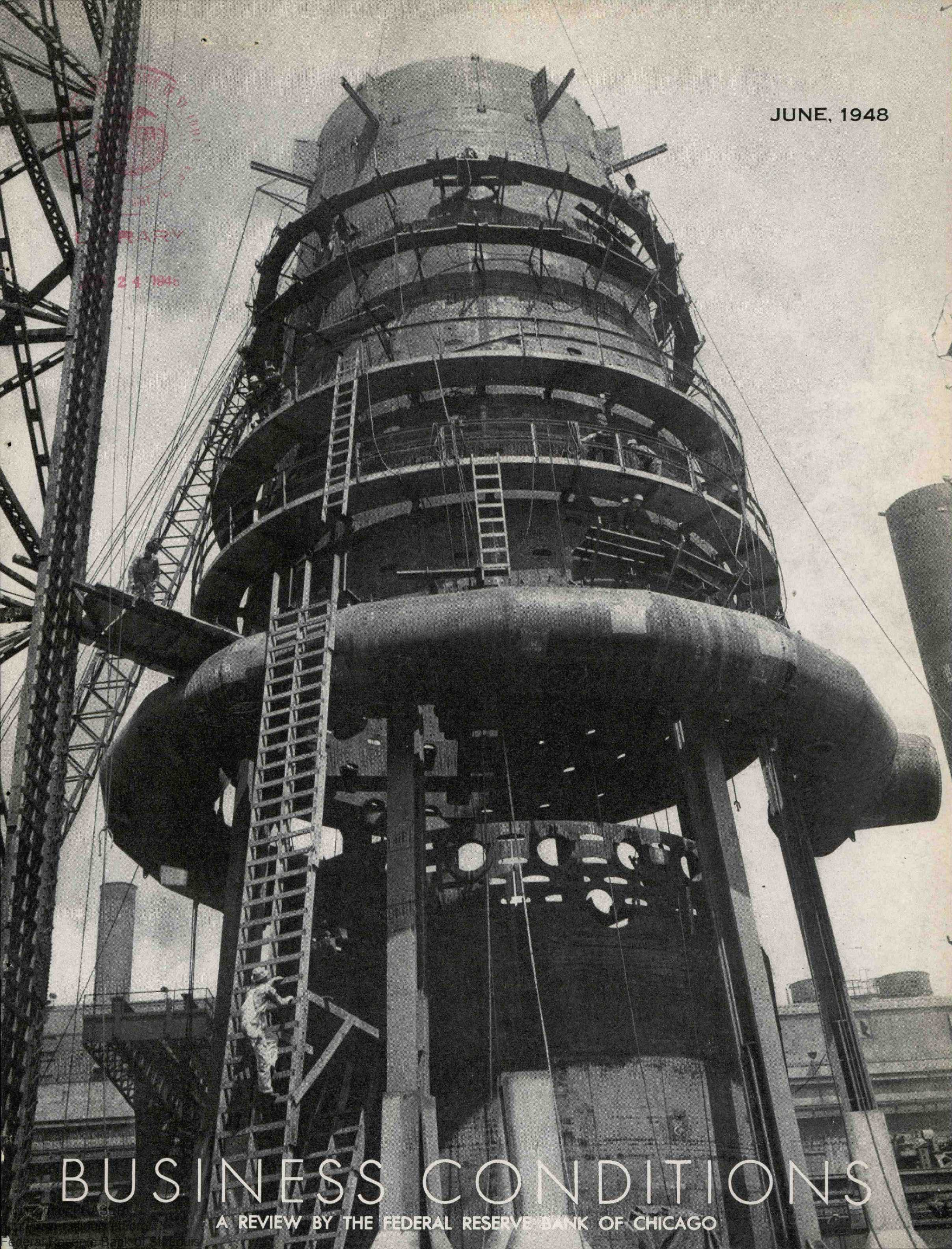


JUNE, 1948

BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

Farm Price Prospects Mixed

Supply Conditions May Bring Shifts

A previous article[1] dealt with recent trends in farm prices and with price prospects generally. The following discussion presents some of the factors likely to determine trends of farm prices for individual commodities or commodity groups through the balance of the year. In the earlier article it was suggested that while farm prices generally appear to be high relative to other prices, it is probable that continued good demand will tend to slow up or postpone any drastic over-all decline in farm products, but that some readjustments might be expected this year.

Demand for farm products is both general and specific. High levels of income furnish sustained purchasing power, but there are, of course, rather definite limits to market prices for individual commodities determined on the one hand by the relative value in the minds of ultimate consumers and on the other by the relative supply (and production) conditions for each commodity or product. Farmers, processors, marketing people, and other factors in the farm economy are naturally most interested in what supply and demand conditions spell out in the way of price prospects for specific products.

FEED GRAINS

The short corn crop of last year is of course still being felt in current prices for feed grains and in livestock-feed price ratios, with feed grains expensive in terms of meat animals and dairy and poultry products. Combined stocks of these grains have disappeared at relatively rapid rates since the first of the year, and on April 1 were 30 per cent below last year as compared with a 25 per cent reduction from the previous year on January 1. Other feeds, such as oilseed cakes and meals and low protein by-product feeds have also been high relative to last year's levels. Prices of animal protein feeds, however, have been slightly lower.

With corn still being planted as this is written it is highly speculative to attempt to suggest what will happen to feed grain prices by harvest time. However, farmers stating intentions as of March 1 on the acreage they intended to plant to feed crops indicate that with yields equal to the 1942-46 average total feed grain production this year will be at least one-fifth above the 1947 total. The carryover will be smaller than last year at the end of the season. Taking the carryover and probable production together would give a total tonnage supply of the major feed grains approximately 13 per cent above last year and only slightly below the average of 1942-46. On the demand, or use side, livestock numbers on farms to be fed during the coming season will be materially below the 1947-48 season and about 15 per cent below the 1942-46 average. These two factors would thus yield a total supply per grain consuming animal unit around 10 to 15 per cent above that available in the current season and 10 per cent larger than in the 1942-46 period.

If the situation develops in these dimensions, it will mean price ratios favorable to livestock feeding during the coming season. Several responsible observors have predicted that corn prices may drop to the support levels by harvest time, possibly at or around a figure of $1.45, farm basis. That this may be too low is suggested by current pricing by the grain trade on the Chicago Board of Trade, where the December future for corn is being priced as this is written near the last of May on a basis that would yield a little more than the support level, farm basis. This would be a drop of between 25 and 30 per cent in corn prices from present levels. A drop of similar proportions would be expected for oats.

WHEAT

Food grain crops continue to be dominated by the grain export program, and the schedules for exports may be expected to be a continuing price supporting factor for the 1948 crop. Most recent reports on the wheat crop continue to point to a total of near record proportions — 1,117 million bushels, about equal to the 1,153 million bushel crop of 1946, the second largest on record. With a crop of this size and domestic consumption of 775 million bushels this coming crop year, there would be a residue of above 340 million bushels for addition to year-end carryover or for export. Carryover from the 1947 crop is estimated to be about 175 million bushels. The spring wheat crop is, of course, not yet made, and the winter crop remains to be harvested generally; there is therefore still room for variation below the 1,153 million bushels mentioned above which might be caused by weather troubles and insect and disease impairments. But there is now little doubt that given the 300 million bushels available for export as suggested above, this total can and will be exported. Tentative earmarkings for the European Recovery Program call for nearly a billion bushels of bread grains from world sources during the first year of operation. Export demand for U. S. wheat may thus be expected to maintain vigorous price pressure. It would seem at this time that a price decline in wheat, if it comes, could probably amount to no more than about five per cent.

OILSEED CROPS

With the average level of prices for fats and oils running around 15 per cent above the 1947 level, supply

(Continued on Page 8)

[1]"Farm Prices in Transition," May 1948, *Business Conditions.*

Plant and Equipment Expenditure Trends

Capital Outlays by Business Expected to Continue Strong

Business executives in the Seventh Federal Reserve District and nation in recent months have made upward revisions in their anticipated total expenditures for new plant and equipment for the balance of 1948, especially in nonmanufacturing fields. Even before the March announcement of new defense plans, reports from a cross-section of business managements to the Securities and Exchange Commission and Department of Commerce pointed to a national total of 18.7 billion dollars for 1948, or more than 15 per cent above the previous year's level. During the past two months because of renewed business confidence, attributable to Federal legislative developments generally rather than to direct Government authorizations to expand, plans to enlarge nonagricultural capital facilities have increased still further. As late as the fourth quarter of 1947, however, business leaders, in a survey conducted by another organization, expected capital expenditures during the current year[1] to equal or perhaps even to fall under the 1947 total.

The increase in anticipated capital expenditures between late 1947 and early 1948 resulted principally from: (1) renewed inflationary psychology which gained strength with growing certainty of the eventual enactment of a European Recovery Program (ERP) of more than token size, (2) price increases necessitating larger financial outlays than originally expected, and (3) capital improvements dictated by a need to "keep up" with competitors, particularly as a means of maintaining or expanding a "share" of a market—even a declining one. More recent decisions to "go ahead" with expansion or modernization plans appear to be based upon a new growing conviction among executives that 1948 at least will be a very good year for business generally, and hence uncertainty over business prospects offers less reason to delay carrying out new plant and equipment programs.

The prospect of added defense expenditures has greatly increased expectations of further inflationary pressures. Current estimates suggest additional defense expenditures of two to four billion dollars, which together with the ERP promise to raise the added foreign aid and defense expenses of the Government for the fiscal year ending June 30, 1949, some five to seven billion dollars. The full effects of this augmented rearmament program on the various parts of the economy, of course, cannot be known until its size—during the next year and in subsequent years—scope, and speed of introduction have been determined more specifically than at present. Nevertheless, there is likelihood that the effect of such a rearmament program, at least in its incipient stage and under present conditions of full employment, will be to stimulate higher capital expenditures.

The inflationary effects of the rearmament program arise, of course, from the fact that Government buying will withdraw consumers and producers goods from the markets at a time when civilian purchasing power promises to continue its upward trend of the last several years. Insofar as there is a net increase in plant and equipment expenditures in coming months, such expenditures will further intensify the upward pressure on prices.

Improved productivity, the major offsetting factor to higher prices under current conditions of full employment, is essentially a long-run development and, therefore, cannot be expected to provide more than partial relief in the near future. The recent price cuts of several large manufacturers in heavy industries fields, in part at least, reflect some recent improvement in productive efficiency.

These augmented expenditure programs will necessitate increased "outside" financing which provided about two-fifths of capital funds needed in business last year. This is not only because of the absolute size of these planned outlays, but also because internal sources of funds are now smaller relative to external sources than at any time since V-J Day. Corporations generally, however, are in sufficiently strong financial condition so that the funds needed for the most part will be forthcoming from external sources to the extent that internal sources prove inadequate. If security prices continue to advance as they have in the past few months, security flotations will be facilitated. During the first quarter of 1948, issues for new plant and equipment equaled roughly 800 million dollars, more than double the corresponding figure for the first quarter of 1947. Banks and insurance companies undoubtedly also will feel some increased demand for loans.

CAPITAL OUTLAYS AND BUSINESS LEVELS

Being the final and perhaps most vital link in the saving-investing process and exhibiting much more fluctuating behavior than consumer spending, capital expenditures are often referred to as the "backbone of business." Chart 1 reveals that years of rising gross national product have been marked by rising capital expenditures, and years of falling gross national product by declines in such expenditures. The war period offers no real exception to this rule since Federally financed capital expenditures replaced private capital formation.

THIS MONTH'S COVER

New blast furnace under construction at the Ford Motor Company Rouge Plant in Dearborn, Mich.

(Courtesy of Ford Motor Company)

[1]McGraw-Hill survey on "The Capital Expansion Boom," *Business Week*, Feb. 7, 1948.

Government expenditures fell over 52 billion dollars in 1946 and another two billion dollars in 1947. Under these conditions, the sharp rise in capital expenditures since V-J Day has been one of the most vital forces in promoting record postwar levels of general business, employment, and prices. As already indicated, capital expenditures this year are now expected to be 15 per cent above the 1947 level and more than double the sum spent by business in 1929 and 1941, the two prewar high years (see table). Even in physical terms it is anticipated that the 1948 total will exceed last year's.

CURRENT INDUSTRY TRENDS

Utilities, railroads, and petroleum refiners account for almost 45 per cent of total projected plant and equipment expenditures in 1948 (see Chart 2). With a combined increase of about 30 per cent over 1947, double the gain for nonagricultural business as a whole, these three industry groups are largely responsible for the strong tone underlying anticipated 1948 plant and equipment expenditures. The new defense program confronts railroad, utility, and petroleum managements with still greater demands at a time when productive capacity expansion is already being pushed to physical limits.

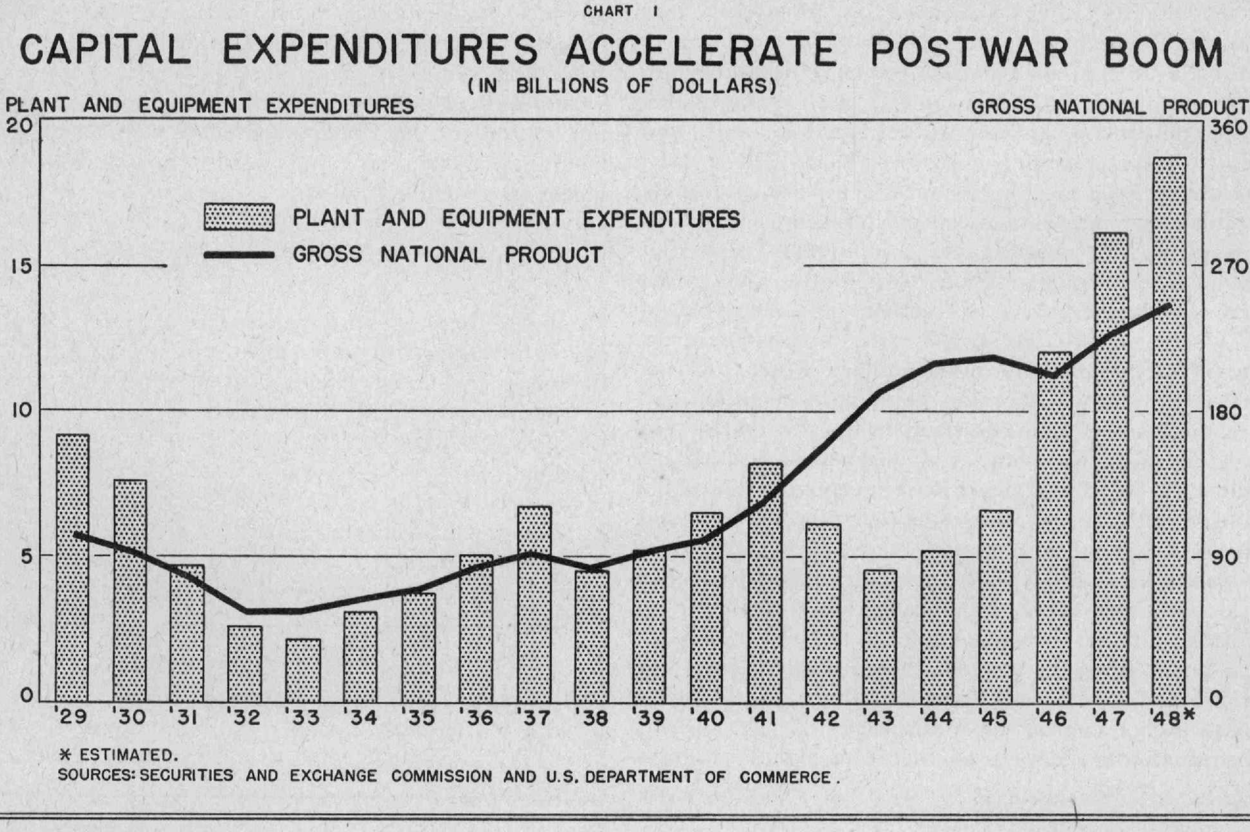
Utilities and petroleum are experiencing a marked secular increase in the demand for their products and services. This has resulted in part from a population growth through the war years unaccompanied by a corresponding wartime growth in physical facilities and in part from greater per capita use of their products and services. The petroleum industry, for example, is grappling with increased civilian demand on all fronts—manufactures, railroads, other businesses, farmers, and general consumers. Conversion of coal to oil-burning facilities has been an important consideration in this increased demand. Railroad expenditures have been motivated chiefly by a need to replace obsolete and worn out equipment and to meet rail and non-rail competition. The competitive factor is noticeable in the trend toward Diesel engines—a very expensive type of capital improvement.

With the return of buyers markets in one line after another, the need for more intensive selling effort, including more attractive physical surroundings, as well as the need for keeping up with competition are exerting increasingly powerful influences on capital expenditures in trade and service establishments. Even financial institutions, normally conservative in this respect, have undertaken substantial capital improvements since the end of the war. For these groups combined 1948 expenditures in new plant and equipment are expected to exceed the previous year's level by about 20 per cent.

Manufacturers throughout the nation expect to spend 7.8 billion dollars on new plant and equipment in 1948, an increase of four per cent over the 1947 level. Scattered information indicates considerable diversity of trend among individual manufacturing industries. In addition to petroleum, other industries with continued substantial expansion programs include steel, chemicals, and paper. Like petroleum, the demand for the products of these industries remains strong and promises to continue so for some time.

The industries in which current expansion plans represent a considerable slowing up or actual decline from 1947

CHART I



* ESTIMATED.
SOURCES: SECURITIES AND EXCHANGE COMMISSION AND U.S. DEPARTMENT OF COMMERCE.

PLANT AND EQUIPMENT EXPENDITURES, SELECTED YEARS

(Index 1939 = 100)

Year	Dollar Volume (In billions)	Unadjusted for Price Changes	Adjusted for Price Changes[1]
1929	$ 9.2	177	156
1939	5.2	100	100
1941	8.2	158	144
1947	16.2	312	188
1948	18.7[2]	360[3]	195[3]

[1]Adjusted by wholesale price index of U.S. Bureau of Labor Statistics. The index used excludes foods and farm products.

[2]Anticipated.

[3]Estimated by the Federal Reserve Bank of Chicago.

SOURCE: Securities and Exchange Commission and U.S. Department of Commerce.

levels fall into two general categories: (1) those which are undergoing a relatively declining demand for their products as consumers readjust spending patterns toward prewar norms, e. g., food, textiles, apparel, and related industries, and (2) a number of metal-using industries with products in strong demand but which are unable to utilize fully present, let alone expanded, facilities because of shortages of steel and other basic raw materials.

ANTICIPATED VS. ACTUAL EXPENDITURES

Although there now appears to be general belief among business executives that their capital expenditures during the year will exceed last year's record levels, there is, of course, no assurance that current plans will be carried into action. How accurately have these same businessmen estimated their capital outlays in the past? What are the prospects for financing such record expansion programs? How vulnerable are current plans to unexpected changes in domestic business conditions and international relations?

Since V-J Day, quarterly dollar expenditures on plant and equipment, with one exception, have been greater than the level which businessmen originally anticipated would be spent. When allowance is made for intra-quarter price changes, the estimated capital outlays are somewhat closer to the actual expenditures (see Chart 3). For 1946 and 1947 the excesses of actual over anticipated dollar expenditures were about eight per cent; when corrected for prices, the difference is under half this amount.

Probably the major factor responsible for this postwar pattern has been the increase in cost between the planning and completion stages of most projects as a result of the sharp upward postwar trend in material and labor prices. Construction delays also have added to such costs. Actual expenditures, moreover, often have been keyed to delivery schedules over which the purchaser has had little or no control. Hence, an estimate of capital outlays for any future quarter has necessarily reflected a guess as to when a new plant would reach a given stage of completion requiring a payment, or when some new equipment might be received.

The manufacturing and mining, electric and gas utilities, and commercial and miscellaneous groups have all followed the over-all industry pattern, with actual expenditures exceeding those previously anticipated. During the first four quarters after V-J Day the excesses were particularly great in the commercial and miscellaneous group, which includes communications. This was the period in which Federal permits were necessary; companies in the commercial and miscellaneous groups tended to face greater uncertainty in getting permits than companies in the other groups. Since the end of Federal control, the excesses of actual over anticipated expenditures have exhibited no uniform pattern among the three industry groups.

In the case of railroads, executives have consistently over-estimated their capital expenditures. The explanation here lies almost entirely with actual deliveries lagging well behind original expectations.

The importance since V-J Day of higher prices in pushing actual above previously anticipated plant and equipment expenditures reinforces the probability of continuation of a similar trend if inflationary forces gather new momentum under the impetus of the rearmament program. In any event, price strength continues to be quite evident in the metals and other building materials spheres, a condition which has prevailed since long before talk of rearmament started.

CAN EXPANSIONS BE FINANCED?

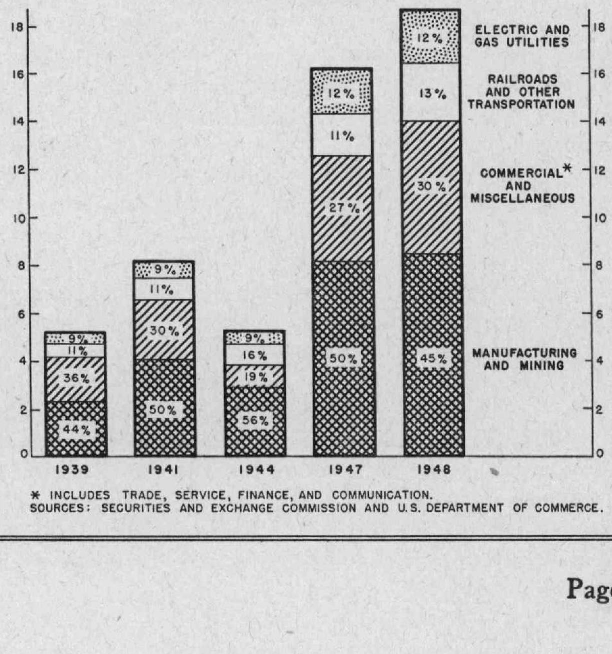
Stepped-up capital expenditures programs will con-

CHART 2

RAILROADS AND UTILITIES SHOW GREATEST EXPANSION POTENTIAL FOR 1948

PLANT AND EQUIPMENT EXPENDITURES

(IN BILLIONS OF DOLLARS)



* INCLUDES TRADE, SERVICE, FINANCE, AND COMMUNICATION.
SOURCES: SECURITIES AND EXCHANGE COMMISSION AND U.S. DEPARTMENT OF COMMERCE.

front many companies with financing problems. However, only a negligible fraction of the 1948 programs is likely to be held up by lack of necessary funds.

In spite of record postwar levels of security flotations and bank borrowing, about three-fifths of the cost of expansion programs since V-J Day have been financed from earnings, depreciation allowances, and wartime accumulated liquid asset holdings. Although, as indicated in the April 1948 issue of *Business Conditions,* corporations in the aggregate are still in a better financial condition than they were prewar, their liquid assets are now about equal to the level required to meet regular operating expenses at the current rate of sales. With earnings leveling off and dividend payments still rising many corporations of necessity will have to place increased reliance on outside sources of funds to finance capital expansion.

This is especially true of railroads and utilities. Since needed funds are of the long-term variety, the security markets logically provide a much more likely source than banks. The recent upward trend in security prices, if maintained, will be an important factor in facilitating new security flotations.

The high postwar level of corporate earnings has been a factor of some importance in offsetting the recognized general inadequacy of depreciation allowances in providing for replacement of existing facilities. Depreciation allowances have been inadequate for this purpose because, being based on cost, they do not, and cannot under present tax statutes, reflect the sharp price rise which has taken place in the last several years. Corporations, therefore, have required supplementary sources of relief in providing for replacement, including in many instances setting up special reserves for this purpose. Additions to these reserves, of course, are subject to corporate taxes as a part of earnings, but do provide a means for retaining such funds rather than paying them out as dividends. The replacement cost problem will continue to be a difficult one as long as prices exceed those which prevailed at the time the facilities to be replaced were acquired originally.

WHAT OF THE FUTURE?

Although the 15 per cent expected increase in capital expenditures by business this year compared with 1947 is considerably lower than the 35 per cent rise between 1946 and 1947, there are several reasons for believing that the underlying tone of capital expansion should remain rather firm well into 1949. Businessmen in general appear to be becoming more conscious of the expansion in, and modernization of, capacity that may be required because of population growth and technological developments. There is evidence of a substantial volume of plans based upon such considerations which may become active when conditions are deemed to be favorable to such action.

The three industries which now account for well over one-third of total new capital expenditures—gas and electric utilities, telephone, and petroleum—have expansion programs extending several years into the future. For both physical and financial reasons, these programs necessitate long-range commitments, and, therefore, will undoubtedly be carried out as planned or even augmented more or less regardless of specific changes in general business trends. Electric and gas utilities expect to spend at least 7.5 billion dollars on new facilities in the next five years. Recent discoveries of oil off shore in the Gulf of Mexico may accelerate even more the already substantial expansion program in petroleum where the bottleneck to production is now clearly seen to be lack of refining facilities. Continuation of favorable business conditions will assure high expenditures for badly needed equipment by railroads and local transit companies.

The pressure of increased competition will undoubtedly act as a continuing spur to capital improvements and additions in wholesale and retail trade. Probably the weakest sector is manufacturing in general. The decline in the annual rate of increase in capital expenditures since V-J Day has been greater in manufacturing than in any of the other over-all groups. The McGraw-Hill study estimated that "the capital programs of manufacturing companies will be 85 per cent complete by the end of this year (1948)." This study was made in late 1947 and, therefore, no doubt is subject to upward revision as a result of the general increases in anticipations which since have occurred among manufacturers. Also, as new facilities for turning out steel and other basic metals come into operation, those metal-using industries with products remaining in strong demand may be encouraged to consider undertaking additional capital expansion. The heavy rate of use of manufacturing equipment during the war and postwar years of full production clearly points to a heavy replacement demand in coming years.

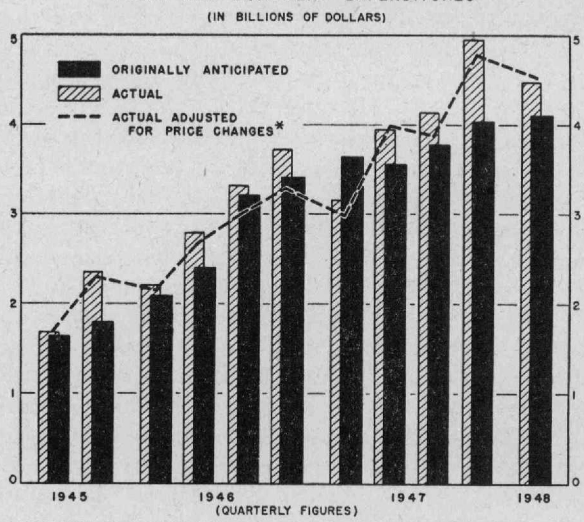
Over the longer-run, national prosperity will hinge on the ability of the economy to generate an appropriate rate of capital expenditures. Over the coming months, rising capital expenditures under present conditions of full employment clearly accentuate existing inflationary pressures.

CHART 3

ACTUAL EXPENDITURES EXCEED THOSE ORIGINALLY ANTICIPATED

PLANT AND EQUIPMENT EXPENDITURES

(IN BILLIONS OF DOLLARS)



* ADJUSTED BY U.S. BUREAU OF LABOR STATISTICS INDEX OF WHOLESALE PRICES.
SOURCES: SECURITIES AND EXCHANGE COMMISSION AND U.S. DEPARTMENT OF COMMERCE.

Rescuing Local Government

Subsidy, Self-Sufficiency, or Supplantation

The growing concern and responsibility of states and the Federal Government for functions that have traditionally been regarded as exclusively within the sphere of local government are converging more and more attention on local governmental organization and its suitability for administering and financing government services. Over the past two or three decades proposals to overhaul the structure of local government have met with indifferent success; changes have been made in some areas where existing conditions required drastic action; more often such proposals have been deferred to the indefinite future, or simply ignored. Financial stringencies and the competing interest of the "higher" levels of government may well provide a new sense of urgency for doing something about local government.

Suggested reforms are usually sought from or urged by local public officials, state officers, and spokesmen for community taxpayer groups. Generally widespread public interest is stimulated only if important public services or substantial changes in taxes are involved. In most of their aspects the problems of local government are those of relations with the state and the Federal Government; reform proposals are mainly concerned with altering these relations.

The most frequently suggested remedy is a more liberal sharing with the localities of state revenues (illustrated by the demands for cutbacks of sales taxes) and the extension of state and Federal grants. Tapping the lucrative sources of state tax revenues takes several forms. The yield of a specific tax or array of taxes may be shared on a percentage basis, an entire tax yield less the cost of administration may be earmarked for local use, or a fixed lump sum or per capita amount from all state taxes may be set aside. Some proposals do not tie local shares to particular taxes or even to the entire state tax system, but allocate grants from general state funds for particular functions such as education or welfare. These allocations are typically for fixed amounts although the state sometimes assumes a contingent liability for the payment of costs in excess of a locally financed minimum. Although petitions for an increasing measure of support are ordinarily directed at the states, grants from the Federal Government also enter into such proposals as Federal aid is becoming available for a growing list of local functions.

In contrast to those urging the states to establish a community of interest in their revenue systems with the localities, there are numerous advocates of self-sufficiency for local units, particularly the cities. Many of these advocates have long since despaired of anything better than a stepchild status for the "creatures of the state." They seek home rule in the fullest sense—complete financial responsibility for the level of municipal services offered. This alternative is usually expected to add substantially to existing local tax systems.

A third alternative is composed of recommendations looking toward a sweeping reorganization of local government and the realignment of Federal, state, and local services. Ignoring the traditional disposition of functions among these governments such suggestions are primarily directed at the reorganization of local government to provide essentially local services. More efficient administrative areas and greater simplicity in the structure of local government are expected to provide more responsiveness to community needs at reduced costs.

Those who have been working with these problems recognize that tinkering and patching the status quo, though often the only immediately practical alternative, has seldom done more than postpone the remedying of a steadily deteriorating condition. The older cities, for example, faced with the accumulated burdens of obsolescence in private investment, to say nothing of the condition of their own capital plant, must in the near future look to heroic measures for any adequate means of relief.

NATURE OF LOCAL SERVICES

The activities of the 155,000 local units of government in the United States, over 40,000 of which are in the Seventh District states, are numerous and varied. Interspersed with some of the most basic of government functions are incidental services and remnants of discontinued functions that have accumulated over several decades. While no brief characterization of the nature of such services is adequately descriptive, they tend to fall into two categories: (1) those of a regulatory, inspectional, and recording nature that are large in number but comparatively cheap to administer and do not even *in toto* bulk large in the cost of local government; and (2) those involving substantial costs and playing an integral part in the citizen's day-to-day working and living environment.

Many of these services are those in which the beneficiaries are also the persons who pay for them. For such services the extent of use tends to determine the amount of payment, and prices or fees are often used in lieu of taxes. Thus, the costs of utility services such as water, gas, electricity, waste disposal, and transportation are more often than not covered by the pricing rather than taxing policies. Road and street costs are in a roughly similar category although the special devices for financing

This article is the first in a series dealing with the financial problems of local government in the states of the Seventh District. Subsequent articles will cover the organization and functions of local governments, their tax systems, and the comparative effects on their operations of varying fiscal policies adopted by the District states.

these outlays—special assessments, motor fuel taxes, ton mile taxes, and motor vehicle licenses—are not as accurately adjusted to relative use or benefit as in the case of a water utility, for example. The trend among local units is toward placing a larger and larger proportion of their services on a fee or price basis.

Less than 10 major functions account for over 90 per cent of the expenditures of local governments. Education costs, including the construction, maintenance, and operation of schools and libraries, are of first importance. Outlays for streets, alleys, bridges, and roads together with maintenance, cleaning, snow removal, and lighting are very substantial items despite state and Federal interest in highways. Police and fire protection are significant costs in urban communities; in the larger cities they constitute between 20 and 25 per cent of current operating expenditures. Sanitation, including sewerage systems, disposal plants, refuse and garbage collection and disposal, entail very substantial capital outlays second only to those for streets and alleys.

Local units have long had many health and public welfare responsibilities, but until fairly recent times the costs associated with these functions have been comparatively minor. The provision of hospital care, particularly the specialized institutions for tuberculosis, communicable diseases, and mental ailments, has been at sharply increasing costs. Public health programs have shown a similar development; the rudimentary function of control of contagious diseases has grown into a many pronged effort to create and maintain conditions conducive to good community health. Public welfare activities of local units are, since the advent of the social security program, largely fixed by state and Federal standards and programs; they are usually fully supported or very heavily aided by grants from these governments.

It will be noted that transfer payments of local units are usually limited to interest, aids to the indigent, and in some states a portion of social security pensions. However, most local expenditures are of the exhaustive type, i. e., they specify given quantities and the character of goods and services to be purchased by such expenditure. Finally the character of local government organization tends not only to identify an area of tax contribution with an area of service, but also to attain a similar correspondence in various social and economic sectors of the community.

FEDERAL-STATE INTEREST IN LOCAL SERVICES

The causes underlying the increasing interest of the states and Federal Government in such matters as education, welfare, health, and transportation are attributable to the cultural and social evolution of the nation or the state as a single community in which economic, educational, and social inequalities are much reduced. Thus, commercial advertisers, propagandists, and educators have used new and improved methods of communication for the nationwide introduction and promotion of products and ideas. These developments together with the increased mobility of the labor force during and following the war have greatly accelerated trends toward the reduction of geographic disparities in scales of living. Among the important items of consumption in these scales of living is government, particularly local services. Although such services have previously been regarded as a local concern only, the notion is growing that national instead of local standards of performance should be attained.

Before the recognition of a national minimum of governmental service becomes effective, it has to overcome the very great disparities in taxable capacities of the traditional units of local government to pay the cost of such a policy. The simplest means of coping with this problem has been through the use of the grant-in-aid or the shared revenue.

The "intrusion" of states and the Federal Government into what have long been regarded as purely local affairs may also arise from the assumption by the former of entirely new government functions. Thus the social security program, while it did not replace local pensions to the aged or blind with Federal and state pensions, did remove a contingent liability from local governments to support indigent persons who came into that status by virtue of incapacities due to age or these particular physical handicaps.

LIMITS OF SELF-SUFFICIENCY

The incapacity of many cities, usually the most hard pressed of local units, currently to pay for the array of public services thought necessary by their electorates is due in large measure to the leveling effect on the distribution of income of taxation and public expenditure. Given the present-day role of government in the United States it is axiomatic that tax revenues have ultimately to come from persons who have the capacity to pay taxes in excess of their needs for government service and that governmental expenditures tend to be concentrated on those persons in the community whose needs for service are greater than their capacity to pay for them.

The natural tendency for taxpayers to elude the leveling process and to avoid locations of higher tax liability unless there is an offsetting benefit to them makes it hazardous for a city, and to a lesser extent a state, to impose higher taxes than its neighbors. The limited area over which the city, or even a state, exercises jurisdiction makes possible much diversity in tax policy. Areas in which this diversity takes the form of materially higher tax burdens will often be found to have retarded their rate of growth and economic development as a result of such tax policies.

In actual fact the dominating characteristic of local tax systems is an overwhelming dependence on investment as a basis for distributing tax burdens. While segments of the local government structure employ supplemental tax schemes, the over-all reliance on property taxation has not, up to now, been materially affected by the adoption of other local taxes. The urban tax base is largely investment in developed sites, residential, commercial, industrial and public utility structures, and a great deal of business, industrial and public utility personal property.

The rural tax base is mainly improved agricultural land, livestock, and other farm inventories. Investment in most of these components is long lived and incapable of transference from one location to another—the equity of the investor is thus exposed to the gradual encroachment of rising property taxes unless he can as landlord shift these costs to occupiers or as an entrepreneurial owner treat them as business expense.

These possibilities are variable in extent and time, dependent upon the type of investment. Even in an established community the economic adjustments brought into action by relative overtaxation are slow in their reaction on local finance since the total investment base changes but slowly, and an extended deterioration in the interests of property owners must be generally anticipated.

On the other hand, if there were no important income leveling effects involved in tax spending of local governments, and if the property tax were used primarily as a benefit levy, it would be practical for cities to continue to collect even larger property taxes on the presumption of a proximate correspondence between the benefits of public expenditure and their cost to individual taxpayers.

Self-sufficiency as a policy for local governments can be most practically sought by the extension of fees and prices for government services. Users can thus demand as much or little as they can afford at the established price. Obviously, many government services cannot be financed in this manner, but the list is longer than current practice indicates.

The resort to sales, net income, payroll, or business taxes if levied at rates which result in tax liabilities large enough to influence decisions of taxpayers is likely to encounter quicker and more drastic evasive action than experienced with property taxes. The leverage gained from long-term commitments is greatly diminished, and new taxes are likely to make disparities in tax burdens from one area to another more obvious than equivalent differentials in effective property tax rates. If nominal tax rates are applied to previously unused sources of local revenue to obtain partial relief, taxpayer resistance will be minimized but at the cost of unnecessarily complicating the entire tax system and compounding the cost of taxpayer compliance and government administration.

APPRAISAL OF COMPARATIVE POLICIES

The combinations of remedies being adopted to ease the financial dilemma of local government vary from state to state and one section of the country to another. Superficial facts of comparative government finance are widely and often inconsistently cited to demonstrate the efficacy of various self-sufficiency proposals or grant-in-aid policies. Such data can be used to demonstrate many pertinent consequences of alternative policies, but care must be taken to insure that noncomparability in underlying factual situations is taken into account.

Some of the more obvious cases of misleading comparison are apparent in tabulations of state aid to particular types of local governments or specified functions. Frequently reference is made to exhibits of per capita state aid for education, public welfare, or highways with a view to demonstrating that a given state has an inferior or a superior rank relative to the position of other states in respect to the financing of a particular function. Or the relative amounts of state grants and the sharing of state taxes with counties, cities, or other types of government are advanced as evidence that that state is fully meeting its responsibilities to local units as judged by the practices of other states.

Comparisons of these types are likely to lead to erroneous conclusions because they fail to take into account the allocation of services and taxes between the state and localities; they ignore variations in the structure of local government; they overlook the practicability of shifting property tax support from one function to another or one level of local government to another. Thus, if a given state assumes the greater portion of welfare cost and administration, it can hardly be expected to make substantial grants to localities for the financing of remaining welfare functions. Aid for elementary and high schools may be at a comparatively low level in a particular state because the expenditure for another costly local function is heavily subsidized by the state.

Some of the most impressive statistical demonstrations of the over-all sharing of state revenues with local units are by virtue of the fact that the generous state has imposed a larger than typical segment of services on its localities while retaining within its administrative jurisdiction a larger than typical portion of the state-local tax system. Obviously the level of its sharing and grant programs will be very much higher than that of the state which has taken over important welfare, health, or highway functions or left to the localities a larger portion of the tax system. Such institutional and structural variations among states are not only common but typical; thus the lessons of comparative finance are seldom readily available.

As a first approximation to obtaining reliable data on comparative state and local policies, it is essential to embrace in the analysis all taxes and functions of the state and its localities, or at least those that may appear in different positions in the governmental organization of states being compared. Such a procedure will eliminate the cruder types of distortion introduced by an incomplete consideration of facts of state and local finance. Less apparent limitations in this procedure arise from the fact that comparisons among states of taxes and expenditures implicitly assume comparability in the taxable resources and in the cost of "necessary" services.

Viewing the state and its local governments as a unit is helpful to analyzing the comparative relations between state and local governments. When the consolidated approach is used, levels of taxation are relatively meaningless unless they are expressed in terms of available taxable resources. Strictly speaking, a state may only count as its tax resources the events, transactions, or wealth over which it can establish a taxable situs.

All important taxes are measured by the physical or dollar volume of transactions, the value of real and personal property, pay rolls, or the net income of individuals or business. To determine the taxable resources of a given state it is necessary to make a quantitative estimate of each of the major measuring devices used to determine tax liability and devise some formula for combining them into an over-all gauge of capacity. The obstacles to such a procedure are both practical and theoretical. In the alternative it has become fairly common to assume that taxable capacity for the various states is proportional to income payments to individuals. The relationship is probably closer if the payments series is adjusted by the deduction of Federal income taxes.

Just as there are divergencies in taxable capacity among the states and their localities, there are also significant differences in the cost of providing "necessary" government services. Such disparities may arise from the definition of "necessary"; whether it is expressed by a conventional service standard or in some such welfare terms as that level of government expenditure which will clearly advance the community interest, taking into account the effect on private expenditure of attendant tax payments. However necessary services are defined, there are admitted differences in requirements from one region or area to another. Moreover, there will also be cost differentials for identical services inherent in varying climatic, geographical, and cultural conditions.

A high or low level of taxation and governmental expenditures is thus in part a matter of deliberate policy and in part a function of the environment in which the government must operate. Beyond these considerations are the effects of varying degrees of competence in self-government, administrative organization, and management. On the revenue side a poor tax system difficult to administer and applying unequally among similarly situated taxpayers would be comparatively unproductive and might well have adverse economic effects upon the local business activity and investment. Equivalent taxable capacities may be exploited quite differently through the selection and emphasis on various kinds of taxes and the calibre of administration.

On the expenditure side varying degrees of administrative competence are obvious factors in comparative analyses. The structural organization of state and local government and its suitability to the functions to be performed is an equally important consideration much too often ignored. The tendency of government incompletely to slough off outmoded organization and obsolete functions is very common, and it is thus that many units accumulate vestiges of prior activities—some extending back over a century—that make for conflicting and overlapping authority and a comparatively clumsy and inefficient structure. Even a better than average administration cannot cope with the obstacles inherent in jumbled responsibilities and powers.

Comparisons among states in their approach to the problems of local government thus provide reliable precedents for action only if they are qualified by an understanding of the comparative environment in which alternative policies have been tested and are expected to operate.

FARM PRICE PROSPECTS MIXED

(Continued from Inside Front Cover)

and demand outlook indicates the general level will continue above last year through the balance of 1948. Given average yields for oil crops, however, the supply of vegetable oils will be smaller during the rest of 1948 than they were last year. Supplies of lard, grease, and tallow are also expected to be below last year due to the reduced slaughter of livestock and the possibility that they will be slaughtered at lighter weights.

On the other hand, prices of drying oils have been about 15 per cent below the 1947 average and may be expected to continue lower than last year during the remainder of this year. Linseed oil is near the support price level for the 1947 crop, and producers have been assured support prices at the same level for the 1948 crop. Sizable stocks of flaxseed are still on hand, and crushing will continue large throughout the year. Spring planting intentions of farmers indicate a slight increase in acreage, and average yields would give another large crop.

Soybean producers indicated an intention to reduce their plantings this year by almost 10 per cent below the 1947 acreages, but some observers believe that recent market levels of well over $4.00 for soybeans, even though producers now have of course practically none to sell, may lead to a total planted acreage more nearly in line with last year. Presumably if this upward revision in acreage takes place, it would be largely offset in the acreage planted to corn, and the remarks above regarding corn acreage would be to that extent qualified. Currently on the Chicago Board of Trade November soybean futures are being bid at just over $3.00, but with no takers. This would imply a reduction of about 25 per cent from present price levels, some of which should be regarded as a normal seasonal price development, but with no trading in the future at these prices it may be assumed that the fall price of soybeans will be somewhat above this level.

Net imports of all fats, oils, and oilseeds into the United States this year will be only about 75 per cent of the 1947 figure, and exports, based upon international allocations, are expected to be about 80 per cent of last year's.

TROUBLE IN FRUIT

The 1947-48 season now drawing to a close was quite unsatisfactory for some of the major fruits, primarily the citrus and dried varieties. Large supplies of citrus and dried fruits and curtailed exports, due to dollar shortages with which to buy, combined to severely depress prices. Apples and pears suffered a similar experience although possibly less serious. To relieve the distressed conditions the Department of Agriculture purchased about one-third of the dried fruit production and has made substantial purchases of apples and pears.

Fruit exports in 1948 may increase somewhat, but those varieties which normally depend on substantial export demand probably will continue to suffer low prices. Seven million dollars of ERP funds are tentatively earmarked for exports of dried fruits during the current year. As long as Canada and the European countries feel the pinch of limited dollar exchange, fruit exports from the United States probably will suffer.

MEAT ANIMAL PRICES MAY RISE

Seasonal declines in marketings of hogs and fed cattle through the summer months will probably bring corresponding rises in prices. Strength in this part of the livestock price structure will doubtless show up also in lamb and grass fattened cattle prices declining less than seasonal amounts. The short corn crop of last year and the resulting decline in livestock-feed price ratios have lowered the number of cattle on feed in the Corn Belt states for marketing this fall to a low level. The Bureau of Agricultural Economics reported that on April 1 the numbers on feed were 25 per cent below a year earlier, with the bulk of the reduction in the western part of the Corn Belt. Some interests in the cattle trade have expressed considerable doubt that the reduction is quite this great.

The total marketings of hogs in 1948 is expected to be somewhat below 1947. The short corn crop and unfavorable hog-corn price ratio have tended to bring hogs to market earlier this year. As a result, April-June marketings may about equal those of last year, and the reductions will be felt in the late summer and early fall. Currently unfavorable feeding price ratios may lead to one of the smallest fall pig crops in several years. If so, pork supplies would continue to be relatively small into the summer of 1949. It is estimated that the spring pig crop this year is down by as much as 10 per cent. This in turn means reduced output of pork and pork products during the fall marketing season relative to last fall. As a result of the short supply of feed grains during the current feeding season and in response to high demand at high prices for meats, the country's livestock population has been reduced. Most of the "slack" has now been taken out, and marketings of cattle in 1948 will be reduced. This year's early lamb crop is also about 10 per cent smaller than last year's.

All these trends add up to a somewhat reduced meat output, about 10 per cent below 1947. It cannot be over-emphasized that such a reduction will still leave the output well above prewar levels. Meat industry spokesmen estimate this year's slaughter will yield about 21 billion pounds, compared with 23.4 billion in 1947 and 18.7 billion in 1939-41.

Consumer demand shows at present very little if any signs of abating. There have been a few fragmentary indications that demand might be passing a crest and a few doubts about demand holding up, but generally no serious break in demand strength is expected this year.

The reduced supplies from probable slaughter have only to a very limited extent been augmented by the stocks which packers accumulated when they stepped up their storage operations sharply during last winter. They will minimize only temporarily the reductions in marketings. The combination of reduced over-all meat supplies and continued strong demand spell firm prices for meat animals at the farm.

DAIRY PRODUCTS IN STRONG POSITION

The past year has seen a fairly steady rise in farm prices of whole milk, bringing them to a level about 15 per cent above a year ago. The feed situation, as well as other problems of the dairyman, has forced a reduction in milk cow numbers and brought the annual rate of milk production down from the 121 billion pounds of the first quarter of 1947 to 115 billion for January-April of this year. But this summer may see a turning point, for with good crops and pastures milk output during the latter part of the year may equal or exceed the corresponding 1947 period. Continued strong demand for fluid whole milk has shifted milk away from utilization in manufactured dairy products. This has helped and probably will continue to help maintain these products in reasonably strong price positions. Strength to dairy prices has also come from foreign demand and from recent into-storage movement. Under the European Recovery Program substantial quantities of cheese, condensed and evaporated milk, and dried milk solids are tentatively scheduled for export from the United States, although as yet approximate quantities of each dairy product to be exported have not been determined. Recent action of the House in paring down the ERP program is apt to cut dairy export prospects.

GOOD PROSPECT FOR POULTRY AND EGG PRICES

Currently the Department of Agriculture has found it necessary to institute a purchase program covering dried eggs in order to meet its price support commitments. It is probable, however, that this is only a temporary condition reflecting seasonal production peaks. Production during the balance of the year is expected to run about five per cent below last year. Relative meat shortages and strong domestic demand are expected to keep egg prices on the whole above those of last year. Culling of flocks and slightly curtailed production operations had reduced the number of hens and pullets on farms January 1 by two per cent below the first of last year, and by the end of 1948 the number of layers on farms is expected to have been reduced five per cent during the year. The number of chicks and young chickens on farms is currently 20 to 25 per cent below a year ago.

Increased commercial broiler production and fairly large cold storage holdings of chicken meat will very largely offset the decline of 10 to 15 per cent in chickens raised this year, so that supplies may be only slightly below last year during the remainder of 1948. Turkey supplies for the 1948 holiday season, it appears now, will be about one-fourth below last year. Production is being reduced, and storage stocks are smaller. It is expected that turkey prices will be somewhat higher this year than last.

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