LIBRARY
MAR 3 1948

MARCH, 1948

# BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

# International Trade Barriers Lowered

## *Current Effects Limited by Goods Shortages*

Two years of intensive preparation and study, including six months of continuous international negotiations, culminated in a *General Agreement on Tariffs and Trade* signed at Geneva by 23 countries on October 30, 1947. This agreement included tariff concessions – elimination, reduction, or agreement not to increase tariff rates or quantity restrictions–on products accounting for approximately two-thirds of all imports of the negotiating countries and for substantially half of total world imports. Negotiations by the United States were conducted under authority of the Trade Agreements Act which, if not extended by Congress, expires in June of this year. The life of the recently negotiated agreement is three years.

In addition to the detailed adjustments negotiated in the tariff schedules for individual commodities, and possibly of even greater importance, are the *General Provisions* of the agreement. These provisions incorporate basic rules for the conduct of international trade which will eliminate many practices that have handicapped international commerce and will standardize procedure with respect to other restrictive practices. These basic rules apply to *all* trade between the parties to the agreement. Thus, for the first time, a generally accepted code of fair treatment in international commercial relations is established. These general provisions may be fully as effective a stimulant to international commerce as the reduction made in tariff rates.

Efforts of the United States and a number of other countries to develop generally acceptable international policies which will promote greater freedom in the exchange of goods and services at the international level continue. Only three weeks after conclusion of the session on tariffs and trade at Geneva, the United Nations Conference on Trade and Employment convened at Havana, Cuba, and at this writing still is in session. Objective of this conference is to reach agreement on a proposed charter for an International Trade Organization, embracing not only the constitution of an international agency to deal with trade and employment problems, but also a detailed code of international conduct with respect to commercial policy, employment policy, international investment and economic development, restrictive business practices, and inter-governmental commodity agreements. Any agreement reached on international trade at this conference presumably will include the *General Provisions* of the *Agreement on Tariffs and Trade*.

Present conditions of intense demand and limited supplies of goods in many countries, resulting from wartime expansion of money supplies and disruptions of production, have caused a number of governments to adopt emergency controls over exports and imports. Such controls prevent significant parts of the *General Agreement on Tariffs and Trade* from becoming effective immediately.

As production increases and commerce returns to a more normal status, these emergency measures must be terminated. Then the tariff rates and conditions of trade agreed upon at Geneva by the 23 countries are designed to permit a more nearly optimum use of the resources of these countries with the people benefiting from more efficient production and improved distribution of goods and services.

Of interest in the new agreement are the extensive precautions taken to prevent the development of unforeseen hardships for the producers of any product covered by the agreement. An American sponsored "escape clause" provides that if through unforeseen developments a particular tariff reduction should increase imports sufficiently to cause or threaten serious injury to domestic producers, the country granting the concession may withdraw or modify it in whole or in part. If the concession is in fact modified or withdrawn, other interested countries may then withdraw or modify substantially equivalent concessions. In addition to this general safeguard, further precautions were included by some countries for specific commodities. These loopholes may constitute a serious weakness in the agreement and result in the loss of much of the progress made under the agreement toward increasing imports.

The revised tariffs became effective on January 1, 1948, for the major countries participating in the agreement. Other participating countries must put them into effect as soon as they can comply with procedures required by their constitutions or laws, but no later than June 30, 1948.

### CONCESSIONS OBTAINED BY THE UNITED STATES

Concessions were made by other countries on products accounting for a large part of total United States exports to those countries and including almost all the important United States export products, both agricultural and industrial. Commodities on which tariff concessions were obtained had 1939 exports valued at 1.4 billion dollars.

Tariff preferences which permitted mutual exchange of products among members of the British Commonwealth at lower tariffs than applied to products from other sources affected a significant part of United States trade, and had long been a handicap to United States exporters. Such preferences were substantially reduced, and those on a considerable list of products which the United States exports to countries of the Commonwealth were eliminated entirely. Under the terms of the agreement no new preference may be created, and no existing preference may be increased on *any* product whether or not listed in the agreement.

Concessions were obtained on farm and industrial products of interest to all major regions of the United States. Among the farm products major concessions were received on *fruits and juices*–fresh, dried, and canned. Citrus and

*(Continued on Inside Back Cover)*

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

# Michigan State Finance – II

*A Review of State Borrowing and Debt Management*

The State of Michigan has used its credit in the past three decades principally to finance veterans' bonuses after World Wars I and II and to initiate the program of state highway construction in the 1920's. Provisions of the Michigan constitutions of 1850 and 1908 have made it difficult for the State to borrow on either a short-term or long-term basis. Short-term loans to meet deficits in the revenues are restricted to a total of $250,000 at any one time, and long-term borrowing except "to repel invasion, suppress insurrection, defend the state or aid the United States in time of war" is prohibited.[1]

These drastic limitations on the authority of the General Assembly to incur debt go back to the State's early experience with borrowing for internal improvements. Shortly after admission to the Union the Michigan legislature carried out a mandate of the Constitution of 1835 to encourage internal improvements within the state by authorizing a five million dollar loan for a system of state railroads. Since that Constitution contained no restrictions on borrowing, an additional million dollars was loaned chiefly for state aid to private railroads, for the establishment of a state university, and the assumption of delinquent local taxes. The climate of opinion throughout the country led the State to expect to repay these loans out of the earnings of the enterprises—great expectations shattered by the financial crisis and depression of late 1830's. The State had realized only 1.4 million of the five million dollar loan placed with the U. S. Bank of Philadelphia; the remainder was sold to banks on a partial payment plan. In 1841 no appropriation was made for interest, and the State declared itself unable to meet its obligations. At that time the outstanding debt was 15 times as great as the State's annual income. During the next five years, the debt was reduced to manageable proportions chiefly by the sale of the railroads to private investors. Responsibility for the principal and unpaid interest on 1.4 million for which full payment had been received was assumed, but the remaining bonds were paid at a 60 per cent discount with back interest ignored. By the end of 1846 the outstanding debt approximated two million dollars. This was refunded in 1861 and finally liquidated by 1881.

In their determination to avoid similar abuses in the future the framers of the Constitution of 1850 not only virtually prohibited all borrowing by limiting the indebtedness to covering deficits in the revenue, but also forbade the State to engage in internal improvements. Constitutional amendments have been necessary to enable the State to assume the now familiar functions of state governments, namely, the construction and maintenance of highways, the development of natural resources, and the construction of airfields. (See Section 14 of footnote 1.)

The Michigan constitutions have been construed to per-

[1]The sections of Article X of the Michigan Constitution of 1908 affecting the power of the State to borrow follow:

*Sec. 10* "The state may contract debts to meet deficits in revenue, but such debts shall not in the aggregate at any time exceed $250,000. The state may also contract debts to repel invasion, suppress insurrection, defend the state or aid the United States in time of war. The money so raised shall be applied to the purposes for which it is raised or to the payment of the debts contracted." [These provisions do not vary from those in the Constitution of 1850 except that the limit for borrowing to meet deficits was $50,000. The following authorization was added in 1919.] "The state may borrow not to exceed $50,000,000 for the improvement of highways and pledge its credit and issue bonds therefor on such terms as shall be provided by law." [Laws enacted pursuant to this provision specified that a maximum of five million dollars, increased to 10 million in 1921, could be borrowed in any one year. Interest rates could not exceed 5½ per cent, and the bond maturities could not exceed 30 years. All bonds sold, with the exception of seven million, carried 20-year maturities. The Auditor General was directed to transfer annually to a sinking fund created for the retirement of such bonds a sum sufficient to pay interest and to retire the bonds at maturity. In 1926, this amount was set by the Legislature at $4,082,000.]

*Sec. 11* "No scrip, certificate, or other evidence of state indebtedness shall be issued except for such debts as are expressly authorized in this constitution.

*Sec. 12* "The credit of the state shall not be granted to, nor in aid of any person, association, or corporation.

*Sec. 13* "The state shall not be interested in the stock of any company, association, or corporation.

*Sec. 14* "The state shall not be a party to, nor be interested in any work of internal improvement, nor engage in carrying on any such work except:

1. In the development, improvement and control of or aiding in the development, improvement and control of public roads, harbors of refuge, waterways, airways, airports, landing fields and aeronautical facilities;
2. In the development, improvement and control of or aiding in the development, improvement and control of rivers, streams, lakes and water levels, for purposes of drainage, public health, control of flood waters and soil erosion;
3. In reforestration, protection and improvement of lands in the state of Michigan;
4. In the expenditure of grants to the state of land or other property." [In the Constitution of 1850 section 4 above was the single exception to the general exclusion of state participation in internal improvement projects. An amendment adopted in 1905 permitted expenditures for public wagon roads. This was incorporated in the Constitution of 1908, and sub-section 3 was added. The remaining authorizations were incorporated in amendments ratified in 1945.]

*Sec. 20 (b)* "The state shall borrow not to exceed thirty million dollars, pledge its faith and credit and issue its notes or bonds therefor, for the purpose of paying to each person who entered into the military, naval or marine forces of the United States between April sixth, 1917 and November eleventh, 1918 who was a resident in this state the sum of $15.00 per month and major fraction thereof of such service, up to and including August first, 1919." [This amendment was adopted in 1921. The legislature of that year provided that maturities on bond issues should not exceed 30 years, and interest paid should not exceed 5¾ per cent. Bonds issued matured in 20 years with the exception of five million of bonds originally issued as short-term notes. A sinking fund was established to which the General Fund was directed to pay an amount sufficient to pay the interest and retire the principal at maturity but not less than $500,000 annually.]

*Sec. 23* This section, adopted in 1946, authorized the State to issue an amount not to exceed 270 million dollars of serial bonds or notes for the purpose of paying a bonus to each resident of Michigan or survivor who served in the armed forces between September 16, 1940, and June 30, 1946. Payments are computed at the rate of $10 for each month of domestic service and $15 for each month of foreign service with a maximum of $500. In the event that the issue authorized proves to be insufficient the legislature is directed to meet the deficiency from the General Fund. [The 1947 Legislature fixed the interest at a rate not to exceed 2½ per cent; 200 million dollars of the issue carrying an average coupon rate of 1.5 per cent was sold in March 1947, at a yield of 1.473; an additional block of 30 millions with an average coupon of 1.25 was sold in September 1947. The proceeds of a new cigarette tax levied during the life of the bonds are earmarked for the payment of interest and retirement. Should this source be insufficient, payment will be made from other General Fund revenues.]

**THIS MONTH'S COVER**

Michigan State Capitol in Lansing



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

mit war loans and amended to authorize bonus issues. There were war loans for the Civil War, Spanish American War, and World War I, the latter for 3.5 million dollars. The proceeds of this loan were used for a variety of purposes—hospitals, community centers near training camps, roads, dependents of military personnel, state troops, and the home guard.

The 50 million dollar loan for highways was also authorized by constitutional amendment. A small loan of one million dollars originally contracted by the State Fair Board was assumed by the state in 1929. In 1931 the Michigan voters rejected a constitutional amendment to borrow 38 million dollars for public works and other relief measures.

Since the issuance of the war loan of 1917, Michigan has been debt free for only a short period prior to the issuance of the World War II bonus. The State's net indebtedness outstanding, as indicated in Table 1, rose sharply in the early 1920's as the bonus and highway issues were sold; by 1925 it was approximately 75 million dollars, one and one-third times the State's annual tax income. Within a decade retirements and the gradual growth in sinking fund assets reduced the net debt to about 30 million dollars. The doubling of the State's tax yield in the same interval reduced the relative importance of the debt to about a quarter of the annual tax income. The World War II bonus issue of 270 million dollars of which 230 million dollars was outstanding on December 31, 1947, will make a relative debt in 1948 comparable to that of 1926-27, approximately 90 per cent of the State's tax income.

## AGENCY BORROWING

Borrowing by state agencies in Michigan and elsewhere was infrequent and of little importance prior to the incentives given public building construction by the Federal public works programs. Before 1930 such borrowing in Michigan was limited to the State Fair Board, to a million dollar dormitory issue by the University of Michigan, and to a 1.5 million dollar issue by the Board in Control of Athletics at the University of Michigan. By 1937 statutory authorization to issue revenue bonds had been extended to the State Bridge Commission, the State Board of Education, and the College of Mining and Technology.

The greater portion of agency debt has been incurred for educational and quasi-educational facilities at institutions of higher learning. At the end of 1939 the outstanding indebtedness for this purpose totaled 11 million dollars. In order to provide facilities for tremendously increased enrollments some 15 million dollars of bonds and notes was sold during 1946 and 1947. These issues approximately doubled the prewar peak in outstanding indebtedness reached in 1939. Postwar expansion programs are still uncompleted, and during the first six months of the fiscal year 1948 an additional five million dollars of bonds was sold. The total outstanding January 1, 1948, was 30 million dollars.

In other District states borrowing by state educational institutions has been nominal with the exception of Indiana where there is now an obligation of 14 million dollars, almost triple the 1945 total. As noted in earlier articles in this series, Seventh District states generally use the legal device of a separate corporation which borrows the money, pledging the improved property as security, and then leases the property to the institution for the duration of the loan. In Michigan statutory restrictions prohibit the mortgaging of such property, and the corporation device is not used. The state agency, however, is authorized to pledge the revenues from self-liquidating enterprises for the retirement of any indebtedness incurred. This authority is defined by the court in *Eaves v. State Bridge Commission.*[2] In this case

[2]269 N.W. 388 (1936)

### Table 1
### STATE OF MICHIGAN
### OUTSTANDING INDEBTEDNESS[1] 1920-47
(In millions of dollars)

| Fiscal Year Ending June 30 | Direct Debt | | | | | | | | Indirect Debt[5] |
|---|---|---|---|---|---|---|---|---|---|
| | Totals | | Highway[3] | | Soldiers' Bonus[3] | | All Other[4] | | |
| | Gross | Net[2] | Gross | Net | Gross | Net | Gross | Net | |
| 1920 | 8.5 | 8.0 | 5.0 | 5.0 | — | — | 3.5 | 3.0 | — |
| 1921 | 13.6 | 12.2 | 10.1 | 9.5 | — | — | 3.5 | 2.7 | — |
| 1922 | 53.6 | 50.2 | 20.1 | 19.0 | 30.0 | 28.3 | 3.5 | 2.8 | — |
| 1923 | 63.6 | 58.5 | 30.1 | 27.4 | 30.0 | 28.4 | 3.5 | 2.7 | — |
| 1924 | 73.6 | 67.0 | 40.1 | 37.6 | 30.0 | 26.9 | 3.5 | 2.6 | 1.0 |
| 1925 | 83.5 | 74.5 | 50.0 | 44.1 | 30.0 | 28.0 | 3.5 | 2.4 | 1.0 |
| 1926 | 83.5 | 68.2 | 50.0 | 42.0 | 30.0 | 24.0 | 3.5 | 2.3 | 3.6 |
| 1927 | 83.5 | 66.6 | 50.0 | 40.7 | 30.0 | 23.9 | 3.5 | 2.1 | 3.6 |
| 1928 | 82.3 | 62.6 | 50.0 | 37.6 | 30.0 | 23.2 | 2.3 | 1.8 | 3.5 |
| 1929 | 83.2 | 56.6 | 50.0 | 35.3 | 30.0 | 18.9 | 3.2 | 2.3 | 2.5 |
| 1930 | 83.2 | 52.0 | 50.0 | 32.9 | 30.0 | 17.2 | 3.2 | 2.0 | 2.4 |
| 1931 | 83.2 | 47.9 | 50.0 | 30.7 | 30.0 | 15.4 | 3.2 | 1.8 | 2.8 |
| 1932 | 82.7 | 43.3 | 50.0 | 28.4 | 29.4 | 13.4 | 3.2 | 1.5 | 2.7 |
| 1933 | 81.6 | 41.7 | 50.0 | 26.8 | 28.3 | 13.5 | 3.2 | 1.3 | 2.6 |
| 1934 | 81.2 | 35.2 | 50.0 | 23.0 | 27.9 | 12.0 | 3.2 | 1.0 | 2.6 |
| 1935 | 78.7 | 30.6 | 48.4 | 20.1 | 27.0 | 9.7 | 3.2 | .8 | 2.5 |
| 1936 | 77.2 | 28.6 | 48.4 | 18.9 | 26.0 | 9.2 | 2.8 | .5 | 4.4 |
| 1937 | 76.2 | 26.0 | 48.4 | 17.9 | 25.0 | 7.9 | 2.8 | .2 | 4.8 |
| 1938 | 72.4 | 22.1 | 47.4 | 15.7 | 25.0 | 6.4 | — | — | 8.6 |
| 1939 | 72.4 | 17.2 | 47.4 | 11.3 | 25.0 | 5.9 | — | — | 11.3 |
| 1940 | 69.4 | 10.4 | 44.4 | 6.4 | 25.0 | 4.1 | — | — | 12.1 |
| 1941 | 64.1 | 4.3 | 39.1 | 3.7 | 25.0 | .6 | — | — | 11.3 |
| 1942 | 33.7 | 1.7 | 32.0 | 2.0 | 1.7 | .2 | — | — | 10.6 |
| 1943 | 16.2 | .3 | 15.2 | .2 | 1.0 | .1 | — | — | 10.0 |
| 1944 | 7.9 | .4 | 7.2 | .2 | .7 | .2 | — | — | 9.2 |
| 1945 | .3 | —.1 | .2 | —.1 | * | — | — | — | 8.6 |
| 1946 | .2 | —.1 | .2 | —.1 | * | — | — | — | 23.0 |
| 1947 | 200.7 | 200.5 | .2 | —.1 | 200.5 | 200.5 | — | — | 25.8 |

[1]This table does not include in the total direct state indebtedness the amount due the several state educational trust funds. Michigan, like Illinois, adopted the policy of diverting proceeds from the sale of Federal land grants for educational purposes and establishing thereby a nonmaturing debt to the school funds. During 1920-47 the credits to these funds increased from seven to 8.9 million dollars. On their portion of this amount, the Agricultural College, the University, and Normal School Funds receive interest of seven per cent from specific taxes constitutionally earmarked for this purpose; in addition to interest, the Primary School Fund receives the balance of specific tax collections remaining after distributions of interest. In the last three years this balance has averaged 20 million dollars.

[2]Gross indebtedness less assets held in sinking funds. Assets include cash held in sinking funds less warrants outstanding against the sinking funds, cash held by fiscal agents, investments at par value, securities given in lieu of interest, and loans to other state funds; principal and interest due from other funds but not transferred prior to June 30 are not included.

[3]During 1920-25 includes short-term highway and soldiers' bonus notes which were later converted to bonds.

[4]Includes the 1917 War Loan and the state fair indebtedness assumed in 1929.

[5]Includes indebtedness of the Michigan State Fair Board prior to the assumption of the debt by the State (1924-28); indebtedness of the University of Michigan, Michigan State College, the State Board of Education, and the College of Mining and Technology for residence halls, health service facilities, music buildings, and miscellaneous facilities for athletic, dramatic, and social activities; and the indebtedness of the State Bridge Commission (1936-47).

*Less than $50,000.

SOURCE: *Report of the Auditor General* and Office of the Auditor General; Office of the State Bridge Commission; Business Offices of University of Michigan, Michigan State College, Central Michigan College of Education, and Northern Michigan College of Education.



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

the State Bridge Commission issued 2.3 million of bonds to supplement expenditures by the Federal, State, and Canadian governments for the construction of the Blue Water Bridge at Port Huron. The bonds issued were expressly stated to be payable solely from toll earnings and not an obligation of the State. The court held that since neither the State's revenue nor credit was involved, the bonds were not within the constitutional prohibition.

Except for the foregoing instances and a loan made by the Memorial Union at the State College and purchased by two of the state sinking funds, there has been no other borrowing by state agencies. At the present time the International Bridge Authority is considering the feasibility of issuing revenue bonds for the construction of a bridge and necessary appurtenances at Sault Sainte Marie.

Although purchasers of agency issues in Michigan do not have a lien on the property, most of the bonds sold contain a pledge by the issuing authority to maintain charges for the use of the facilities at sufficiently high levels to meet principal and interest payments. In case of default the bondholder may ask the court to fix rates, enjoin the governing body to stop acts or policies detrimental to operation, or appoint receivers. In addition to these legal safeguards the moral prestige of the borrower is an additional protection to the investor. Moreover in some instances, particularly in the construction of dormitories and social centers at the state colleges of education, state appropriations have covered up to one-half of the total cost of construction, and at the State College and University facilities for which revenue bonds are issued are constructed on sites originally purchased from state appropriations. This has afforded an unencumbered equity which serves as a cushion for debt service requirements.

Table 2

**APPROPRIATIONS FOR DEBT SERVICE AND NET EARNINGS OF SINKING FUNDS FISCAL YEARS 1918-47**

(In millions of dollars)

| Year | Appropriations for Debt Service | | | Net Earnings of Sinking Fund | Bonds Redeemed |
|---|---|---|---|---|---|
| | Total | Interest on Outstanding Debt | Sinking Fund | | |
| 1918 | .1 | .1 | — | — | — |
| 1919 | .4 | .1 | .3 | — | — |
| 1920 | .3 | .1 | .2 | * | — |
| 1921 | 1.1 | .4 | .7 | .2 | — |
| 1922 | 3.7 | 1.8 | 1.9 | .1 | — |
| 1923 | 4.7 | 3.2 | 1.5 | .2 | — |
| 1924 | 4.5 | 3.2 | 1.3 | .1 | — |
| 1925 | 6.1 | 3.8 | 2.3 | .2 | — |
| 1926 | 10.1 | 4.1 | 6.0 | .2 | — |
| 1927 | 5.2 | 4.1 | 1.1 | .5 | — |
| 1928 | 7.1 | 3.8 | 3.3 | .8 | 1.2 |
| 1929 | 10.2 | 4.0 | 6.2 | .8 | — |
| 1930 | 7.6 | 4.0 | 3.6 | 1.0 | — |
| 1931 | 7.4 | 4.0 | 3.4 | .9 | — |
| 1932 | 7.5 | 4.2 | 3.3 | 1.0 | .6 |
| 1933 | 4.3 | 3.9 | .4 | .8 | 1.1 |
| 1934 | 8.1 | 4.0 | 4.1 | 2.0 | .4 |
| 1935 | 7.5 | 3.9 | 3.6 | 1.5 | 2.5 |
| 1936 | 5.0 | 3.7 | 1.3 | 1.6 | 1.4 |
| 1937 | 4.0 | 3.9 | .1 | 1.3 | 1.0 |
| 1938 | 5.3 | 3.4 | 1.9 | 2.2 | 3.9 |
| 1939 | 8.7 | 3.6 | 5.1 | 2.5 | * |
| 1940 | 5.7 | 3.7 | 2.0 | 2.4 | 3.0 |
| 1941 | 6.9 | 3.4 | 3.5 | 2.4 | 5.3 |
| 1942 | 5.8 | 2.1 | 3.7 | .3 | 32.0 |
| 1943 | 2.0 | 1.0 | 1.0 | —.3 | 16.9 |
| 1944 | .4 | .6 | —.2 | * | 8.0 |
| 1945 | .3 | .1 | .2 | * | 7.0 |
| 1946 | — | — | — | — | * |
| 1947 | — | — | — | — | * |
| Total | 140.0 | 78.2 | 61.8 | 22.7 | 84.3 |

*Less than $50,000.
SOURCE: Office of the Auditor General.

## INDIRECT OBLIGATIONS

As is the case also in the states of Wisconsin and Iowa, Michigan has had at least an indirect concern in local government borrowing for highways. Though the State is in no sense legally obligated to contribute to the servicing and retirement of such issues, it has recognized their existence in its highway aid program. The Horton Act of 1932 provides that one-half of the weight tax revenues and $1,225,000 of gasoline tax revenues distributed annually to localities must be used to retire local highway indebtedness. First priority is given special assessment instalments due under the so-called Covert Road Act, second to county road issues, and third to those of townships. At the beginning of 1933 local Covert Road indebtedness approximated 37.3 million dollars. During the years 1934-46, 34 million dollars of state aid was spent for local debt service. In many counties funds so received are sufficient to meet principal and interest charges; however, the distribution of highway user revenues among local governments is not affected by any debts they may have incurred for highways.

## STATE DEBT ADMINISTRATION

Except for the recent bonus borrowing Michigan state debt has been in the form of sinking fund issues instead of the serial type preferred by other states in the Seventh District. If sinking fund bonds have any advantages for the government which issues them, it lies in the flexibility of the provisions for amortizing principal requirements. However, this very flexibility is also a disadvantage in that it exposes the financial plan for redemption to manipulation and uninformed management. Additions to the sinking fund may be postponed nominally in the expectation of better economic conditions when actually uncertain political conditions are a motivating factor. In retrospect it is always comparatively easy to designate those years in which the rate of addition to the sinking fund should have been reduced or accelerated. At the time and in prospect, however, the decision is not always so simple.

It is necessary to appraise the effect of the correlative variation in taxes on the economic health of the community absolutely and relatively for the period in which the debt is outstanding. The manager of the sinking fund has to gauge his recommendation to the appropriating authority in terms of past policy with regard to accumulation as well



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

as to current and prospective economic conditions. The appropriating authority must then weigh such recommendations in terms of the current level of taxation and the present demands for public expenditure against likely changes in these factors in the future. By relying on good financial advice the appropriating authority can generally execute a retirement plan which will be less burdensome to the taxpayers than the rigid schedule of a straight serial issue. The advantage may be small in net effect, however, because of the chance that the calibre of the financial advice may be poor or that the appropriating authority may be inclined to be guided by extraneous factors.

There are other considerations adverse to the use of sinking fund issues. The cost of administration is in excess of that for the serial types, and the handling of the investments in the sinking fund affords opportunities for mismanagement. The latter is not a necessary characteristic but rather a calculated risk that can by proper precautions be reduced to insignificant proportions. An important consideration affecting the comparative advantages of serial and sinking fund issues today and probably for some time in the future is the tax exemption of state and municipal securities from high Federal individual and corporate income tax rates and the value placed by the market on the tax exemption reflected in comparative yields on municipal and Federal bonds.

Michigan's experience with four sinking fund issues during the past 25 years is illustrative of both their advantages and disadvantages. An objective appraisal of the results of legislative and management policy with regard to the sinking funds is not likely to create any great enthusiasm for or against the record. It appears that while the potentialities of the sinking fund approach were utilized to a limited extent, the inherent economies of serial issues for the period 1920-45 could be used to justify the abandonment in 1946 of a sinking fund for the World War II bonus issue.

The year-to-year appropriation of state tax receipts for interest on the outstanding debt and for the sinking fund are set forth in Table 2. It is apparent from the fourth column of the table that the contribution to the sinking fund reflected the exercise of some discretion as to the rate of accumulation, since annual contributions were as much as six million dollars in 1926 and 1929, five million in 1939, and as low as $100,000 in 1937, $400,000 in 1933, and 1.3 million dollars in 1936. Most frequently 3.3 to 3.7 million dollars was set aside. The swing in allocations to the sinking fund from one extreme to the other thus represented between 5.5 and six million dollars or, translated to relative terms, from four to 10 per cent of state tax revenues.

The financial results of the management of the sinking funds are set forth in Table 3. To retire a debt of 84 million dollars and make interest payments of 78 million required tax receipts of 140 million dollars. The net earnings of the sinking fund amounted to 22.7 million dollars after payment of administrative costs and the offset of losses on sale or liquidation of securities. Most of the sinking fund assets were liquidated in a period of prosperous economic conditions when there was a strong demand for municipal securities, which constituted the bulk of the fund's portfolio. Throughout much of the period the State was unable to purchase at par eligible securities with yields equivalent to the coupon rate on state issues, and consequently the use of a sinking fund in preference to a serial issue made for a higher interest cost—in the neighborhood of 33 million dollars.

Data are not available to show the year-to-year changes in the market value of sinking fund assets, but in the economic depression of the early 1930's the impairment of the fund's capital must have been serious. Just prior to the liquidation of the bulk of the sinking fund (1940) 40 per cent of investments were in Federal securities, 40 per cent in obligations of local governments, and 20 per cent in state bonds. In 1937 when the sinking fund assets had a par value of 50 million dollars, 4.7 million were in default as to principal or interest.

With a few exceptions the sinking funds appear not to have been used as an investment pool to purchase securities of the State or its subdivisions that could not find a private market. The State College Union bonds appear to be one of the exceptions. The short-term loans to other state funds were ineligible for private sale, and if the State may borrow from itself, these appear to be an appropriate form of investment. The State of Wisconsin has, as indicated earlier in this series of articles, used two of its investment funds for loans to state agencies. The parallel in practice suggests that inter-agency loans within the whole framework of state government is not without precedent in this area.

**Table 3**
**MANAGEMENT OF THE SINKING FUNDS**
**(In millions of dollars)**

| Item | Grand Total | Highway Improvement 1919-47 | Soldiers' Bonus 1922-47 | War Loan 1917-37 | State Fair 1929-37 |
|---|---|---|---|---|---|
| Receipts | 162.7 | 94.4 | 61.0 | 5.9 | 1.4 |
| From taxes | 140.0 | 80.0 | 53.4 | 5.2 | 1.4 |
| From net earnings of sinking fund | 22.7 | 14.4 | 7.6 | .7 | — |
| Gross earnings as follows: | | | | | |
| Interest on average daily balance | .6 | .3 | .3 | * | * |
| Interest on interfund loans | 3.5 | 3.5 | — | — | — |
| Security investments—interest | 22.9 | 13.0 | 9.0 | .8 | .1 |
| Security investments—premium[1] | 1.7 | .9 | .8 | * | * |
| Total | 28.7 | 17.7 | 10.1 | .8 | .1 |
| Deductions as follows: | | | | | |
| Premiums on investments bought[2] | 4.6 | 2.6 | 1.8 | .1 | .1 |
| Losses[3] | .3 | — | .3 | — | — |
| Accrued interest purchased | 1.1 | .7 | .4 | * | * |
| Total | 6.0 | 3.3 | 2.5 | .1 | .1 |
| Disbursements | 162.7 | 94.4 | 61.0 | 5.9 | 1.4 |
| Bond principal | 84.3 | 49.8 | 30.0 | 3.5 | 1.0 |
| Interest—gross | 78.2 | 44.5 | 31.0 | 2.3 | .4 |
| Less interest and premium on original sales | .3 | .3 | — | — | — |
| Interest—net | 77.9 | 44.2 | 31.0 | 2.3 | .4 |
| Administrative expense | .1 | .1 | * | * | * |
| Balance and transfer | .4 | .3 | * | .1 | — |

[1]Premium received less discount on security investments sold.
[2]Premium received less discount on security investments bought.
[3]Write-off on defaulted investments.
*Less than $50,000.
SOURCE: Office of the Auditor General.



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

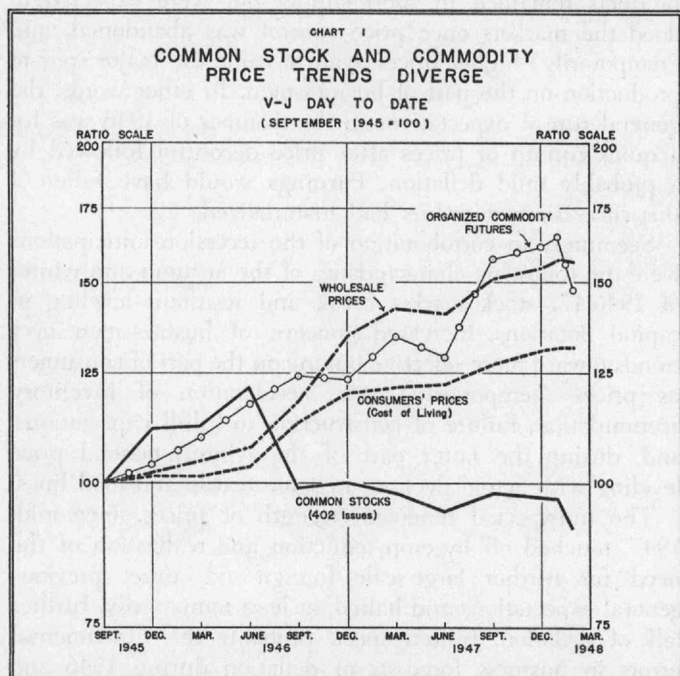
# Prices, Profits, and the Corporate Security Markets

## *Lack of Investor Confidence Underlies Current Trends*

The sharp break in commodity prices during the past month with its depressing effect upon common stock prices is being interpreted widely as confirmation "at last" of the bearishness which has characterized security market price movements since the autumn of 1946. Common stock prices in particular have moved independently of inflationary general business trends. As a result the "stock market" has lost a good deal of its standing as a fairly specific means of forecasting broad changes in business activity, at least in terms of timing.

Few business analysts have questioned the eventual downturn implications of the persisting pessimism in the security markets, but there has been considerable difference of opinion as to the immediate prospects for the long-heralded "postwar recession" suggested in common stock price trends. It is still not clear whether recent price declines actually indicate that the tide of the inflationary battle finally has turned, but such sharp price breaks as recently experienced are a definite warning that many types of business adjustments are in the offing.

Continuation of price declines in commodity and security prices under present conditions, however, does not necessarily mean that such other business measures as employment, income, and expenditures face similar drops. In many sections of the Seventh District the recent price breaks are noted as "healthy," "long overdue," and "hope for consumers." To the extent that price and other adjustments are expected and provided for in business plans, they need not touch off a deep, downward business spiral, particularly among the many Midwest industries which still appear to have strong demand prospects. The possibility that continued declines in commodity and security prices will have a cumulative unfavorable effect upon business expectations generally and induce unwarranted fears and liquidations nevertheless cannot be minimized.




Note: Index data are plotted quarterly through 1947, monthly thereafter; January and mid-February 1948 wholesale prices and consumer prices and mid-February 1948 common stocks are estimated.
SOURCES: U. S. Bureau of Labor Statistics, Dow-Jones & Co., and Standard and Poor's Corporation.

Lack of investor confidence persists on all sides. Despite all-time records in—and at least up to now excellent short-run prospects for—most wholesale and retail sales, earnings, and dividends, security prices in general have remained within fairly narrow limits with frequent downward "adjustments." Investors deem the risk of capital losses consequent upon possible declines in earnings as too great to offset short-run increases in income from higher dividends, particularly under existing high personal income tax rates. In spite of the still relatively large volume of funds accumulated in the past available for investment, it has become more difficult to raise money in the security markets during the past year and one-half. Nevertheless, a very large volume of successful security flotations occurred during the past year, primarily because of the exceptionally high financial standing of firms seeking new funds. In addition, firms requiring financial assistance, generally speaking, were able to meet their requirements from banks and other lending institutions when deterred from the security markets.

A "revival" in the security markets cannot be expected until investors collectively feel that the long-awaited postwar recession has been experienced. Prospects are clouded at present by weakness in commodity and security prices, the abundant supply of securities on the markets, the limited funds from current incomes available for security investment, and also the expectation that even continuing full employment conditions cannot bring higher earnings but rather only rising labor costs and declining profits.

### POSTWAR STOCK PRICE TRENDS

Common stock prices are generally regarded as being very sensitive to the numerous economic maladjustments which build up during periods of prosperity (inflation). As already noted it is extremely difficult, however, to use this sensitivity as a barometer in forecasting the exact time at which prosperity (inflation) will give way to recession (deflation). For example, in 1929 and 1937, there was little or no difference in the timing of the downward movements of common stock prices and prices in general. After World War I, on the contrary, common stock prices fell sharply in the fall of 1919 followed some nine months later by wholesale and retail prices.

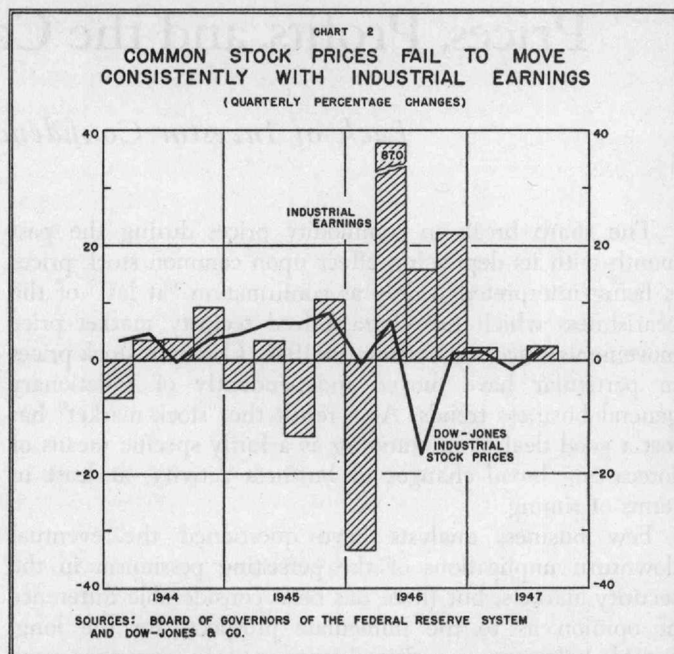


Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

The current postwar patterns of common stock and other prices have exhibited unusual variance (see Chart 1). The months immediately following V-J Day witnessed an acceleration in the upward movement of common stock prices which began early in 1942. Wholesale and retail prices in the same period moved up only slightly, the Office of Price Administration permitting moderate increases in price ceilings in a number of industries to compensate companies for the added costs of first round wage increases. After breaking precipitately in September 1946, common stock prices have since moved sluggishly within a relatively narrow range approximately 15 per cent below their May-September 1946 plateau. With the end of price control in July-October 1946, wholesale and retail prices began their second postwar sharp uphill climb.

In the months immediately following the initial postwar stock market break there was considerable difference of opinion among market analysts as to market prospects, some claiming that a reaction in a bull movement was in progress, others that a bear movement was being initiated. Subsequent events have swung sentiment increasingly in favor of the latter point of view.

As deflationary forces ultimately become paramount, common stock prices should fall relatively less than other prices. Partially offsetting the dampening effect of eventually falling earnings on common stock prices will be a tendency for the price-earnings ratio to rise. During 1947 this ratio averaged 8.4 compared with 16.7 in 1936-39. It should be noted that the drop of 11 per cent in the Dow-Jones organized commodity futures index during the first two weeks in February was accompanied by a much milder reaction—a little over four per cent—in the Dow-Jones index of common stock prices.




## EARNINGS AND COMMON STOCK PRICES

The period from V-J Day to the late summer of 1946 was characterized by rising common stock prices and falling corporate earnings. The subsequent period to date has reversed this pattern, common stock prices falling and corporate earnings generally rising.

Preliminary estimates covering all private corporations indicate fourth quarter 1947 profits in excess of the same quarter in 1946, the previous postwar high.[1] Published reports from a number of individual large corporations in steel, automobiles, and other industries lend support to such a record level.

In the months immediately following V-J Day aggregate corporate profits declined mainly because reconversion and work stoppages caused partial or complete shutdowns in many plants, particularly in the heavy producers and consumers durable goods industries. The automobile industry was particularly hard hit, the profits of 15 *large* companies, as computed by the Board of Governors, Federal Reserve System, dropping from 77 million dollars in the second quarter of 1945 to a negative 34 million dollars in the first quarter of 1946. Profits in those industries which had no reconversion problems and/or in which work stoppages were of brief duration—chemicals and food, for example—moved counter to the trend.

Relaxation of wage and other wartime controls in the closing months of 1945 encouraged a widespread belief that price controls would soon be weakened or abandoned. This expected sequence played a major role underlying higher profit expectations and consequent rising common stock prices in late 1945-early 1946. By the summer of 1946, however, deflation talk was increasing. Markets for some products, textiles are an illustration, seemed to be approaching a more "normal" demand-supply relationship. Other products remained in short supply but were expected to flood the markets once price control was abandoned, and (temporarily) higher prices again became the major spur to production on the part of businessmen. In other words, the general run of expectations in the summer of 1946 was for a quick run-up of prices after price decontrol followed by a probably mild deflation. Earnings would have fallen if this succession of events had materialized.

Seemingly in corroboration of the recession anticipations were the following characteristics of the autumn and winter of 1946-47: stock market break and resultant leveling in capital flotations, increased concern of businessmen over trends toward more selective buying on the part of consumers as prices (temporarily) rose, acceleration of inventory accumulation, failure of construction to fulfill expectations, and, during the latter part of the winter, general price leveling with actual declines in some textile and food lines.

The unexpected renewed strength of prices since mid-1947, touched off by crop reduction and realization of the need for further large-scale foreign aid, upset previous general expectations and halted, at least temporarily, further talk of deflation. In retrospect, probably the fundamental errors in business forecasts of deflation during 1946 and 1947 were (1) an underestimation of the strength of wartime accumulated inflationary forces both here and abroad, especially effective purchasing power, and (2) an over-

[1] *The Economic Report of the President,* 1948.



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

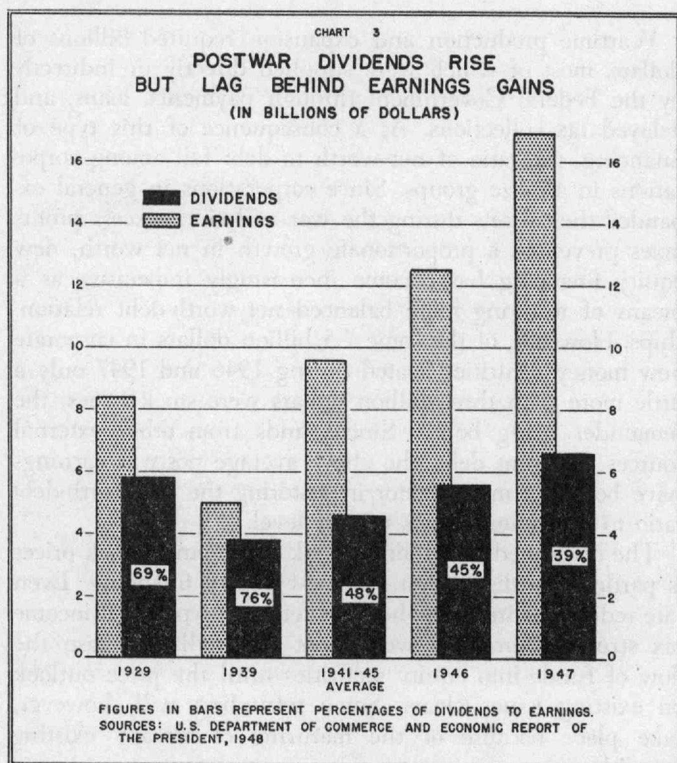
estimation of the magnitude of postwar domestic productive capacity and efficiency. In addition it was extremely difficult to foresee accurately the working out of inflationary forces in an economy in which wage (cost) and price controls were relaxed piecemeal *and* at different times. There is no reason for expecting greater prescience on this score from the stock market than from any other economic market or measure.

## DEFLATION LOOMS AHEAD

The renewed upward movement in prices after the middle of 1947 improved short-run expectations of corporate earnings which were already running at a high rate. The stock market, however, failed to respond. With the economy generally free of wartime controls and with prices and wages moving up fast, the investment community—like business analysts generally—appears to have become more and more convinced over time that the inflationary spiral will end in a sharp deflation similar to that of 1920-21. The longer-run outlook for earnings appears less favorable than the short-run outlook and apparently provides little basis for a sustained up-turn in the market. Even a quick market up-turn of substantial proportions and volume appears to be handicapped by uncertainties of the extent and timing of the "recession" as well as by the continued relative scarcity of speculative funds consequent on margin control.[2]

The importance of the decontrol timetable on the postwar relationship of earnings and common stock price trends is illustrated in Chart 2. The variance in quarterly percentage changes of industrial earnings and common stock prices was particularly great during the period in which controls were being relaxed.

[2]The greater speculative activity on the organized commodity markets in recent months is in part, at least, the result of less stringent margin requirements.



FIGURES IN BARS REPRESENT PERCENTAGES OF DIVIDENDS TO EARNINGS.
SOURCES: U.S. DEPARTMENT OF COMMERCE AND ECONOMIC REPORT OF THE PRESIDENT, 1948

Utilities and railroads have long been subject to price (rate) control. As a result, principally industrial companies were affected directly by the postwar price decontrol program of the Federal Government. Federal wage decontrol, however, cut across all types of business. The resulting rise in costs generally has had a particularly adverse effect on utility and rail earnings. This has in part been responsible for the somewhat wider postwar departures of actual and anticipated earnings and somewhat more marked postwar variations in earnings and common stock price trends in the industrial than in the utility and railroad fields.

## DIVIDEND PATTERNS

Dividend payments of all private corporations reached an estimated 6.6 billion dollars in 1947. This exceeds the previous 1929 high of 5.8 billion dollars and is a billion dollars above the level of the preceding year and two billion dollars in excess of the wartime average. The rise in dividends, however, has failed to keep pace with the postwar increase in earnings (see Chart 3). As a consequence, dividend payments of *all* private corporations have fallen from a wartime level of approximately 45 per cent of earnings to 39 per cent in 1947. A similar trend has characterized *large* corporations but at a higher average. The estimated 1947 figures for the *large* companies in the Federal Reserve Board sample are: railroads, 47 per cent; industrials, 52 per cent; electric light and power, 73 per cent; and telephone, 111 per cent.

The greater stability of dividends than earnings results largely from the conscious effort of many companies to maintain a regular minimum level of dividend payments. This practice, although of importance in governing common stock values over an extended period of time, decreases the influence of dividend trends on shorter-term movements in common stock prices. Substantial extra dividend payments in the last quarter of 1947 had very little buoyant influence in the stock market. They were overshadowed by already described general expectations of downward earnings trends.

The outlook for dividend payments is somewhat better than that for earnings. Any earnings decline will probably be accompanied by a less than proportionate fall in dividends. This follows not only from the greater stability of dividends but also from the fact that under more normal conditions the income tax law provides some pressure for dividend payments up to 70 per cent of earnings.

## CAPITAL FLOTATIONS

Net proceeds, i.e., gross proceeds less cost of flotation, from new corporate security issues, after rising from an end-of-war level of three billion dollars to over 6.7 billion dollars in 1946, fell in 1947 to a level slightly in excess of six billion dollars (see Chart 4). These net proceeds include new money, and funds to retire securities and repay other debt. The stock market break of September 1946 resulted



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in the cancellation of previously announced proposed issues on the part of a number of corporations and undoubtedly discouraged still other companies from considering similar projects. The over-all volume of new corporate security issues, however, continued strong for new money during 1947, although dropping sharply for refunding issues.

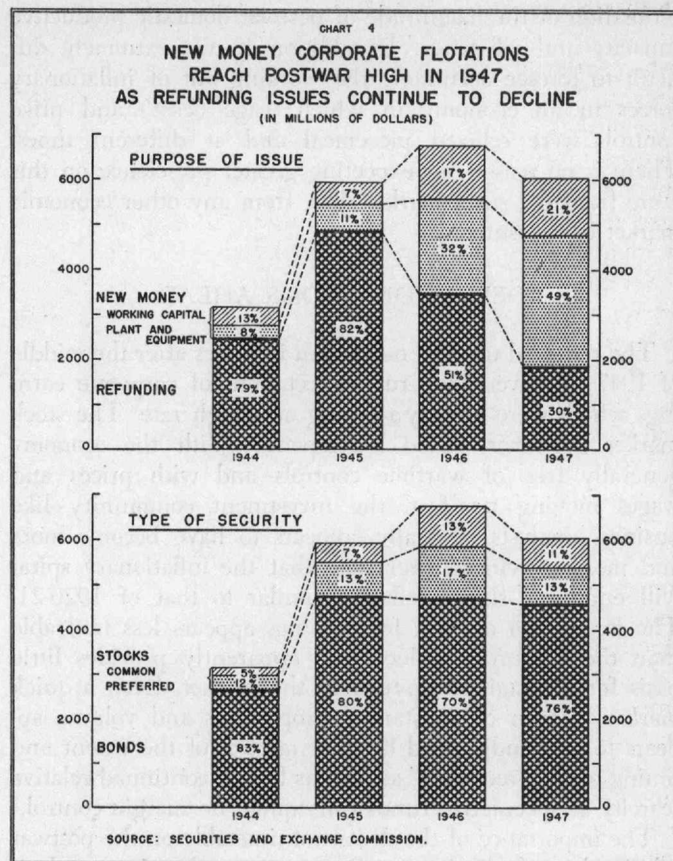
In general, only corporations with above-average credit ratings have ventured into the capital markets for new money in the last year. One indication of this is provided by the fact that private placements accounted for 34 per cent of the total in 1947 compared with 20 and 25 per cent, respectively, in 1945 and 1946.[3] Institutional investors, the recipients of most of the private placements, tend to place a much higher premium on risk than investors generally.

Of particularly great significance have been postwar trends in total new money flotations and that part represented by equity issues. It is here that the postwar financial needs of corporate business have become increasingly urgent.

Since V-J Day corporate business has been expanding its inventories, receivables, and plant and equipment at an average annual rate of approximately 25 billion dollars, about five times the corresponding rate for the years 1944 and 1945. The expansion in 1948 will probably be at a somewhat lower, although still substantial, rate. Present indications still point to plant and equipment expenditures roughly equal to the level of 1947. Receivables should continue to rise as companies increasingly revert toward their prewar reliance on trade credit facilities. Inventory accumulation, however, seems likely to be much lower in 1948; pipelines are becoming increasingly filled, and recent breaks in the commodity markets together with the further possibility of price declines there and elsewhere discourage further accumulation. This outlook for 1948 probably will not be affected materially by a downturn in business unless such decline strongly affects most major industries relatively early in the year.

The rapid expansion in fixed assets, inventories, and receivables created the need for about 50 billion dollars in funds by corporate business in 1946 and 1947. Perhaps as much as two-thirds of this need has been provided from internal sources, i.e., undistributed profits, depreciation allowances, and the drawing down of cash and marketable securities accumulated during the war.[4] These rough measures indicate a dependence on external funds considerably in excess of the 7.5 billion dollars of new money securities which were floated in 1946 and 1947. Sources other than the capital markets thus have supplied a large part of the postwar external funds required by corporate business.

During the last two years corporations have spent approximately 25 billion dollars on new plant and equipment. The capital markets have supplied about five billion dollars for this purpose, roughly one-fifth of the total. This explains, in part at least, the growing demand of business firms for long-term funds from banks, insurance companies, and other lending institutions.




## NET WORTH-DEBT TRENDS

Wartime production and expansion required billions of dollars, most of which were supplied directly or indirectly by the Federal Government through payments, loans, and delayed tax collections. As a consequence of this type of financing, the ratio of net worth to debt fell among corporations in all size groups. Since corporations in general expanded their assets during the war and since excess profits taxes prevented a proportionate growth in net worth, new equity financing has become increasingly imperative as a means of restoring more balanced net worth-debt relationships. However, of the some 7.5 billion dollars in corporate new money securities floated during 1946 and 1947 only a little more than three billion dollars were stock issues, the remainder being bonds. Since funds from other external sources represent debt, the above average postwar earnings have been the major factor in restoring the net worth-debt ratio to approximately its prewar level.

The continued uncertain outlook for common stock prices is particularly discouraging to new equity financing. Even rate reductions in the higher brackets of the personal income tax structure probably would not materially increase the flow of funds into equity securities until the price outlook on existing issues clears. Some refunding will, however, take place because of the maturing of already existing securities.

[3]Private placements represent securities which are sold directly by the issuer to one or a few buyers. Since the general public is not involved, such transactions are exempt from the registration requirements of the Securities and Exchange Commission.

[4]Since inventory appreciation is a factor in both current fund "needs" and profits, the estimated residual fund requirements from outside sources is not overstated to the extent of such inventory appreciation.



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

## INTERNATIONAL TRADE BARRIERS LOWERED

(*Continued from Inside Front Cover*)

some dried fruits were among the first products to experience postwar slumps in prices to levels which cause financial stress to farmers. Consequently, expanded markets for such products are particularly important at this time. Tariff reductions by Canada in seasonal duties for fresh fruits averaged about 33 per cent. France conceded to tariff reductions of from 40 to 70 per cent on canned fruits and juices.

Several countries agreed to keep *raw cotton* on the free list for the duration of the agreement. *Wheat* tariffs were reduced by 66 and 50 per cent, respectively, by France and Cuba. Other important importers bound wheat on the free list. *Rice* received favorable treatment by Cuba. *Soybeans* and *soybean cake and meal* tariffs were reduced.

*Tobacco,* a farm product which is normally exported in large volume and which finds many market outlets closed or sharply reduced at this time, received concessions.

*Lard* duties were reduced 59 per cent by France, and concessions were obtained from France, the United Kingdom, and several other countries on other livestock products, including pork and both condensed and dried milk.

Concessions were obtained on some *vegetables,* including onions, dried beans, canned asparagus, and quick frozen vegetables from several countries. Seasonal duty reductions by Canada on fresh vegetables averaged about 25 per cent. Since the concessions granted by each country varied greatly both as to products included and the amount and kind of concession made, detailed coverage has been impossible in the space available here.

United States farmers will benefit not only from the concessions gained on agricultural products, but also from the concessions received by our export industries which pay, in general, high wages and whose workers constitute an important sector of the domestic market for farm products.

### SELECTED U. S. CONCESSIONS MADE AT GENEVA OF DIRECT INTEREST TO SEVENTH DISTRICT FARMERS

Beef and veal: Tariff reduced from 6¢ to 3¢ per lb.

Butter: Tariff reduced from 14¢ to 7¢ per lb. on imports up to 50 million lbs. from November 1-March 31 only.

Cattle: under 200 lbs., quota increased from 100,000 to 200,000 head;
200 to 700 lbs., no change in either quota or tariff;
700 lbs. and over, quota increased from 225,000 to 400,000 head. Tariff on all cattle is unchanged at 1½¢ per lb. within quotas, 2½¢ over the quotas.

Cheese, cheddar: Tariff reduced from 4¢ to 3½¢ per lb.

Cream, dried: Tariff reduced from 12.3¢ to 6.2¢ per lb.

Coconut oil: Tariff reduced from 2¢ to 1¢ per lb.

Egg products, frozen: Tariff reduced from 11¢ to 7¢ per lb.

Egg products, dried: Tariff reduced from 27¢ to 17¢ per lb.

Milk, condensed and evaporated: Tariff reduced from 1.8¢ to 1¢ per lb. for unsweetened case goods and from 2.75¢ to 1.75¢ per lb. on sweetened case goods.

Milk, dried: Tariff reduced from 6½¢ to 3.1¢ per lb. on whole milk and from 3¢ to 1½¢ on skimmed milk.

Potatoes, for table use: Within the previously established quota of 1 million bu. the tariff was reduced from 60¢ to 37½¢ per cwt. on imports from December-February. Tariff of 75¢ is continued for imports in excess of quota.

Potatoes, certified for seed: Quota increased from 1½ million bu. to 2½ million bu. Tariff not changed.

Sugar: Tariff reduced from ¾¢ to ½¢ per lb. on Cuban sugar, from 94¢ to 69¢ per cwt. on other sugar.

Wheat: Tariff reduced from 42¢ to 21¢ per bu. Quota of 800,000 bu. not changed.

Wheat flour: Tariff reduced from $1.04 to 52¢ per cwt. Quota of 4 million lbs. not changed.

Whiskey: Tariff reduced from $2.50 to $1.50 per gal. proof.

Wool, finer than 44s: Tariff reduced from 34¢ to 25½¢ per lb. clean content. Tariffs on manufactured woolens and worsteds were reduced proportionately, but the U.S. reserved the right to raise tariffs if imports exceed 5 per cent of average domestic production.

Also, concessions made by the United States on industrial products may facilitate importation of such products from countries which are markets for American farm and industrial products. By increasing imports the United States can provide foreign countries with the dollars needed to buy products we wish to export.

Industrial products normally exported from the United States which received substantial concessions include automobiles, aircraft, selected industrial machinery, electrical machinery and appliances, office machinery and appliances, agricultural machinery, some metal products, pharmaceuticals, chemicals, paints, cameras and photographic equipment, and a variety of miscellaneous manufactured products.

### CONCESSIONS MADE BY THE UNITED STATES

Concessions were made by the United States on both agricultural and industrial products in exchange for the concessions granted by other countries. For 1939, duty-free imports into the United States totaled 1,341 million dollars. Products accounting for 85 per cent of these duty-free imports were bound on the free list (i.e., this country agreed not to apply a tariff for the duration of the agreement). Seventy per cent of the products whose duty-free status was thus bound came from participating countries.

Total dutiable imports into the United States in 1939 were valued at 907 million dollars. Existing rates of duty were bound on products accounting for 20 per cent of total dutiable imports, were reduced less than 25 per cent on products accounting for 10 per cent of dutiable imports, were reduced 25 to 35 per cent on products accounting for 27 per cent of dutiable imports, and were reduced 35 to 50 per cent on products accounting for 43 per cent of dutiable imports. Thus, on the average, duties were lowered about 25 per cent on commodities accounting for about 35 per cent of our prewar imports. Of the dutiable commodities on which concessions were made, 85 per cent came from participating countries.

The most-favored-nation clause, the cornerstone of nondiscrimination in international commercial relations, is incorporated in the agreement. This assures the extension by each country to every other nation participating in the agreement of the same tariff treatment.

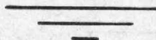
The most-favored-nation provisions extend to export taxes which have in the past largely served as a means of restricting or diverting to particular countries exports of raw materials. This will benefit the United States, for example, by eliminating the discriminatory tax on exports of tin ore and concentrates from the Malayan Union and placing the United States smelting industry in as favorable a position as the smelting industry of any other country in obtaining access to tin supplies in Malaya.

Concessions made on selected agricultural commodities of direct interest to Seventh District farmers are reported in the accompanying table. While reference in this article is made primarily to agricultural products, it should be emphasized that the agreement covers a wide range of products and represents the most extensive single document ever drawn for the promotion of international commerce.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

SEVENTH FEDERAL

RESERVE DISTRICT



Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis