

BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO



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Farm Price Outlook

Up or Down? How Far?

The course of farm product prices probably is being watched more closely at the present time than at any other period in history. Prices received by farmers always have been of prime importance to farm operators and their families, with annual variations in farm incomes resulting mostly from changes in prices, although changes in the volume of sales have at times been of importance. In addition to farmers, rural business men, and processors of farm products, usually follow the trend of farm prices closely. At the present time, however, people with a great diversity of interests are keeping an eye on the course of farm product prices. Much of the unusual current interest results from the expectation that farm product prices indicate the course of other prices and of the general level of business activity in the economy as a whole; also, that they might indicate whether or not prices during the coming year may follow a course similar to that traversed after World War I.

PRICES RISE DURING RECONVERSION

Following the end of hostilities, many wartime controls were relinquished promptly, one of the more important being the consumer rationing of some important foods. The major concern of many people at that time was an anticipated "reconversion slump" which, it was feared, might be the first turn of a downward spiral into depression. Instead, the wartime generated inflationary pressures increased. With appetites for goods and services which appeared insatiable at a time when many items were in short supply, successive bulges developed in the line formed against inflationary price advances. There was fundamental disagreement as to the most effective Governmental action. While some insisted that direct controls were the most feasible means of restricting the upward pressure on prices, others were equally convinced that greater freedom in the price arena would solve the domestic problem readily by accomplishing great increases in supplies of scarce items.

In orthodox domestic relations fashion a compromise was reached. Greater freedom was allowed in some lines while others were continued under direct controls. The negotiations leading to this compromise, however, extended through most of July and left the growing inflationary pressures very much on their own during that month. For some important farm products the "price control holiday" continued through August. Prices received by farmers increased from mid-June to mid-August by an average of 14 per cent, most of the increase occurring in the first part of July following the expiration of price control at the end of June. Sharpest increases occurred in prices received for meat animals which by mid-August experienced a 28 per cent rise, followed by dairy products with a 24 per cent rise, feed grains 18 per cent, and poultry and eggs 12 per cent.

Following renewal of the price control law, prices of some agricultural products, particularly livestock and meats were recontrolled, but ceilings were re-established at higher levels than prevailed in June. By mid-September, average prices received by farmers for all crops and livestock were about 3 per cent below the preceding month with most of the decline occurring in prices of meat animals. On October 14 price controls were removed from livestock, meats, and some other commodities. Prices received by farmers in mid-November averaged 8 per cent higher than for mid-September but 4 per cent below mid-October when prices were the highest for any period of record—273 per cent of the 1909-14 period and two and one-half times 1935-39.

The sharp price increases accompanying decontrol were heralded by those who had predicted disastrous inflation if controls were removed as ample proof that their predictions were accurate. With equal vigor, proponents of decontrol seized upon the tendencies for prices of farm products to stabilize after their initial spurts, then weaken as distribution channels filled and consumers economized in the use of commodities bearing the higher price tags, as proof that the inflation scares were superficial. It is assumed quite generally that post World War II peaks in prices of most farm products have passed, although the average for all such products continues near an all-time high. Interest in farm prices has turned largely from their inflationary potentialities to a consideration of how long the present level can be maintained and how far prices will fall. Some point to recent breaks in stock and commodities markets and suggest that an ex-

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**PRICES RECEIVED BY FARMERS,
PREWAR AVERAGES, JUNE AND NOVEMBER 1946,
AND PARITY PRICES**
(Amounts in dollars)

Commodity and Unit	Aug. 1909- July 1914	Jan. 1935- Dec. 1939	June 15, 1946	Nov. 15, 1946	Parity Price Nov. 15, 1946
Wheat, per bu.....	0.88	0.84	1.74	1.89	1.87
Corn, per bu.....	0.64	0.69	1.42	1.27	1.36
Oats, per bu.....	0.40	0.34	0.81	0.78	0.85
Barley, per bu.....	0.62	0.53	1.25	1.32	1.31
Cotton, per lb.....	0.124	0.103	0.26	0.292	0.263
Soybeans, per bu.....	—	0.95	2.17	3.09	2.04
Flaxseed, per bu.....	1.69	1.69	3.10	6.90	3.58
Potatoes, per bu.....	0.70	0.72	1.47	1.22	1.57
Hogs, per cwt.....	7.27	8.38	14.30	22.80	15.40
Beef cattle, per cwt.....	5.42	6.56	14.10	17.60	11.50
Lambs, per cwt.....	5.88	7.79	14.30	18.40	12.50
Butterfat, per lb.....	0.263	0.291	0.521 ¹	0.842 ¹	0.593 ²
Milk, wholesale, per cwt....	1.60	1.81	3.39 ¹	5.07 ¹	3.73 ²
Chickens, live, per lb.....	0.114	0.149	0.266	0.276	0.242
Turkeys, live, per lb.....	0.114	0.160	0.312	0.372	0.305
Eggs, per doz.....	0.215	0.217	0.335	0.515	0.556 ²

¹Does not include dairy production payments of 15 cents per pound of butterfat in June, 13 cents in July, and about 17 cents in November, of 50 cents per hundredweight of milk in June and July, and about 65 cents in November.

²Adjusted for seasonal variation.

SOURCE: *Agricultural Prices*, U. S. Bureau of Agricultural Economics.

War and Postwar Manufacturing Employment Trends

District Industrial Workers Number 40 Per Cent Above Prewar Level

Manufacturing employment in the Seventh Federal Reserve District states of Illinois, Indiana, Iowa, Michigan, and Wisconsin will average more than three million persons in 1946, over 40 per cent above the 1939 level although about one-fifth under the numbers employed in the peak war years of 1943 and 1944.¹ The downward trend in industrial employment, which began early in 1944 and reached its depth as a result of the post V-J Day wave of strikes, was reversed early in 1946 with subsequent marked increases in manufacturing employment in both the District and the nation (see accompanying chart). The 1946 upward trend, like that of the early war years, was primarily due to the expansion of employment in the durable goods industries, particularly metal working.

IMMEDIATE OUTLOOK

Available evidence points to some continued rise in demand for manufacturing workers, particularly in the skilled classifications, in the months immediately ahead. Labor shortages, already pressing in the District's major industrial areas, may therefore become more acute before they ease. Since V-J Day, manufacturing has been subject to greater competition for workers from non-manufacturing industries, notably construction. In addition, manufacturing and other industries have been handicapped by a number of factors in filling job needs: (1) unexpectedly heavy withdrawal of older workers and women from the labor force since V-J Day, either directly or via the unemployment insurance route, (2) heavy enrollment among younger age groups, including veterans, in educational institutions, (3) a noticeable tendency, now decreasing, for many discharged servicemen

to take some time off before looking for jobs, (4) lack of housing facilities for workers otherwise willing to move from labor surplus to labor deficit areas, and (5) continued abnormally high labor turnover.

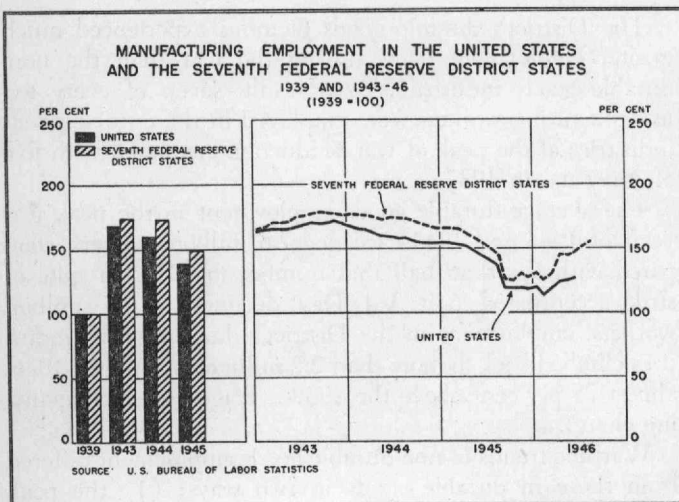
Manufacturing as well as other industries will, for some time at least, probably have to depend to a great extent on persons not now in the labor force, mainly veterans and women, for additional employees. Some relief will come from the ranks of the unemployed, although the current national level of about two million is not out of line with the estimated "normal" unemployment in most of the postwar full employment models (see *Business Conditions* for October 1946). High-wage industries will obtain some employees by drawing on labor forces of low-wage industries.

The decreased work week after V-J Day has been estimated as the equivalent of over one-half million employees in all industries in the Seventh District. Material shortages and other bottlenecks probably account in large part for the failure of industry to utilize its existing manpower more fully through a longer work week. Only in the last few months has there been a tendency for average hours worked per week in manufacturing to recover slightly from the postwar low reached in July of this year. Another source of manpower relief is the expected continued gradual increase in output per man-hour.

The major uncertainties in the employment situation concerns the number and duration of the "second round" of strikes in the coming winter and spring months and the possibility of a period of business readjustment. Seventh District manufacturing employment, as before, would be seriously curtailed by an extended "second round" of work stoppages, not only because of the importance in the District of iron and steel, automobiles, and other heavy manufactures, but also because of the almost complete dependence of these and other industries on coal. The extent to which work stoppages develop will depend on (1) the outcome of negotiations now in progress (coal, meat packing, rubber, petroleum, etc.), (2) the willingness of labor and management in general to accept the wage pattern set by that industry which first successfully reaches a new agreement², and (3) the extent to which matters of "principle," e.g., company security, union security, and annual wage, enter the negotiations in each industry.

Many of the existing labor contracts in the strongly unionized basic industries expire early in 1947 at a time when the Republican controlled Congress will be in session. Whether this will offset or accentuate the economic complexities of the situation depends not only on the type of labor legis-

¹Except where otherwise indicated, the national and state manufacturing employment estimates referred to throughout this article are those of the U. S. Bureau of Labor Statistics.



²The Sinclair Refining Company and the Oil Workers International Union have recently signed a new trade agreement in which wages are geared to the cost of living. Although similar agreements have existed in the past, Sinclair is believed to be the first nationwide company adopting it. However, other companies and unions have not yet indicated their reactions to the Sinclair-Oil Workers type of wage settlement.

lation preferred by Congress but also on the extent of agreement on labor policy between Congress and the Administration.

Recent drops in the commodity and stock markets may be advance indications of a transition from an inflationary to a deflationary economy. The accumulated demand for most durable goods, production of which is particularly important in the Seventh District, remains considerably in excess of supply. Deflationary pressures, if they occur, will be greatest in the non-durable goods industries which have been in relatively more abundant supply throughout the war and postwar period. Some of these industries have exhibited signs of weakness in recent months as consumers again begin to devote an increasing portion of their expenditures to the growing stream of durable goods.

Any manufacturing unemployment resulting from the period of business readjustment will probably be minor in extent and in all likelihood will be concentrated mainly in non-durable goods, particularly textiles and food. This is in contrast with the usual tendency of durable goods to be hardest hit by deflation. However, durable goods manufacturers may use a business recession as an opportune time to "weed out" employees, with the dual aim of increasing output per man-hour and of approaching closer to prewar labor-capital relationship.

DISTRICT AND NATION COMPARED

In the first eight months of 1946, manufacturing employment in the District exceeded its 1939 average by about 38 per cent. In the same period, manufacturing workers throughout the nation averaged in excess of 13.5 million, or about 36 per cent above the 1939 level. Whether the District can maintain its slight relative advantage as well as its absolute differential over 1939 depends primarily on the future demand for consumers' and producers' durable goods, which dominate Seventh District manufacturing.

The increase in manufacturing employment during the war was somewhat later in the Seventh District than in the nation (see *Business Conditions* for December 1944). At its peak in November 1943, manufacturing employment in the nation exceeded 17.8 million, about 77 per cent above the 1939 average of 10 million. Allowing for seasonal variations in food manufacturing employment, the Seventh District wartime peak of 3.8 million manufacturing workers occurred in January 1944 and was 78 per cent higher than the 1939 average of slightly over two million employees (see Table 1).

The decline in employment from their respective wartime peaks to V-J Day was greater in the nation than in the District. This reflects the heavy concentration of Midwest industry on ammunition, artillery, electrical equipment, tanks, and other ordnance items which received continued strong emphasis by the armed services in the later stages of the war. It was these industries which were primarily responsible for the District's marked upward wartime increase in manufacturing employment.

The accelerated downward manufacturing employment trend after V-E Day and the precipitate drop after V-J Day

Table 1
PERCENTAGE CHANGES IN MANUFACTURING
EMPLOYMENT, UNITED STATES AND SEVENTH
FEDERAL RESERVE DISTRICT STATES
SELECTED PERIODS, 1939-46

Period	United States	Seventh Federal Reserve District States
Prewar-war increases		
1939 to wartime peak ¹	+77	+78
1939 to 1945.....	+49	+48
Wartime decreases		
Wartime peak to V-E Day ¹	-9	-9
V-E Day to V-J Day ²	-29	-22
Prewar-postwar increases		
V-J Day to postwar low ³	-5	-1 ⁴
1939 to 1946—1st 8 months....	+36	+38 ⁴

¹November 1943 in the United States and January 1944 in the Seventh Federal Reserve District states.

²For employment purposes, V-E Day is April 15, 1945, and V-J Day is September 15, 1945.

³February 1946 in both the United States and the Seventh Federal Reserve District states.

⁴Estimated by Federal Reserve Bank of Chicago.
SOURCE: U. S. Bureau of Labor Statistics.

in both the District and the nation were the result of the increasing impact of war contract cancellations on the economy, physical reconversion problems, and widespread wage-price-profit controversies.

In the period beginning in September 1945, manufacturing employment in both the District and nation moved in an irregular plateau until the drop in February 1946, occasioned by the accumulated effects of severe nationwide strikes in steel, automobiles, and other heavy industries. This was the period of the completion of the physical phase of postwar reconversion and the more time-consuming development of a postwar wage-price policy. In spite of a heavy concentration of work stoppages in Seventh District steel, auto, and agricultural equipment industries early in 1946, manufacturing employment fell less as a result of strikes than in the nation. This was due in large measure to the greater offsetting effect of increased employment among the District's non-durable industries.

DURABLE AND NON-DURABLE PATTERNS

The District's durable goods factories experienced much greater employment gains during the war than the non-durable goods industries. As a result, seven of every ten manufacturing workers were employed in the durable goods industries at the peak of war production compared with five of every ten in 1939.

The average durable goods employment in the peak war years of 1943 and 1944 exceeded 2.6 million workers, compared with less than half that number in 1939. In spite of strike-accentuated post V-J Day declines to 1.7 million workers, employment in the District's durable goods industries climbed back to more than 2.2 millions by August 1946, almost 75 per cent above the 1939 average (see accompanying chart).

Wartime trends in non-durable goods employment differed from those in durable goods in two ways: (1) the peak

occurred earlier in non-durables, namely, in 1943 compared with 1944 for durables; and (2) the expansion was much less, about 25 per cent above prewar levels compared with the more-than-doubled wartime employment in durable goods. The earlier peak in non-durable goods was partly due to their greater ease of conversion to war production and partly to the emphasis on food in the immediate prewar (lend-lease) period. The 1944-45 employment trend was gradually downward and was followed by a virtually counterbalancing rising trend in 1946. These trends were very little affected by V-J Day or the postwar wave of strikes. Strikes in petroleum and rubber were short-lived and in meat packing were halted by temporary Government assumption of meat packing operations.

METAL WORKING INDUSTRIES

Over nine-tenths of the prewar, war, and postwar durable goods employment in the Seventh District states is concentrated in metal working, the remainder being divided among lumber, furniture, and stone, clay and glass. Of the metal working industries, machinery and transportation equipment experienced the greatest wartime gains in employment, over 140 per cent, and nonferrous metals and iron and steel the least, under 90 per cent. In spite of drastic post V-J Day declines, machinery employment in August 1946 was still almost double the prewar level. Since machinery accounts for more than one-third of all metal working employment, the future behavior of this industry will have a vital bearing on Seventh District employment trends. The important products turned out by this industry include farm machinery, heavy industrial equipment, electrical equipment, and many consumers' durable goods such as radios, phonographs, washing machines, and refrigerators.

The transportation equipment industry, which currently also accounts for about one-third of metal working employment, lost more than half of its wartime employment gains after V-J Day. This was due in large part to the fact that the wartime shipbuilding and aircraft programs were either virtually discontinued or drastically reduced in the four Seventh District states in which they had assumed some

wartime importance, namely, Illinois, Indiana, Michigan, and Wisconsin.

Iron and steel accounts for slightly over one-fifth of the District's metal working employment. Although down substantially from the wartime peak, iron and steel employment still exceeds the prewar level by over 40 per cent and promises to show further gains into 1947 as the industry strives to meet the heavy accumulated demand for its products. Nonferrous metals, the least important of the District's metal working industry groups in terms of numbers of workers, have employment over two-thirds above the prewar level and are having probably the greatest difficulty of recruiting needed manpower in order to fill their heavy backlog of orders. This recruiting problem arises from the heavy nature of the work and the intense heat characteristic of many nonferrous operations. War and postwar trends in the several metal working industries are summarized in Table 2.

FOOD AND OTHER NON-DURABLE INDUSTRIES

Food manufacturing, particularly canning, meat packing, and dairy products, is of relatively great importance in all of the five District states. The heavy wartime requirements of the armed forces, the high wartime levels of disposable income among civilians, and the scarcity of food in most of the other United Nations were reflected in a marked wartime employment rise. Since V-J Day the continued high level of disposable income at home and the needs of UNRRA abroad have resulted in 1946 food employment of over 320,000 workers, substantially above the 1939 average of 280,000, although somewhat under the wartime level. Because of canning and meat packing, food employment has a pronounced seasonal peak in the late summer and fall months of each year.

The remaining non-durable goods industries fall into two major groups: (1) those which have had sharply increased wartime employment followed by varying post V-J Day declines and 1946 rises, and (2) those in which employment was adversely affected by the war but since V-J Day have regained their prewar employment levels, in whole or in part. The first group includes chemicals and rubber and the second, leather, textiles, apparel, and printing. Paper manufacturing is unique in having a relatively unbroken upward war and postwar trend.

INDIVIDUAL STATE PATTERNS

The war and postwar trends in each of the District states are similar in broad outline to the trends in the District as a whole, emphasizing the broad homogeneity of District manufactures. What differences exist among the states are due in large part to the varying importance of individual manufacturing industries in each state's economy. The wartime manufacturing employment gains of Indiana, Iowa, Michigan, and Wisconsin ranged from 83 to 96 per cent; Illinois showed a lesser rise of 65 per cent (see Table 3). As of July 1946, Indiana, Michigan, and Wisconsin had maintained their wartime manufacturing employment gains to a much greater extent than Illinois or Iowa. The staying power of Michigan and Indiana is based largely on the

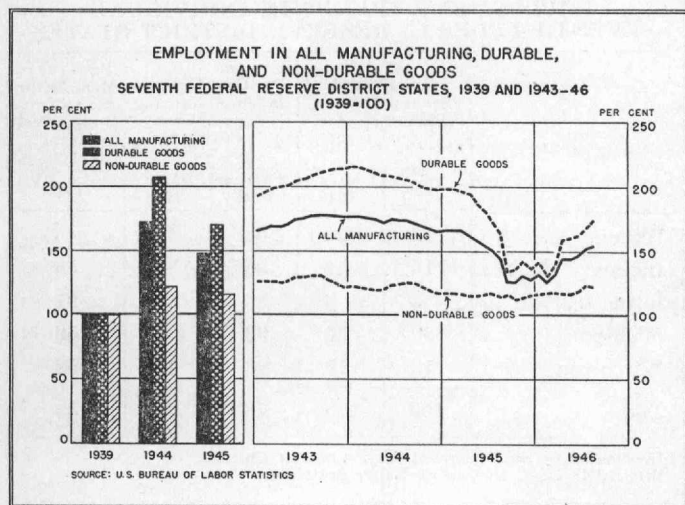


Table 2
**METAL WORKING EMPLOYMENT IN SEVENTH
 FEDERAL RESERVE DISTRICT STATES BY
 INDUSTRY GROUPS, PREWAR, WAR,
 AND POSTWAR**

Industry	Per Cent of Total Metal Working Employment			Per Cent Increase Over 1939	
	1939	1944	July 1946 ¹	1944	July 1946 ¹
Transportation (including automobiles)	35	38	34	147	59
Iron and steel.....	28	22	22	76	44
Other machinery	22	23	27	144	98
Electrical machinery	9	11	10	162	105
Nonferrous metals	6	6	7	96	67
All metal working.....	100	100	100	125	69

¹Excludes Indiana, for which manufacturing employment estimates are available only through December 1945.
 SOURCE: U. S. Bureau of Labor Statistics.

tremendous pent-up postwar demand for the products of each state's major industry, automobiles and iron and steel, respectively. The automobile industry accounts for almost one-half and metal working, including automobiles, for three-fourths of Michigan's manufacturing employment. In Indiana, iron and steel accounts for every fourth manufacturing worker, and metal working for one-half of the manufacturing total.

Illinois and Wisconsin manufacturing employment are more evenly spread among individual industries than that of Michigan and Indiana. Wisconsin's better postwar record compared with Illinois is due in large part to the strong demand for paper, furniture, and lumber products which together employ one in every seven manufacturing workers and which during the war suffered aggregate employment declines. Postwar strength in these three industries as well as sustained demand for heavy machinery, cheese, beer, and other food products has helped to offset Wisconsin's losses in employment occasioned by drastic war contract cancellations in metal working, particularly shipbuilding.

Prior to the war Iowa was primarily a food producing state. The few key ordnance plants located there during the war were largely instrumental in stimulating Iowa's wartime manufacturing employment. As a result of the closing of some of these plants since V-J Day, Iowa's considerable wartime expansion in chemical munitions employment has been virtually eliminated, and in metal working largely reduced. Iowa's ability to maintain or increase its 1946 metal working employment of about 42,000, twice the 1939 average, therefore is crucial in determining future manufacturing employment levels.

All the District states are thus heavily dependent upon a sustained demand for durable (metal) products in keeping their postwar employment above prewar levels. This is particularly true for Indiana and Michigan, not only because of their one-dominant-manufacturing-industry characteristic, but also because manufacturing employees constitute a much higher proportion of all non-agricultural workers than in Illinois and Iowa (see Table 3).

Total non-agricultural employment in the Seventh Federal Reserve District states has increased over 15 per cent since the end of the war, about the same rate of increase as for manufacturing workers. The reversal of the wartime downward trend in non-manufacturing employment represents the beginning of increased competition of these industries for workers. Such non-manufacturing industries as construction and transportation have wage levels which in many cases are as high or higher than those in manufacturing. Other non-manufacturing industries pay lower wages than manufacturing but offer non-pecuniary advantages such as permanence, pleasant working conditions, convenience of location, etc. As a result, a number of manufacturing companies have instituted recruiting campaigns, aimed primarily at women.

The exodus of women from the labor force began in the later stages of the war and gained momentum after V-J Day. Reports from several United States Employment Service offices in the Seventh District indicate, however, that in the last several months more women have entered than have left the labor force, but not in sufficient numbers to fill available job openings. Total female employment still remains considerably under wartime levels. This is particularly true of women in the marriageable and childbearing age groups between 20 and 35.

Servicemen have in recent months reduced considerably the average time between discharge and seeking employment. Consequently, the number of employed veterans has increased more sharply than employment in general. Of the nationwide estimated total of two million unemployed, however, about 750,000 were veterans. The length of time of average unemployment of both veterans and non-veterans has shown a tendency to increase compared with a year ago, indicating that a growing number of the currently unemployed may represent persons who are becoming more difficult to place.

Table 3
**WAR AND POSTWAR MANUFACTURING
 EMPLOYMENT TRENDS IN INDIVIDUAL
 SEVENTH FEDERAL RESERVE DISTRICT STATES**

State	Per Cent of Seventh District Manufacturing Employment		Per Cent Increase in Manufacturing Employment from 1939 to:		Per Cent of Manufacturing to Total Non-agricultural Employment
	1939	July 1946	Wartime Peak	July 1946	
Illinois	38	35	65	40	43
Indiana	16	19	96	52 ¹	56
Iowa	4	4	85	43	31
Michigan	30	30	92	52	59
Wisconsin	12	12	83	57	52
Total	100	100	78	51 ¹	49

¹Estimated by the Federal Reserve Bank of Chicago.
 SOURCE: U. S. Bureau of Labor Statistics.

Wisconsin State Finance—III

Substitutes for State Debt: Taxes, Local Credit, Loans from Trust Funds

The economic and legal capacity to use credit on a long- or short-term basis may have important advantages for a state or local government. The relative significance of these advantages is, however, dependent upon such factors as the size of the government, the character of the functions it performs, the nature of its tax system, and the rate of growth of the community served.

Governments furnishing services which occasionally require capital outlays that are large, relative to annual operating expenses, must be able to use credit or to draw on a cash reserve. Otherwise they will impose excessive taxes during years of construction and forego the contribution of the facility created by the capital outlay to defray amortization

charges. New or developing communities are seriously retarded unless they can, through credit devices, keep public investment apace of private investment and anticipate tax receipts from a larger and more prosperous population.

The yields from certain types of tax systems fluctuate widely in prosperity and depression, and a government largely dependent on flexible tax revenues may find short-term borrowing preferable to carrying a large enough cash surplus in normal or prosperous years to suffice for depressed periods, or to falling back on the alternative of raising tax rates at the depths of depression.

BARRIERS TO USE OF STATE CREDIT

The disadvantages of using state or local credit arise from the fact that it is often possible for a government to borrow more than is necessary or desirable from the standpoint of the community. An excess of this character is no different in kind from inappropriate expenditures from annual taxation, but it is much more likely to have serious economic and political consequences because of the amounts involved. Even the best intentioned judgments on the wisdom of a given expenditure policy may thus have the effect of unwisely committing a substantial amount of state expenditure not for a year or a biennium but for ten to twenty-five years. The framers of many state constitutions, and particularly those adopted about a century ago, were acutely aware of the hazards of public investment, and incorporated provisions into the fundamental laws of their states calculated to restrict borrowing within very narrow limits. Thus, the provisions of the Wisconsin Constitution have been so restrictive that the State has not borrowed money in the manner prescribed by its Constitution since Civil War days. A portion of the Civil War debt was outstanding until 1944 (see Table 1), although the obligation had been held by State trust funds after 1886.

The constitutional prohibition against State debt in Wisconsin (*Constitution*, Article VIII, section 9) permits borrowing for only two purposes: (1) to defend the State in time of war (Article VIII, section 7), and (2) to defray extraordinary expenditures not in excess of 100 thousand dollars (Article VIII, section 6). Any other evidence of State debt which can be shown to create a legal obligation on the State would require an amendment to the Constitution. Such an amendment has never been adopted. In addition to this broad prohibition against borrowing, the State Constitution as originally adopted prohibited the State Government from contracting any debt for works of internal improvement or to being a party in carrying out such works (Article VIII, section 10). This restriction on the scope of State activities reflects the prevailing sentiment of the era in which the Constitution was originally adopted (1848).

Table 1
OUTSTANDING STATE DEBT, INTERFUND
BORROWING AND COUNTY INDEBTEDNESS FOR
STATE TRUNK HIGHWAYS JUNE 30, 1920-45
(In millions of dollars)

Year	Direct Debt ¹	Inter-fund Borrowing ²	Deferred Payments to Teachers' Retirement Fund	County Issues for State Trunk Highways
1920	2.7	—	—	—
1921	2.3	—	—	—
1922	2.2	—	—	—
1923	2.1	—	—	—
1924	2.0	—	—	—
1925	1.9	—	—	—
1926	1.8	.4	—	—
1927	1.7	.4	—	—
1928	1.6	.8	—	—
1929	1.5	.8	—	—
1930	1.4	1.4	1.6	—
1931	1.3	1.8	1.7	35.8
1932	1.2	1.8	1.8	34.4
1933	1.2	2.0	2.2	31.2
1934	1.2	1.9	2.8	28.4
1935	1.2	1.8	3.8	26.1
1936	1.2	1.7	4.7	24.8
1937	1.2	1.7	5.0	23.4
1938	1.2	1.8	5.2	21.8
1939	1.2	2.9	5.8	19.4
1940	1.2	4.2	6.2	16.3
1941	1.2	4.3	5.9	13.3
1942	1.2	4.2	3.2	10.1
1943	1.2	4.3	—	6.8
1944	—	4.2	—	4.1
1945	—	3.9	—	2.4

¹Consists of Civil War obligations and notes issued to compensate the Normal Fund for the State's diversion of monies designated by statute for normal school use.

²Includes loans made from the Teachers' Insurance and Retirement Fund and other trust funds by the Wisconsin University Building Corporation and appropriations made from the State Insurance Fund.

SOURCES: Taken from the *Biennial Report of the Secretary of State of the State of Wisconsin, Report of the Business Manager* (formerly the Comptroller), University of Wisconsin, the *Wisconsin State Budget*, and the *Wisconsin Taxpayer*.

Illinois, Michigan, and other states were at that time suffering severe financial distress arising from ill-considered and overly ambitious programs of internal improvement. The framers of the Wisconsin Constitution were firmly resolved to prevent their State's credit and resources from being involved in any such schemes. As they did not wish to discourage all public participation in internal improvements, they did not inhibit the use of local taxes or credit.

The prohibition against State participation in internal improvements proved too restrictive to endure, and the Constitution subsequently was amended to permit the State to use funds in the public treasury or the proceeds of taxes to aid in the construction and maintenance of highways (1908), a State forestry program (1924), and airports (1945). The section in its present form reads as follows:

Sec. 10.—The state shall never contract any debt for works of internal improvement, or be a party in carrying on such works; but whenever grants of land or other property shall have been made to the state, especially dedicated by the grant to particular works of internal improvement, the state may carry on such particular works, and shall devote thereto the avails of such grants, and may pledge or appropriate the revenues derived from such works in aid of their completion. Provided, that the state may appropriate money in the treasury or to be thereafter raised by taxation for the construction or improvement of public highways or the development, improvement and construction of airports or other aeronautical projects. Provided, that the state may appropriate moneys for the purposes of acquiring, preserving, and developing the forests of the state; but there shall not be appropriated under the authority of this section in any one year an amount to exceed two-tenths of one mill of the taxable property of the state as determined by the last preceding state assessment.

Though section 10 has been liberalized on three occasions, none of the amendments authorized the use of the State's credit. After almost a century of experience, the State still prefers pay-as-you-go to loans for internal improvements.

ALTERNATIVES TO BORROWING

Between 1920 and 1940, the 48 state governments borrowed in the neighborhood of 4 billion dollars. Approximately 45 per cent of the total was for highways, 12 per cent for soldiers' bonuses, 16 per cent for unemployment relief and general operating purposes, and 12 per cent for public buildings. In Wisconsin these functions were financed as follows: bonus payments following World War I and the State's share of unemployment relief in the 1930's were paid for by special taxes; the State's contribution to highways was almost entirely from highway-user taxes, supplemented by extensive borrowing of the counties and local units of government; State buildings and institutional facilities were financed out of current revenues and by special credit devices now typical of many states having strict prohibitions against state borrowing.

The most pressing demands for the use of state credit undoubtedly have been associated with the rapid expansion of highway facilities. In Wisconsin, motor vehicle license fees and State and local property taxes were early sources of highway revenue. A motor fuel tax was adopted in 1925. The over-all highway program integrated state, county, and local plans and particularly encouraged the use of county credit to build a state highway network. In 1931 the State recognized a moral obligation to assist the counties in servic-

ing debts incurred for the state system and provided grants out of highway-user revenues in amounts sufficient to pay the principal on the bonds issued. The State by earmarking aids for the repayment of county bonds did not assume any legal responsibility for meeting future debt service. However, it would have required a most unusual combination of circumstances for the State to discontinue a policy thus embarked upon even though no legal compulsion was involved.

Despite county borrowing, development of highways in Wisconsin has been at a somewhat slower rate than in states which have used credit more extensively. The difference is most noticeable in the proportion of highway facilities that are improved with a high type of pavement. The necessary delay in the pay-as-you-go financing scheme has probably accounted in part for the failure of the State to extend as substantial aid to municipalities for city streets as might otherwise have been practicable. The indirect use of local government credit for a function otherwise regarded as that of the state is fairly common in several states where for constitutional reasons it has been difficult, if not impossible, for the state to borrow.

The financing of the World War I bonus is another example of the State's preference for pay-as-you-go financing. Both a cash and an educational bonus given to veterans of World War I were currently financed by property and income tax levies.

In the early 1930's, when declining State revenues and the growing burden of providing unemployment relief brought State finances into serious difficulty, the State met the emergency by imposing additional taxes on net income and by diversion of revenues earmarked for trust funds and special functions. Thus, statutory provision for the Teachers' Retirement Fund required contributions from the General Fund when the yield of the surtax levied for retirement purposes was inadequate to meet the actuarial liability. Conversely, when the receipts from this levy were in excess of the requirements, transfers from the Retirement Fund to the General Fund of the surplus were required. With a sharp reduction in tax yields in depression years, the General Fund incurred substantial liabilities to the Retirement Fund which it did not meet; as indicated by Table 1 the accumulated liability at one time amounted to some 6 million dollars. In these same years the State also diverted funds from the highway account to general State purposes. There was no hard and fast legal requirement then that the motor fuel tax and the motor vehicle licenses should be used exclusively for road construction, maintenance, and aids. Actually a portion of the yields from these taxes in the years of financial strain were a vital factor in maintaining expenditures for general state government.

As early as 1925, certain quasi-educational facilities at the State University called for fairly substantial capital outlays. The Union Building and dormitories were financed by the organization of the University Building Corporation which leased property from the University, borrowed money from State trust funds, constructed the improvements, and leased the improved property back to the University. The University in operating the facilities charged fees and, from the earnings accruing from operation of the property, made

rental payments to the building corporation. The building corporation thus acted as an agency which made it possible for one State agency to borrow from another. This arrangement was challenged in the Wisconsin courts, but the State Supreme Court held that while the device was admittedly a subterfuge, the State had not incurred any legal liability for such debts and they therefore could not come within the prohibition of the State Constitution.¹

In the late 1920's, another device of a somewhat similar nature was adopted. The State needed additional office space and, being unwilling or unable to finance construction of an office building from the General Fund, appropriated monies for this purpose from a trust fund (the State Insurance Fund) to the State Office Building Commission. The Building Commission constructed the building and leased it to various State departments at regular space rentals sufficient to amortize the loans from the Insurance Fund in twenty-five years with interest at 3 per cent. This situation differs from that of the University Building Corporation in that the

earnings of the improvement are dependent upon State appropriations and not upon tenants who have no particular connection with the State Government. From these examples it appears that the State can indirectly borrow for some types of public improvement of a limited character. That this device will be widely and generally used in financing a large program of public works construction hardly seems likely, although the existence of substantial trust funds (see Table 2) for which profitable investment by the State is sought may suggest the extension of present practices.

THE NATURE OF WISCONSIN TRUST FUNDS

The cash and investment balances in Wisconsin trust funds are set forth in Table 2. A brief summary of their size, function and character will roughly indicate the limits of interfund borrowing.

The school trust funds were founded with the proceeds from Federal land grants. There have been no accretions to the Agricultural College Fund (300 thousand dollars) nor to the University Fund (233 thousand dollars) during the years 1920-45. The School Fund, which receives for investment monies reverting to the State from escheats, forfeitures, and fines in counties, has grown steadily. The annual earning of all these trust funds goes for school operation.

Among the group of insurance funds, the State Insurance Fund provides fire insurance for all State property and that of cities, towns, and villages; the Life Fund provides insurance for residents of Wisconsin; and the Deposit Fund provides for insurance of public funds in designated depositories. All of these funds receive some type of "premium" payment—and must be prepared to meet the financial contingencies for which they were created.

The teachers' insurance and retirement system was created in 1911 and extensively amended in 1921. The State Employees' Retirement and Municipal Employee Retirement were established in 1943. All of these systems are operated on a reserve basis, being supported by payroll deductions from participants and by State or local taxes. The Teachers' Insurance and Retirement Fund holds about 98 per cent of the total balances in all pension funds.

The investments of the several trust funds are subject to varying restrictions, the major one being that the Unemployment Trust Fund is invested by the Secretary of the U. S. Treasury in the securities of the United States. Otherwise, the bulk of the trust funds may be invested in such assets as would be legal for domestic life insurance companies in Wisconsin: Federal, state, local bonds; Canadian Dominion and Provincial bonds; U. S. or Canadian public utility bonds; first mortgages on improved or partially improved real estate up to 50 per cent of fair cash value. Seventy per cent of the investments of pension funds by the State Annuity and Investment Board are to be made in Wisconsin. Within these restrictions, and by specific legislative authorization, the State Government can shift cash resources from one of its agencies or functions to another by interfund borrowing and provide a plan of repayment that will be both certain and properly adjusted to the later expenditure needs of the loaning agency or fund.

¹"It is of no legal consequence to say that the plan is a subterfuge and devised for the mere purpose of circumventing the constitution. This may be admitted without answering the question one way or the other. In order to condemn the transaction it must be found that it creates a state debt within the meaning of the constitution." *Locmis vs. Callahan* (1928) 220 N.W. 816.

Table 2
BALANCES IN STATE OF WISCONSIN TRUST FUNDS
JUNE 30, 1920-45
(In millions of dollars)

Fiscal Year	Total	School ¹	Insurance ²	Pension ³	Unemployment Compensation Trust	All Other ⁵
1920	9.8	8.6	.3	.7	—	.2
1921	10.2	8.8	.4	.8	—	.2
1922	12.4	9.1	.5	2.6	—	.2
1923	14.6	9.8	.7	3.9	—	.2
1924	17.2	10.3	1.1	5.6	—	.2
1925	20.3	10.8	1.3	7.6	—	.6
1926	23.8	11.5	1.6	9.6	—	1.1
1927	27.1	12.1	1.9	11.8	—	1.3
1928	28.6	12.7	2.0	12.9	—	1.0
1929	31.3	12.8	2.3	15.4	—	.8
1930	34.0	13.3	2.5	17.3	—	.9
1931	37.2	13.6	2.2	20.1	—	1.3
1932	40.0	13.8	2.5	22.4	—	1.3
1933	43.0	13.8	2.3	25.0	—	1.4
1934	44.4	13.9	2.6	26.6	—	1.3
1935	47.4	14.0	2.8	28.5	—	2.1
1936	61.1	14.2	2.9	30.7	11.5	1.8
1937	76.0	14.4	3.1	33.3	23.2	1.5
1938	90.3	14.6	3.4	37.4	33.3	1.6
1939	104.9	14.8	4.1	40.8	43.4	1.8
1940	118.9	15.1	4.5	44.0	53.4	1.9
1941	131.8	15.4	5.3	48.0	61.4 ⁴	1.7
1942	150.1	15.7	6.5	54.8	71.1	2.0
1943	182.9	15.9	7.7	64.4	92.5	2.4
1944	223.7	16.2	8.5	70.7	131.0	2.3
1945 ⁶	281.3	17.9	9.0	78.5	173.3	2.6

¹Consists of the School, University, Agricultural College, and Normal School Trust Funds.

²Consists of the State Insurance Fund, State Deposit Fund (1932-45), and Life Fund.

³Consists of the Teachers' Insurance and Retirement Fund and, beginning in 1944 and thereafter, the Wisconsin Municipal Employee and the State Employees' Retirement Funds.

⁴Balances are adjusted in this year for a transfer of \$1,964,000 to the railroad unemployment insurance accounts.

⁵Consists of the University Trust and Trust Fund Income, Death Benefit, Injuries Indemnity, Benevolent Fund and Fund Income, and the Mutual, Stock, and Reciprocal Workmen's Compensation Security Funds.

⁶Balances for 1945 have been estimated from the *Monthly Report of the State Treasurer*.

SOURCES: State of Wisconsin, *Report of the State Treasurer; Biennial Report of the Secretary of State of the State of Wisconsin*; Unemployment Compensation Trust Fund balances from the *Annual Report of the Social Security Board*.

FARM PRICE OUTLOOK

(Continued from Inside Front Cover)

perience similar to that of 1920-21 awaits us now.

FARM PRICES COLLAPSED IN 1920-21

Prices received by farmers in June 1920 averaged 234 per cent of the 1910-14 average. By December prices had declined 36 per cent with a further decline to the following June, making a total decline in one year of 52 per cent. The farm price of wheat dropped from \$2.56 per bushel in June 1920 to \$1.46 in December and declined further to \$1.20 in June 1921. Corn averaged \$1.85 per bushel in June 1920, \$0.67 in December, and \$0.62 the following June. Hogs reached an average of \$20.12 per hundredweight for mid-July 1919, had declined to \$13.23 in June 1920, and to \$8.50 in December. Other agricultural commodities experienced similar price adjustments. Will this experience be repeated? Most observers say yes, but expect the price declines to be smaller and more gradual than in 1920-1921.

Many similarities exist between the current farm price situation and conditions prevailing after World War I. Also there are many differences. Important similarities include the increased output capacity of farms, the relatively high level of farm product prices, and the intense worldwide demand for food at the close of the wars. The important differences which lead most observers to expect a less drastic deflation of farm product prices than occurred following World War I include an anticipated high level of employment and incomes, Government commitments to support prices of most farm products, less speculative accumulation of inventories of farm products (an awareness that prices can decline as well as rise), and a substantial backlog of liquid savings held by consumers, some of which may be spent to maintain a high level of consumption.

Of prime importance currently, as always, in determining the future course of prices of farm products is the level of income payments. If a high level of industrial production and employment is maintained, the outlook for farm prices is relatively favorable; if not, farm prices are likely to experience precipitous declines. Even with high levels of industrial production and employment, prices of farm products are expected to decline relative to prices of other commodities and services. This would be, in part, a readjustment resulting from the relatively greater increase in prices of farm products than in prices of other important groups of commodities and services commonly experienced during wars or other periods of sharply increased demand.

Parity prices have been a goal of some farm leaders for many years and have been written into laws establishing them as the official goal of the Government in its activities affecting prices of farm products. To facilitate increased production of products required for the successful prosecution of World War II, price supports were announced by the Secretary of Agriculture for many farm products. Legislation adopted during the war obligated the Government to support prices of the commodities for which the Secretary requested increased production during the war at 90 per cent of parity¹ for at least two years following official declara-

tion of the end of the war (not yet declared ended).

Prices received by farmers on November 15, 1946, averaged 124 per cent of parity. The actual price as a per cent of the calculated parity price differed for each commodity ranging from 78 and 92 per cent for potatoes and oats to 193 and 153 per cent for flaxseed and beef cattle. A drop in farm product prices to the 90 per cent of parity level would represent a decline from the present level of about one-third. Since some commodities are not expected to decline to support levels, the average price of all farm products probably will continue above 90 per cent of parity for the duration of the support price commitment.

A longer-run outlook for farm product prices is even more heavily clouded by uncertainty. There is increasing evidence that the large output of farm products during recent years was due in large part to technological progress in agriculture with unusually favorable weather making some contribution. Further increases in production are anticipated with continued technological advances in agriculture. Unless demand increases as rapidly as production, farm prices can be expected to follow a declining trend relative to prices of other goods and services. Population still is increasing and will provide some increase in demand. However, much of the increase required to maintain farm product prices at a level comparable to parity must result from a high per capita consumption. With wartime incomes and shortages of industrial products, civilians consumed during recent years from 10 to 15 per cent more food per capita than in 1935-39. Continuation of a high level of employment and business activity may provide sufficient demand to maintain the average of farm product prices at about 90 per cent of parity over a period of years. If, on the other hand, substantial unemployment should develop, it is quite possible that the curtailed demands for farm products, in conjunction with the large volume of production which is in prospect, would result in prices materially below this level.

SHORT-RUN PROSPECTS GOOD

Recent weaknesses in the commodities markets—cotton, grains, butter, eggs, and poultry—have dampened speculative enthusiasm in many quarters but have been evaluated by most traders as indicating a much less serious price readjustment than occurred in 1920-21. While conceding generally that farm product prices have passed their postwar peaks, sufficiently strong demand is expected to prevail throughout most of 1947 to sustain prices at a level, although below the average for 1946, sufficiently high to yield a cash farm income in 1947, possibly 5 per cent smaller than the record 23.9 billion dollars estimated for 1946. Production expenses may increase further, with net farm income declining possibly 10 to 15 per cent. Prices are expected to weaken during 1947, largely as a result of factors operating to weaken demand, both foreign and domestic. The high volume of production of farm products during recent years is expected to continue and will tend to depress prices.

¹In general, parity is that price which bears the same relationship to prices paid by farmers for commodities used in production, for family maintenance, and for taxes and interest as prevailed during the 1910-14 period.

Business Conditions

A Review by the Federal Reserve Bank of Chicago

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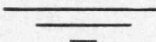
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SEVENTH FEDERAL



RESERVE DISTRICT



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