during the Fifth. Nevertheless, the increase in those loans to others than brokers and dealers was considerably more than it has been in any previous drive. Although many of these loans reflect purchases of securities which will be resold after the drive, it is probable that a larger percentage than usual will be repaid out of current income in the next few months, particularly since so much of the sales total was in the restricted issues. During the two weeks following July 4,



loans on Governments by these banks declined more than 500 million dollars compared with a continued increase in holdings of Governments other than bills of only about 150 million.

The large amount of  $2\frac{1}{2}$ s and  $2\frac{1}{4}$ s acquired by corporations and associations during the latest drive cannot be sold to banks for some years. Thus, although the restrictions on these issues had little immediate effect in holding down indirect bank financing, they will hamper roll-over operations in the next drive.

#### DECLINE IN YIELDS ON GOVERNMENTS

The growing popularity of the medium and longer-term bonds for bank investment, coupled with the scarcity of these securities eligible for bank purchase, was reflected in a rise in market prices and a corresponding decline in yields of Treasury bonds and notes in the first six months of 1945. The counterpart of this development is the increase in the spread between the yields on restricted and non-restricted securities and the consequent separation of the market for long-term investments from that for the medium and shorter-term bank eligible issues. The following tabulation shows the change in yields over the past 18 months on three general classes of Governments outstanding:

	Dec. 1943	Dec. 1944	June 1945
Taxable bonds 15 years and over...	2.49	2.48	2.35
Taxable bonds 7 to 9 years.....	2.00	1.93	1.56
Taxable notes 3 to 5 years.....	1.30	1.35	1.16

Within the long-term category, the premium on bank

eligibility is indicated by the difference in yield between the  $2\frac{1}{2}$ s of September, 1967-72, the only long-term fully taxable issue now eligible for bank investment, and the ineligible  $2\frac{1}{2}$ s of 1966-71. On July 10 the former were selling at 105 to yield 2.20 per cent to call date while the latter were selling to yield 2.39 per cent. During the inter-drive period yields on the eligible  $2\frac{1}{2}$ s reached a minimum of 2.37 per cent but reacted to 2.43 in April and May after the announcement of continued offerings of a  $2\frac{1}{2}$  per cent issue in the Seventh Drive. By issuing  $2\frac{1}{4}$  and  $2\frac{1}{2}$  per cent restricted bonds while eliminating the medium-term unrestricted issues, the Treasury can differentiate between individuals and institutions which are really investing for long periods of time and others whose funds are primarily short-term in character and whose required liquidity in purchases of longer-term issues is dependent upon the stability of the market.

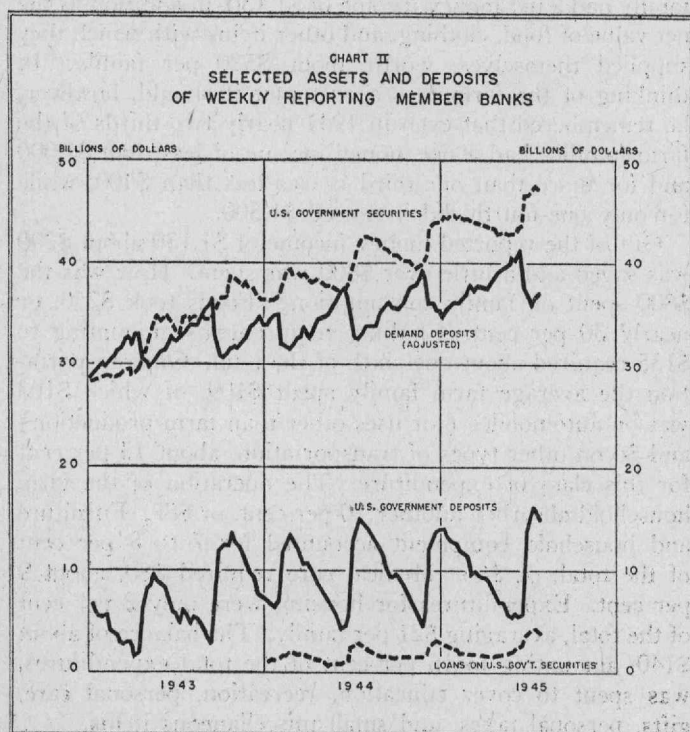
#### BANK RESERVE AND DEPOSIT CHANGES

Banks were enabled to buy large amounts of Governments in the Seventh as in other war loan drives because of the relative ease in their reserve positions resulting from customers' withdrawals of deposits to purchase the war loan securities. Such purchases were in turn reflected in the expansion in war loan accounts, against which no reserves are required.

Chart II shows the effect of the war loan drives on deposits and Government security holdings of the weekly reporting member banks. From their peak on June 13 through July 4, private deposits of these banks declined 5.3 billion dollars—about 1 billion more than during the Sixth Drive—while the corresponding growth in Government deposits, expanded by the indirect financing of the Seventh Drive issues, was 10.8 billion.

In the period between drives, required reserves of all member banks rose about 1.8 billion dollars. The Reserve Banks supplied reserve funds to member banks both to meet the higher amounts required and to offset drains on reserve balances through increased money in circulation and gold outflow. The total expansion in Reserve Bank credit from January 3 through June 13 amounted to 2.8 billion dollars. Because of the low level of Treasury bill holdings by member banks, fewer bills than usual were sold under the repurchase agreement to adjust reserve positions while more reliance was placed on borrowing from the Reserve Banks. Discounts and advances of all the Federal Reserve Banks reached a new high of 912 million dollars on June 6, compared with a high of 593 million prior to the Sixth Drive.

As required reserves dropped with the impact of the Seventh Drive, member banks again reduced their indebtedness and replenished their Treasury bill portfolios. Only part of the reserves freed through deposit shifts was utilized in the reduction of Reserve Bank credit and purchase of Governments. The remainder was reflected in a rise of excess reserves of member banks from 800 million to 1.7 billion dollars, the highest level recorded since October, 1943.





## THE FARMER AS A CUSTOMER

*(Continued from inside front cover)*

are home consumed. In many of the South Atlantic and Southeastern states it is not uncommon for the value of home-consumed products to represent from one-fifth to one-third of the total value of farm products. These are the states in which small-scale, "subsistence" farming is relatively most important.

At the other extreme are the states where large-scale or highly specialized farming on a more commercial basis is predominant. The proportion of home consumption to total production runs as low as 5 per cent in such states as Delaware and New Jersey. The ratio is less than 2 per cent for California. Among Seventh District states the ratio for Iowa runs about 5 per cent, Illinois 6 to 7 per cent, Indiana and Wisconsin 8 to 10 per cent, and Michigan about 12 per cent. On the whole these states, like others in the Corn Belt, rank high in the products they supply to the farm house, but they are states where the commercial farm dominates, producing a large surplus above family needs for cash sale at markets.

Size of farm unit and extent of "subsistence" farming, however, are not the only factors explaining the geographic and temporal differences in the relative importance of home consumption. Variations arise also from the fact that there are important differences in the types of products raised in different states and regions. For some products, hogs, for example, a high proportion of the total production is consumed on the farms where they are produced. At the other extreme are such commodities as tobacco, of which practically none is consumed on the farms on which it is produced.

Nationally about one-fifth of the dollar value of hogs produced is eaten right on the farm where they mature, but the proportion ranges from less than 5 to 10 per cent in important Corn Belt states up to two-thirds of the value of production in some of the Southern and South Atlantic states. More than one-fifth of the eggs and about one-third of the chickens normally never leave the nation's farms. About 20 per cent of the country's dairy products never leave the farm, and this ranges from less than 5 per cent in Wisconsin to over two-thirds in Alabama and the Carolinas, and over half in Georgia, Mississippi, Arkansas, and Louisiana.

### FARMER A CUSTOMER IN TWO CAPACITIES

Before looking at the farmer as a family consumer comparable to other consumers, his capacity as a customer in the broadest sense must first be examined. Normally about 40 per cent of the farmer's expenditures is to cover the costs of production. The remaining 60 per cent is devoted to expenditures covering the living needs of the family.

In analyzing production expenses the year 1941 has been selected for illustrative purposes, chiefly because it was the last year before the distortions of the war began to alter the picture materially, and is in that sense probably more nearly "normal" than any recent year. The expenses of

production in that year were estimated to have been about \$7.4 billion, or \$1,235 per farm. Slightly less than half of this (\$580) went to meet current direct operating expenses, excluding hired labor, while the balance covered building and machinery expense, hired labor, property taxes, interest, and rent. But of the \$580, about \$275 was spent for feed and livestock purchases, which largely one farmer buys from another and which, aside from commercial feed sales, may represent partial double-counting.

Almost \$50 per farm was spent for fertilizers and lime. Operations of motor vehicles chargeable to production (not including family and household uses) cost about \$106, while the remaining \$150 was spent for other miscellaneous expenditures, such as veterinary expense, hardware, twine, containers, insecticides, dairy supplies, etc. In addition to these items about \$205 per farm was spent for the maintenance of buildings, machinery, and equipment.

To rearrange the figures a little, the expenses treated as a whole may be better defined as an area for merchandising by deducting most of the 22 per cent of total spent for feed and livestock purchases, 16 per cent for the wages of hired farm labor, another 10 per cent for payment of net rents to landlords, 6 per cent for farm property taxes, and 4 per cent for payment of interest on farm mortgage debt. Taken together these deductions amount to approximately 60 per cent of the total expense, leaving the remaining 40 per cent (or about \$500 per farm in 1941) as the main field for urban merchandising.

### FARMERS SAVED ONE-FOURTH OF NET INCOME

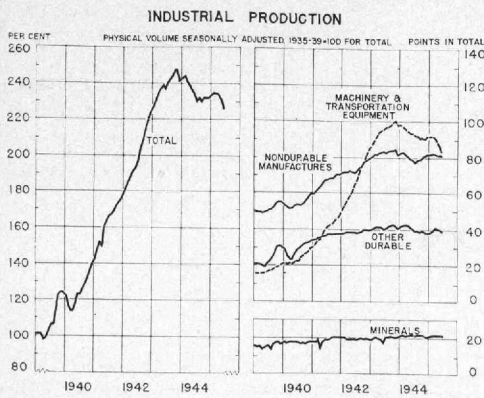
Turning now to the farm household, to the farm family as a consuming unit, it is reported by the U. S. Department of Agriculture that in 1941 the average rural farm family had a net money income of \$1,130, in addition to the net value of food, clothing, and other items with which they supplied themselves, worth about \$520 per family. In thinking of the farmer as a customer it should, however, be remembered that even in 1941 nearly two-thirds of the farm families had a net money income of less than \$1,000 and for more than one-third it was less than \$400, while for only one-fourth did it exceed \$1,500.

Out of the reported money income of \$1,130 about \$290 was saved and a little over \$800 was spent. How was the \$800 spent on family consumption? Foods took \$250, or nearly 30 per cent. Clothing requirements amounting to \$135 required about one-sixth of the total. On transportation the average farm family spent \$109, of which \$103 was on automobiles (for uses other than farm production) and \$6 on other types of transportation, about 13 per cent for this class of expenditure. The operation of the farm household absorbed another 10 per cent, or \$87. Furniture and household equipment accounted for 7 to 8 per cent of the total, or \$66. Medical care required \$80, about 9 per cent. Expenditures for housing were only 2 per cent of the total, averaging \$21 per family. The balance of about \$140, amounting to 16 per cent of the total expenditures, was spent to cover education, recreation, personal care, gifts, personal taxes, and small miscellaneous items.



# NATIONAL SUMMARY OF BUSINESS CONDITIONS

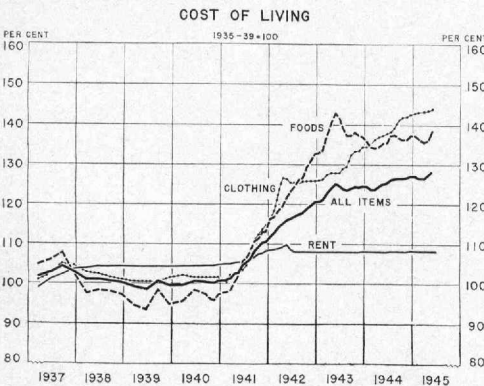
BY BOARD OF GOVERNORS OF FEDERAL RESERVE SYSTEM



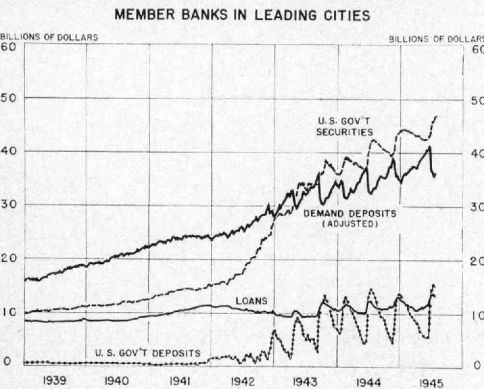
Federal Reserve indexes. Groups are expressed in terms of points in the total index. Monthly figures, latest shown are for May 1945.



Federal Reserve indexes. Monthly figures, latest sales figures shown are for June 1945, latest stock figures shown are for May 1945.



Bureau of Labor Statistics' indexes. Last month in each calendar quarter through September 1940, monthly thereafter. Mid-month figures, latest shown are for May 1945.



Demand deposits (adjusted) exclude U. S. Government and interbank deposits and collection items. Government securities include direct and guaranteed issues. Wednesday figures, latest shown are for July 11, 1945.

Production and employment at factories declined somewhat further in June reflecting mainly reduced output of munitions. Value of department store sales in June and the early part of July were considerably above year-ago levels.

**Industrial production**—Industrial production declined about 2 per cent in June and the Board's seasonally adjusted index was 222 per cent of the 1935-39 average as compared with 226 in May and 235 in March of this year.

Reduced activity in munitions industries accounted for most of the decrease. Aircraft production in June was at a daily average rate 5 per cent below May. The volume of work done on new ship construction continued to decline, while ship repair activity was maintained at a high level. Total munitions production was about 10 per cent below the March level, which was the last month under the full two-front war program. The decline is scheduled to accelerate in July, with over-all munitions output planned at a rate about 15 per cent below March.

Steel production in June and the first three weeks of July was down 7 per cent from the May level, and was 5 per cent below the corresponding period a year ago. Output in the nonferrous metal industries also declined, particularly at fabricating plants, due primarily to the large drop in military demand for most aluminum and copper products.

Production of most nondurable goods showed little change in June. Civilian supplies of some of these goods such as butter and tobacco products have increased in July as a result of reduced military purchases. Distilleries have been permitted to produce beverage alcohol in July. Production of shoes and textile products for civilians is expected to increase by autumn.

Output of minerals rose 5 per cent in June, reflecting mainly a large rise in coal production to the highest rate since last November. Crude petroleum production continued to increase, reflecting even greater military demand for some petroleum products for the Pacific War than for the two-front war prior to VE day.

**Commodity prices**—Prices of wheat and of fruits and vegetables declined somewhat from the middle of June to the third week of July reflecting chiefly seasonal increases in supplies. Prices of most other farm products showed little change after reaching a new peak for the wartime period on June 15.

Steel scrap prices, which had declined somewhat in May, increased to ceiling levels in the latter part of June and prices of most other industrial materials were maintained at ceiling levels.

**Agriculture**—Production prospects for most major crops were generally favorable on July 1. Cotton acreage reported in cultivation, however, was 10 per cent smaller than last year, and prospective corn production this year was indicated on July 1 to be 17 per cent smaller than last season's large harvest.

Milk production continued at a record level in June. The number of young chickens on farms has increased rapidly this spring and on July 1 was 11 per cent greater than on the same date in 1944. Marketings of cattle and sheep were larger in June than in the same period last year, while the number of hogs marketed continued to be much less than in 1944.

**Bank credit**—Reporting member banks in 101 leading cities increased their holdings of U. S. Government securities by 4.5 billions of dollars in the eight weeks ending July 11, which period included the major portion of the Seventh War Loan drive. This amount corresponds closely to increases for comparable periods of the two previous drives. During the Seventh Loan banks added substantially to their holdings of bills, certificates, and notes, and they have also continued to increase their holdings of bonds.

Loans for purchasing and carrying Government securities extended to customers other than brokers and dealers by weekly reporting banks increased 1.6 billions during the four weeks ended June 27, in contrast to 1.1 billions during the comparable period of the Sixth drive, and 1.3 billions in the Fifth. Loans to brokers and dealers for purchasing or carrying Government securities started increasing somewhat earlier and expanded more than in preceding drives. Both categories of these loans at their peaks were above high points reached in previous drives. Declines in these loans began in July.

Excess reserves expanded more and reached a higher level than in any drive since the Third War Loan drive in September, 1943. Owing to the great success of the Seventh Loan in obtaining subscriptions from nonbank investors, the shift of funds from deposits subject to reserve requirements to reserve-exempt United States Government deposits and the consequent decline in required reserves were larger than usual. Member banks used a part of the funds thus made available to pay off borrowings at Reserve Banks, which had risen to a high level of over 900 million dollars in June. Reserve Bank holdings in Treasury bills showed less decline during and following the Seventh Loan than at the time of the previous drive. Holdings of certificates and notes continued to increase.



**SEVENTH FEDERAL**



**RESERVE DISTRICT**