BUSINESS CONDITIONS

A REVIEW BY THE FEDERAL RESERVE BANK OF CHICAGO

JUNE 1950

Federal Housing Aids for Agriculture

Small-Scale Program Now Under Way

The provision of adequate housing for the nation's population has become a matter of increasing public interest as indicated by the appropriation of tax moneys for this purpose. As a result, a number of public housing projects have been initiated in urban centers in recent years. Although there has been only limited demand for a similar program for farmers, there was included in the Housing Act of 1949 authorization for the investment of approximately 300 million dollars of public funds over a four-year period for the improvement of farm buildings. The absence of a general and persistent demand for public assistance in the improvement of farm housing reflects, for the most part, differences in the institutional arrangements under which farm and urban dwellings are constructed and used rather than any lesser relative need for improved housing in rural areas.

It is difficult, of course, to measure the degree of adequacy of housing. One measure which has been used is the presence of certain facilities, such as electric lighting, running water, bath, and flush toilet. This type of measure indicates that farm dwellings as a group are relatively much less adequate than urban dwellings (see table). Other measures, such as space per occupant, have, in general, given similar indications.

These data on farm housing are cited merely to indicate that the tremendous range in adequacy of housing facilities available to urban families occurs also in rural areas. Similar variations probably exist in the quantity and quality of many other types of goods and services utilized by consumers, both by occupational groups and geographic areas and, particularly, by individual families —as determined largely by their level of income. Thus, if it be judged desirable policy to devote public funds to the improvement of housing facilities available to low income families, there is a large group within agriculture which merits attention. There are, however, some special problems peculiar to the provision of farm as compared with urban housing.

BOTH LOANS AND GRANTS PROVIDED

Among other things the Housing Act of 1949 authorizes the Secretary of Agriculture "to extend financial assistance, through the Farmers Home Administration (FHA) to owners of farms . . . . to enable them to construct, improve, alter, repair, or replace dwellings and other farm buildings on their farms, to provide them, their tenants, lessees, sharecroppers, and laborers with decent, safe, and sanitary living conditions and adequate farm buildings . . . . ."

Financial assistance is made available to "qualified farmers" in the form of loans and grants for three purposes: (1) construction and repair of dwellings and other buildings on "adequate farms," (2) construction and repair of dwellings and other buildings on "potentially adequate farms," and (3) special loans and grants for minor improvements to farm housing and buildings. No loan limits are specified except in connection with loans and grants for minor improvements. In that connection grants are limited to $500 (whether or not combined with a loan) and loans, or a combined loan and grant, are limited to $1,000.

An "adequate farm" is one determined by the FHA to have sufficient earning power and income, including income from other sources, to maintain a reasonable standard of living for the owner and other farm inhabitants and to enable the borrower to repay the loan in full, with interest.

A "potentially adequate farm" is one not now considered adequate but which in a period of five years may by improvement, enlargement, better practices, or production adjustments reach sufficient earning power to enable the borrower to make annual payments with interest on the indebtedness thereafter. During this five-year period the interest and one-half the principal payment may be written off for any one or all of the years. Thereafter, the farm unit is presumed to have become productive enough to carry the remaining indebtedness.

The Secretary of Agriculture issues notes and other obligations for purchase by the Secretary of Treasury to provide such funds as Congress may from time to time determine to be used for making loans on "adequate" and "potentially adequate" farms, except loans for farm enlargement or development for which other funds are authorized. The maximum authorization for loans for construction and improvement of farm buildings is 25 million dollars for the year ending June 30, 1950, and additional amounts of 50, 75, and 100 million dollars for fiscal years 1951, 1952, and 1953, respectively.

In connection with loans on "potentially adequate farms," the Secretary is authorized to make commitments for contributions not to exceed $500,000 per year for five years beginning July 1, 1949, and additional amounts of

(Continued on Inside Back Cover)

MODERN FACILITIES IN OWNER-OCCUPIED AND TENANT-OCCUPIED DWELLINGS

(Per cent of occupied urban and rural-farm dwelling units having designated facilities, April 1947[1])

Facility	United States		Urban		Rural-Farm	
	Owner-Occupied	Tenant-Occupied	Owner-Occupied	Tenant-Occupied	Owner-Occupied	Tenant-Occupied
Cook stove[2]	97.8	96.1	99.2	97.0	95.7	92.9
Electric lights	91.7	89.6	99.0	97.5	70.6	49.8
Running water	80.6	80.3	97.0	94.6	43.4	20.6
Private bath or shower and flush toilet	70.4	64.6	89.8	79.2	28.6	9.4
All designated facilities	69.6	63.6	89.2	78.1	27.6	8.8

[1]All facilities must be in dwelling unit and for exclusive use of occupants.
[2]Cook stove means installed cooking facilities such as stove standing on floor or built into a cabinet—something more substantial than a one- or two-burner hot plate.
SOURCE: *Rural Family Living Charts*, Bureau of Human Nutrition and Home Economics, U. S. Department of Agriculture, p. 68, issued October 1949.

Capital Spending Continues High

Total Outlays Close to Peak Levels

Renewed optimism and confidence in the continuance of high levels of activity on the part of Seventh District business leaders are currently being reflected in decisions on new capital spending. Last year it was believed that plant and equipment expenditures were well past their peak with further considerable decline in prospect. This year numerous projects, some of substantial size, have been announced in this area. Developments are being pushed in a wide variety of industries, including steel fabricating, television, tractors, refrigerators, food processing, and other consumer goods lines. A surprisingly large proportion of the new activity planned or under way in the Midwest involves further expansion, not merely improvements or modernization.

Last fall the business outlook was clouded by the strike situation and the prospect of declines in the price level and general business activity. The strengthening of the price structure, the continuance of heavy demand, and the desire to cut costs through more modern facilities have led many firms to proceed with projects which had been shelved or considered only tentatively heretofore.

Total capital outlays for the nation in 1950, as estimated by the Securities and Exchange Commission and the Department of Commerce, will be off about 11 per cent from 1949, which in turn was 5 per cent under the record 1948 figure. However, the 16.1 billion dollars to be spent on new plant and equipment this year is an impressive amount when compared with the years 1935-39 when the average annual outlay was about five billion dollars. Current levels of capital spending are especially encouraging when it is considered that the inflationary boom and years of scarcity following the war are over. Capital expenditures now being planned are based upon the firm ground of continuing high levels of consumer spending and general prosperity.

Current estimates of capital expenditures for 1950 are probably too low. An earlier suvey by McGraw-Hill released in January suggested a 13 per cent drop this year, but later data indicate that the decline will be restricted to only seven per cent[1]. Orders for machine tools, motor trucks, diesel locomotives, freight cars, and machinery have been rising. Totals of "industrial developments" in the Chicago area (including purchases of existing plants and sites) tabulated by the Chicago Association of Commerce and Industry were three times as large in the first four months of this year as in the same period in 1949. F. W. Dodge contract awards for manufacturing construction during the first quarter of 1950 in the Seventh District were 20 per cent above 1949. Indications are that capital outlays in the Midwest this year may exceed the total for 1949. It is not likely, however, that the surge of the first quarter will be continued throughout the year. The extremely large number of projects announced in the first quarter may be looked upon as a temporary bulge.

[1] *Business Week*, January 21, 1950, and May 20, 1950.

EXPENDITURES ON NEW PLANT AND EQUIPMENT BY U. S. BUSINESS 1946-50

(In millions of dollars)

Item	1946	1947	1948	1949	1950*	Total
Manufacturing	5,910	7,460	8,340	7,250	6,740	35,700
Mining	560	690	800	740	650	3,440
Railroad	570	910	1,320	1,350	930	5,080
Other transportation	660	800	700	520	350	3,030
Electric and gas utilities	1,040	1,900	2,680	3,140	2,940	11,700
Commercial and miscellaneous	3,300	4,430	5,390	5,120	4,480	22,720
Total	12,040	16,180	19,230	18,120	16,090	81,670

*Estimated.
SOURCE: Securities and Exchange Commission.

INDUSTRIAL EXPANSION 1946-50

The postwar years have witnessed a phenomenal expansion of American industry. If estimates for the current year prove to be reasonably accurate, expenditures by private business on new plant and equipment will have totaled over 80 billion dollars in the five-year period, 1946-50, or more than 16 billion dollars per year. The average for the five prosperous years, 1926-30, was about half of this total. Even when price changes are taken into account, the increase over the previous period of prosperity is almost 25 per cent.

Another comparison points up the great expansion of recent years even more forcibly. Producers durable goods, including agricultural equipment, accounted for 6.2 per cent of all goods and services produced in this country in 1929. In the three-year period, 1947-49, this ratio was 7.6 per cent. It can be argued that producers durable goods series are the better data to use in this type of analysis. First, the SEC estimates include only that equipment which is added to fixed asset accounts. A considerable portion of the equipment purchased by business today, particularly by the oil industry, is charged off immediately as current expense. Second, equipment has accounted for a larger proportion of capital goods purchases in recent years, partly because of the emphasis upon modernization and partly because of the many surplus war plants purchased from the Government which were not included in the figures on new capital expenditures. The SEC data also understate the total to some extent because of the plant and equipment which industry operates under leasing agreements.

Immediately after the war American industry rushed plans to bring productive capacity up to the levels needed

to supply consumer demand. During the hard years of the thirties most firms had restricted new improvements and replacements to essentials. Important expansion was unnecessary because in most cases concerns were operating well below capacity. In 1946 it was a different story. Capital outlays had been restricted during the war, and the postwar demand for goods greatly exceeded capacity.

Manufacturing firms pushed their expansion plans more vigorously than did other categories of business in the earlier stages of the expansion. In 1946 manufacturing accounted for about half of all business capital expenditures. By 1949 this proportion had fallen to 40 per cent, and it appeared that most manufacturing firms had completed their programs. However, the preliminary estimates for 1950 indicate that the proportion of all plant and equipment expenditures made by manufacturing firms is rising once more.

Steel—The Midwest, particularly the Chicago area, has obtained a large portion of the new steel facilities. This trend has been underway for many years, since the area consumes more steel than it produces. The three largest steel-consuming areas in the nation are within the Seventh District: Detroit, Chicago, and Milwaukee. The end of basing point pricing has served to accelerate the movement.

Automobiles—Offsetting the developments in the steel industry favorable to this area is the trend toward decentralization in automobile production. Some of the capital expenditures of the automobile group, which are currently running over one-half billion dollars per year, are for facilities in Michigan, Indiana, and Wisconsin, but the greater proportion of new outlays is for assembly or parts plants in the South, Southwest, and West Coast in an attempt to cut transportation costs.

Electric Utilities—From 1946 through 1949 the private and municipally-owned electric power companies spent 6.7 billion dollars on new facilities which increased generating capacity from 50.1 to 61.2 million kilowatts. About 2.5 billion dollars will be spent in 1950, almost as much as in 1949. These outlays will continue to be large through 1955, at which time the industry hopes to have 92 million kilowatts of capacity, about double the prewar figure.

Railroads—Despite a recent show of strength, capital outlays by railroads during 1950 will be well below last year's total. The need for modernization of rolling stock is pressing. Half of the freight cars in this country are over twenty years old, and the major part of the tractive power for our railroads is still provided by steam although the highly efficient diesels have demonstrated they can pay for themselves over a period of years. In February of this year only 12 of the 1,100 locomotives on order were of the steam type.

EXPANSION VS. MODERNIZATION

A growing proportion of the capital expenditures is for modernization and replacement of outworn or outmoded equipment. The McGraw-Hill survey discloses that business executives expect 65 per cent of all outlays to be for this purpose in 1950. Equipment costs have risen considerably since 1939, but savings are possible through the greater efficiency of new facilities. This is especially true of the electric utility industry. Fuel cost per kilowatt hour has dropped steadily, and new generating equipment often permits lower unit output costs despite the fact that the older facilities were acquired at a much lower initial cost.

The postwar expansion has begun to bear fruits in greater output per man hour. During the reconversion period productivity dropped off, but from 1947 on, the increase has equaled or, more probably, exceeded the long-run trend of three per cent per year for all industry. Recent developments indicate that break-even points for firms which have engaged in extensive modernization or expansion programs are well below previous estimates. The steel companies were able to show a profit in the fourth quarter of 1949, despite the fact that they operated at only 50 per cent of capacity. Corporate profits in the aggregate have been rising steadily since the second quarter of last year, and certain manufacturing firms are enjoying higher earnings on a somewhat smaller volume of sales.

IMPORTANCE OF CAPITAL SPENDING

Plant and equipment expenditures have been assigned a critical role in the study of business booms and depressions by many writers. Such spending usually drops off drastically in any cyclical downturn and increases rapidly in times of great prosperity. Obviously, outlays for capital goods will be greatly increased if current capacity is inadequate to meet demand. When business activity drops off, industrial expansion becomes unattractive, and it is possible to defer even normal replacement outlays. Consumption expenditures, on the other hand, fluctuate far less throughout the turns of the business cycle. After adjustment for price changes capital expenditures dropped 71 per cent from 1929 to 1933, while consumption expenditures fell only 22 per cent.

Trends in plant and equipment expenditures by private business merit careful study. First, great variations in the volume of capital outlays over the years have amplified booms and depressions and, second, a continuing rise in the nation's output of goods and services can be achieved only by increasing the stock of tools at the disposal of the American worker.

What are the foremost considerations of business managements in decisions concerning new capital expenditures? If the intention is to expand capacity, the executive will be influenced most strongly by the relation of new orders to present capacity. When demand is expected to exceed supply for the foreseeable future, expansion is the obvious course. The other important motive for capital outlays is the attempt to modernize and compete more effectively through lowered costs. Other factors influencing investment decisions include population changes, wage rates, innovations, and related matters.

Numerous suggestions have been advanced by leaders in business and government as a solution to the invest-

ment problem. Whatever the merit of the proposals, none of them are concerned with helping stabilize business investment. They are all directed toward stimulating new outlays. Even without specialized "inducements" to investment, business has been making capital expenditures in enormous amounts over the postwar period. A high and rising level of capital outlays was one of several potent inflationary forces operating in the country during the years 1946-48. While these new facilities were in the process of construction, they constituted a drain upon scarce resources which were desired for the production of consumer goods. Further stimulus to investment would have increased the general problem of inflation at that time.

Through the years our basic difficulty has not been adequate investment, as our steadily rising standard of living would testify, but rather reducing the fluctuations in capital outlays over the cycle. Perhaps some of the proposals for increasing investment could be put into effect when business was in the doldrums and removed during periods of great prosperity or inflation. These inducements cannot solve our over-all investment problems. Most of so-called impediments to new investment did not exist in the 1929-33 period.

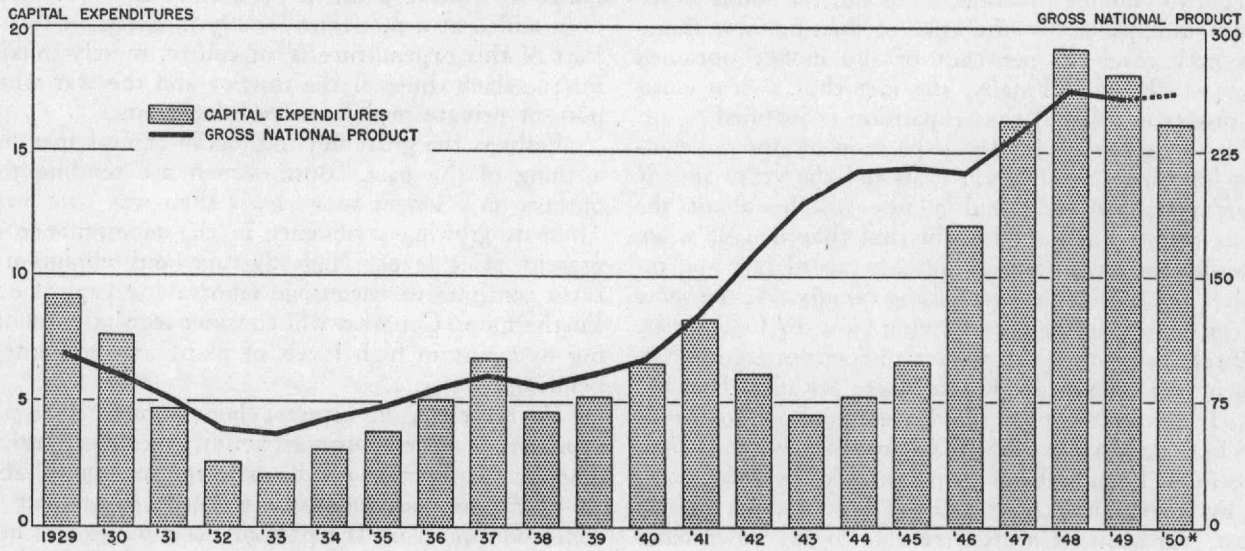
WHERE IS THE MONEY COMING FROM?

American corporations required 60 billion dollars in the four-year period 1946-49 to make expenditures on plant and equipment. This was 65 per cent more than the amount needed to finance increases in inventories and receivables, the other important uses of corporate funds, during the same period.

Corporations obtained money from a variety of sources, including sales of Government securities, bank loans, and security issues, but the greatest proportion of the funds was generated by business itself through retained earnings, depreciation, and depletion allowances. The funds obtained from these internal sources amounted to 60 billion dollars, about equal to the amount of expenditure on plant and equipment in the same years. Other sources provided the following amounts during the period 1946-49: (1) new security issues, 17.8 billion dollars, of which 12.6 billion was in bonds, (2) bank loans, 5.5 billion, (3) mortgages, 2.6 billion, and (4) other current liabilities, 2.4 billion. New capital expenditures, in general, do not appear to have been limited to any important extent by a lack of available money.

Has the financing of recent years resulted in top heavy capital structures for American industry through too great a reliance on debt? The answer seems to be "no." Retained earnings and sales of new stock increased corporate capital and surplus accounts by 44.3 billion dollars from 1946 through 1949 while new bond issues plus the increase in bank loans and mortgages amounted to only 20.7 billion. Long-term corporate debt today is only moderately above the previous peak established in 1930, although revenues and profits are much higher. Some debt has been avoided or reduced through agreements to lease newly acquired assets.

While long-term debt outstanding has remained low, service charges have actually declined. Twenty years ago, five per cent was a usual coupon rate on corporate bonds as compared with three per cent or less on an obligation of similar quality now. Furthermore, financial statements do not reflect the full amount of equity in the nation's business. Book values are often understated because of the fact that fixed assets were originally purchased at a lower price level, and depreciation is usually handled more conservatively than was formerly the case.



* ESTIMATED.
SOURCES: U.S. DEPARTMENT OF COMMERCE, SECURITIES AND EXCHANGE COMMISSION, AND BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.

If serious recession lies ahead, business, in general, is in a strong financial position and could withstand shocks which would have brought great difficulties years ago.

It is often stated that a "shortage of equity capital" exists. Business is said to hold back new investment because it is difficult to obtain equity funds through the sale of common stocks to the public on reasonable terms. Supposedly this is a result of steeply progressive income taxes, the tendency for individuals to desire greater security for their savings along with other factors, and the refusal of corporations to offer new stock at prices which would unfairly dilute the interests of existing stockholders. The importance of the "equity capital" problem has probably been overstated insofar as it applies to the level of capital expenditures. A survey of business executives taken late last year by McGraw-Hill disclosed that 90 per cent of the manufacturing firms would not increase capital expenditure programs even if they could sell common stock at prices 50 per cent above those of last November.

A number of studies have indicated that the basis for expansion of American industry has always been retained earnings and depreciation reserves. Some outside money is necessary as a nucleus, but the typical business firm in this country has reached its present size by restricting dividend payments and ploughing earnings back into the business. New common stock usually finds ready purchasers only in a rising stock market, but even in 1929 it is probable that no more than two billion dollars was made available to operating companies through stock sales.

Objections are often made to financing through retained earnings. It is said that the capital markets do not have the opportunity to evaluate the company's claim for additional funds, and the investor is not free to decide whether or not he wishes to add to his interest in a firm in which he holds stock. However, excellent arguments can be offered for the retained earnings device. First, if profits are paid out to stockholders in dividends, they are subjected to "double taxation." Second, the funds available are diminished by the cost of floating new issues which may reach 20 per cent of the money obtained through stock sales. Finally, the fact that a firm earns large profits is a signal that expansion is justified.

Will funds needed for the expansion of American industry be readily available in 1950 and the years ahead? Requirements for additional money will be about the same as last year and considerably less than in 1948 when capital outlays were being made at a record rate and inventories and receivables were rising rapidly. At the same time corporate earnings are moving close to 1948 peaks. Funds retained through depreciation reserves are increasing each year as more high-cost assets are placed on the books. Insurance companies and trustees of pension funds are seeking outlets for a larger volume of new funds than ever before. Even sales of common stock will be facilitated by current market trends.

Last year business firms were able to pay down bank debt and increase dividend payments in the face of lowered earnings. Barring resumption of inflationary pressures upon working capital, it appears that money for capital expansion will be plentiful for the foreseeable future.

Some observers believe that adequate funds are available for large established firms but decry the situation that a small business without large earnings faces when it seeks additional financing. Some 600,000 new firms have been added to the business population since the end of the war, but it is said that many of these firms cannot obtain the money they need to grow. This problem is not new. Even in 1929 the problems of a small firm seeking additional capital were subject for comment. Proposals to aid small business will be discussed in greater detail in a future *Business Conditions* article.

THE FUTURE OF CAPITAL EXPENDITURES

This year almost 1,000,000 people will be added to the labor force at a time when the heavy capital outlays of recent years and the return of competition are bringing higher productivity per man hour. Steadily rising unemployment can be avoided only through a continuing high volume of expenditures on goods and services, including business expenditures on plant and equipment, or a reduction in the work week.

During the last half of the thirties many writers came to think of the American economy as "stagnant." Population was leveling off, no important new industries were being started, and inventions and innovations were more likely to be of the "capital saving," (i.e., bringing greater efficiency) rather than the capital using, expansionary type. During the decade of the forties the nation resumed its upward progress. Population of the United States increased about 20 million from 1940 to 1950, and vast new expansions were undertaken in all lines of industry.

Since 1870 outlays for producers durable goods adjusted for price changes have increased three per cent a year on the average. In recent years, according to estimates of the Department of Commerce, equipment has been added at a rate considerably in excess of this trend. Part of this expenditure is, of course, merely making up for the slack times of the thirties and the war when important private projects were infrequent.

Perhaps the great fluctuations in capital spending are a thing of the past. Businessmen are tending to plan outlays on a longer range basis than was true formerly. There is growing confidence in the maintenance of the present price level. High average and minimum wage rates continue to encourage laborsaving capital outlays. Furthermore, Congress will consider legislation endeavoring to maintain high levels of plant and equipment expenditures.

Nevertheless, investment booms have always been short-lived. When business activity declines, outlays on plant and equipment can be expected to drop off sharply. Co-operation between business and Government and a continuing faith on the part of business leaders in long-run national growth will be necessary to keep capital outlays high and stable.

Unemployment Insurance in the 1950 Economy

Higher Unemployment Revives Old Problems, Raises New Ones

Among the more complex problems raised by the existence of a significant volume of unemployment is that of the functioning of the Federal-state unemployment insurance system. This system is now in its fifteenth year; during this period there have been major changes in the financial status of the program and the economic impact of unemployment benefits and pay roll taxes.

Despite the recent improvement in the employment picture, the two and one-half million increase in unemployment since the fall of 1948 has created new and somewhat unexpected problems for unemployment insurance. Despite the relative prosperity, there have been substantial drains on the unemployment trust fund reserves built up during the war and postwar period of minimum unemployment. The large volume of benefit payments has contributed to the maintenance of national income at high levels, but the higher pay roll tax rates which automatically result from increased unemployment promise to have a depressing influence on business conditions.

DECLINE IN RESERVE FUNDS

During 1949 balances in state accounts in the unemployment trust fund, which constitute the reserves for payment of insurance claims, declined by almost 650 million dollars from the all-time peak reached in December 1948 of 7.6 billion dollars. Individual state reserves declined in 28 states and the District of Columbia by amounts ranging up to almost 50 per cent of December 1948 balances. In eight other states benefit payments also exceeded receipts from pay roll taxes, but the difference was made up by the interest credited on obligations of the United States Government held by the trust fund.

What happens to the reserves is determined by both economic conditions and the unemployment insurance laws themselves. Increased unemployment reduces balances in two ways: it produces additional claims for benefits and usually reduces the size of pay rolls, the taxes on which finance the system. State unemployment insurance laws largely determine eligibility for and the amount and duration of benefits and, within certain limits, the pay roll tax rates. Benefits were limited in the original state laws to low maximum amounts for maximum periods of brief duration. The Social Security Act, which established the program in 1935, imposed a three per cent pay roll tax on employers of eight people or more. Nine-tenths of this tax, or 2.7 per cent, is offset by state unemployment insurance taxes which are deposited in the Federal unemployment trust fund.

The favorable experience during the primarily prosperous years in which the program has been functioning has led to considerable revision in benefit and tax provisions. As wages have risen, benefits have automatically followed suit although there has been some lag in the raising of statutory ceilings on weekly benefit amounts. Maximum duration provisions also have been very much liberalized. Despite this liberalization, it was apparent that the 2.7 per cent tax rate would produce balances far in excess of all conceivable needs, and the Social Security Act was amended in 1939 to permit states to reduce tax rates on the basis of individual employers' favorable employment experience ("experience-rating"). By 1948 the average tax rate was only 1.2 per cent.

This framework of higher benefit provisions and lower tax rates provides the setting for the experience during 1949 with rising unemployment. The declines in reserves noted above were most marked in the larger and more industrialized states, where unemployment increased more rapidly and benefit provisions are usually more generous. Specifically, the excess of benefit payments was greatest percentagewise in the New England, Middle Atlantic, and Pacific Coast states. All but one of the 15 other states

TABLE 1

UNEMPLOYMENT INSURANCE FINANCES, 1949

(Amounts in millions of dollars)

Item	Seventh District States					Other States				United States Total
	Ill.	Ind.	Ia.	Mich.	Wis.	Calif.	Mass.	N. Y.	Pa.	
Unemployment trust fund balances:										
December 31, 1948	515.0	193.7	85.5	291.8	218.7	702.1	175.8	1,050.7	636.5	7,572.3[1]
December 31, 1949	479.9	187.1	92.6	293.2	215.7	578.6	106.5	880.7	562.5	6,924.4[1]
Contributions[2]	61.9	16.6	10.6	78.3	12.5	117.4	44.2	167.3	62.8	997.2
Benefits paid	105.4	27.0	5.3	80.8	19.6	253.1	115.2	356.4	140.5	1,736.8
Average employer contribution rate[3]	1.0	.7	1.3	1.8	.7	1.8	1.4	1.9	.9	1.3
Ratio of benefits to taxable wages (per cent)	1.7	1.2	.7	1.9	1.1	3.9	3.6	3.3	2.0	2.2
Per cent of workers who could be paid maximum benefits out of 1949 balances[4]	40.6	56.0	69.1	37.4	48.5	39.0	13.5	34.1	35.8	45.8

[1]State accounts only.
[2]Includes penalty and interest collections and employee contributions.
[3]Per cent of taxable wages.
[4]Employed covered workers, monthly average, April 1948-March 1949; maximum duration in effect January 1, 1950; average weekly payment equal to average weekly benefit, January 1950; all claimants assumed to be eligible for and receiving the maximum number of weeks of benefits payable under the state law. For United States total figure, maximum duration assumed to be 20 weeks.
SOURCES: *Social Security Bulletin*; Bureau of Employment Security; *Daily Treasury Statement.*

showing declines had average tax rates below the national average. In the Seventh District, Illinois, Indiana, and Wisconsin balances declined slightly while Iowa and Michigan balances increased (see Table 1). Michigan's increase was due in large measure to its relatively high tax rates; however, all of the changes in the District states were moderate.

By itself the fact that declines did occur is of little importance; more significant is the question of the adequacy of the remaining reserves, together with expected receipts, to meet anticipated claims. The last line of Table 1 provides a rough measure of fund adequacy: it indicates for the states listed the percentage of workers currently in covered employment who could be paid benefits at the current average rate for the maximum duration permitted under state laws out of state balances at the end of 1949. This makes no allowance for current pay roll tax receipts, which would be appreciable at any conceivable level of unemployment and at 1949 levels would add 2-10 per cent to the figures given. It is apparent that, except for Massachusetts (and other New England states), existing reserves afford a great deal of protection, unless unemployment is assumed to reach very high levels and remain at those levels for at least two years. Moreover, the prospect for the immediate future is that unemployment will vary within a relatively small range from present levels. Furthermore, the automatic increases in tax rates caused by the higher unemployment experience during 1949 in most states will be effective this year and should produce significant increases in receipts.

UNEVEN INCIDENCE OF UNEMPLOYMENT

Despite the generally favorable reserve picture, the geographically uneven incidence of unemployment could result in even small amounts of additional unemployment creating fairly serious problems for the states, such as those in New England, whose reserves are now less adequate than is typical. The segregation of state accounts in the unemployment trust fund permits the exhaustion of certain state accounts while the total balance is still very large. Recognition of this problem caused Congress in 1944 to establish a system of Federal reinsurance loans to states whose balances were at dangerously low levels. This system was designed to aid the states to deal with the high levels of unemployment expected during the reconversion period, and when these did not materialize, the provision was permitted to expire.

The President, in a Message to Congress on April 6, 1950, recommended the provision of Federal assistance to states "unable to maintain the solvency of their unemployment funds in a period of severe unemployment" without increasing their tax rates unduly. This recommendation, together with others made by the President in this Message, is incorporated in HR 8059, introduced by Representative McCormack. Section 1201 of this bill provides for grants to states having balances which are less than the benefits paid during the previous six months and having a minimum tax rate of 1.2 per cent. The grants are to be three-fourths of current benefit payments in excess of two per cent of taxable pay rolls. Although no states would have been eligible for such grants had they existed in 1949, states experiencing several years of covered unemployment in excess of 10 per cent probably would conform to the specified conditions.

BENEFIT PROVISIONS AND PAYMENTS

Another factor complicating this picture of adequate reserves in most states is the possibility of the enactment of substantially more generous benefit provisions, such as those suggested by the President in his Message. Such liberalization would increase benefits payable by as much as 50 per cent on the average, thus reducing the "adequacy" percentages in Table 1 by one-third or more, depending on how generous existing benefit provisions are.

As noted above, benefit provisions have been substantially liberalized, and benefit amounts have risen sharply since the inauguration of the program. Neverthe-

TABLE 2

SELECTED BENEFIT PROVISIONS IN UNEMPLOYMENT INSURANCE[1]

JANUARY 1, 1950

Item	Seventh District States					Other States				Minimum Requirements Under H.R. 8059
	Ill.	Ind.	Ia.	Mich.	Wis.	Calif.	Mass.	N. Y.	Pa.	
Minimum number of employees in firm for coverage	6	8	8	8	6[2]	1	1	4	1	1
Weekly benefit amount:										
Fraction of high-quarter wages	1/20	1/25	1/20	....	....	1/20–1/23	1/20	1/23	1/25	....
Per cent of average weekly wage	....	....	....	64–57	68–51	....	....	....	....	70–50[3]
Dependents' allowances (per dependent)	....	....	....	$1 or $2[4]	....	....	$2	....	....	$3 or $6[5]
Maximum benefit amount	$25	$20	$22.50	$24–$32[3]	$26	$25	$25[3]	$26	$25	$30–$42[3]
Average weekly benefit, January 1950	$19.30	$18.69	$19.60	$24.63	$22.67	$22.97	$23.69	$22.89	$21.13	$24.75[6]
Maximum duration of benefits (weeks)	26	20	20	20	26	26	23	26	24	26

[1]Information applies only to total unemployment, where differences exist between total and partial unemployment.
[2]Or $10,000 minimum pay roll in any quarter.
[3]Higher figure includes dependents' allowances. Augmented maximum not shown for Massachusetts because there is no limit on the number of dependents for whom allowances are paid.
[4]Up to $8 per beneficiary.
[5]Up to $12 per beneficiary.
[6]Estimated national average in January 1950, if requirements of H.R. 8059 had been in effect.
SOURCES: *Social Security Bulletin, Monthly Labor Review.*

less, legislatures in nearly all states have not raised statutory maximums sufficiently to meet the original objective of the program, that of replacing one-half of the wage loss during the period in which benefits are paid. In early 1949 the program was typically paying benefits equal to about 36 per cent of average wages. However, this percentage varies widely among the states; Table 2 indicates some of the more important differences in benefit provisions in state laws in District states and other larger states. If all states were included, the variation would be even greater, since statutory ceilings on both benefit amount and duration are usually less generous in the primarily agricultural states, particularly those in the South.

These wide discrepancies in benefit provisions, which are associated with interstate differences in wage levels and costs of living of much smaller proportions, tend to dampen the labor force mobility considered desirable in a dynamic economy. An additional problem created by low benefit provisions is in terms of the maintenance of high levels of aggregate personal income. Unemployment insurance, with benefit payments rising automatically to counteract somewhat the drop in national income associated with rising unemployment, is one of most trouble-free instruments of economic policy. In 1949, although 1.7 billion dollars were paid out in benefits, more than double the previous year's figure, this amounted to only a small portion of the moderate decline in personal income from the 1948 peak. In periods of more serious declines larger proportionate additions to the income stream through unemployment insurance might be advisable as a means of preventing the downturn from cumulating. The duration provisions also are of importance; even in 1949 nearly two million persons exhausted their benefit rights and still were unemployed.

The major benefit recommendations of the President's April 6 Message, as included in HR 8059, are shown in Table 2. It is estimated that they would have cost an additional 850 million had they been in effect in 1949; this represents a 50 per cent increase. The potential percentage increase caused by these recommendations, if enacted, would be much greater than this if unemployment were higher.

RISING LABOR FORCE

HR 8059, in common with most other recent proposals, fails to treat one of the important areas in which unemployment insurance does not currently provide protection, that is, the prolonged unemployment of many persons who have failed to qualify for benefits. Current experience with increased unemployment indicates that the critical problem is not that of reduced employment, but of a rising labor force with a relatively stable number of jobs. New entrants to the labor force, largely young persons leaving school, are not being readily absorbed, and these people lack the employment record with which to qualify for benefits. Many of these persons, unemployed but not receiving benefits, are supported through public assistance payments, which constitute smaller percentages of average wages. The increasing fiscal difficulties of state and local governments, which are the major source of support for the types of public assistance received by unemployed persons, have led to a number of reductions in assistance payments. If the problem of unemployment among new entrants to the labor force continues to grow, as is the prospect, a system of Federally-financed unemployment benefits for such persons, at low levels, to be supplemented where needed by public assistance, may receive more consideration than increasing benefit levels for workers who are now given some protection.

The very liberal basis of computing benefit amounts under HR 8059—up to 70 per cent of average weekly wages for persons with dependents—has been criticized by those who feel it would intensify existing problems of administration by providing in many cases an inducement to malingering. At any rate, the prospects for action on the bill in this session of Congress seem slight.

PAY ROLL TAX PROBLEMS

The reduction in pay roll tax rates under state experience-rating plans during the prosperous years of the 1940's, from the 2.7 per cent rate imposed under the Social Security Act to the 1.2 per cent average rate in 1948, was noted above. The average rate increased slightly to 1.3 per cent in 1949, due primarily to less favorable employment conditions during 1948 in a few states. In 1950 the average will increase, based on the generally less favorable conditions during the past year. For certain states this increase will be sharp; New York employers, for example, all will pay the 2.7 per cent rate this year.

The passing of the halcyon days of very low rates will bring into sharp focus some of the problems inherent in the experience-rating method. Most obvious is the cyclical "perversity" of this method: tax rates rise sharply and automatically when employers are faced with declines in sales and profits and are thus less able to pay higher rates. Since the base of the tax is pay rolls, this tends to discourage higher levels of employment and to intensify the spiral effects of a downturn. The increased withdrawals from the income stream due to higher taxes offset to some extent the additions to income due to increased benefit payments. Conversely, the lowering of rates in boom periods tends to encourage competition for already scarce supplies of labor and thus feeds an inflation. If tax rates were more stable, the automatic counter-cyclical nature of unemployment insurance would be substantially strengthened, for in a downturn stable tax rates levied on smaller pay rolls would produce lower receipts while benefit payments increased. The net effect would be much more clearly expansionary.

Additional problems are created by the fact that tax rates determined under experience-rating are necessarily not well integrated with the two other variables in unemployment insurance financing, the benefit provisions and the reserves. The cost of benefit increases enacted in prosperous years is obscure until unemployment in significant volumes reappears, and the tax implications of the cost problem are thus often not a factor at the time the legislation is under consideration. Depletion of re-

serves while rates, determined without direct regard for the over-all financing of the system, are low can result in very sharp increases coming rather suddenly and at the wrong times. In addition, interstate competition for industry through the progressive lowering of tax rates is apparently an important factor in the present financial difficulties in the New England states. If, as was assumed when the Social Security Act was passed, unemployment is a problem of national scope and beyond the power of any individual state to affect significantly, there appears to be little gained by the wide differentials in tax rates.

There have been serious doubts raised concerning the main argument for experience-rating—that individual employers, faced with tax penalties for poor employment experience, can do much to regularize employment and thus lower total unemployment. There are inherent inter-industry differences in sensitivity to changes in business conditions, which cannot be avoided to any great extent; experience-rating tends to discourage rather than encourage sensitive industries from maintaining pay rolls in uncertain periods. Rationalization of business operations in order to lower turnover and reduce such types of unemployment as brief seasonal layoffs will hardly affect more than a relatively small portion of unemployment at levels of four million or more.

A second argument for experience-rating is that it encourages employers to take an interest in the administration of unemployment insurance to prevent the payment of benefits to persons legally ineligible, since benefit payments in most states are charged to employers' records and will increase their tax rates. Obviously this works against smaller employers who cannot afford the expense of participating in hearings and other litigation. The additional litigation produced by employer participation in administration often adds enough additional work to make the administration considerably less effective.

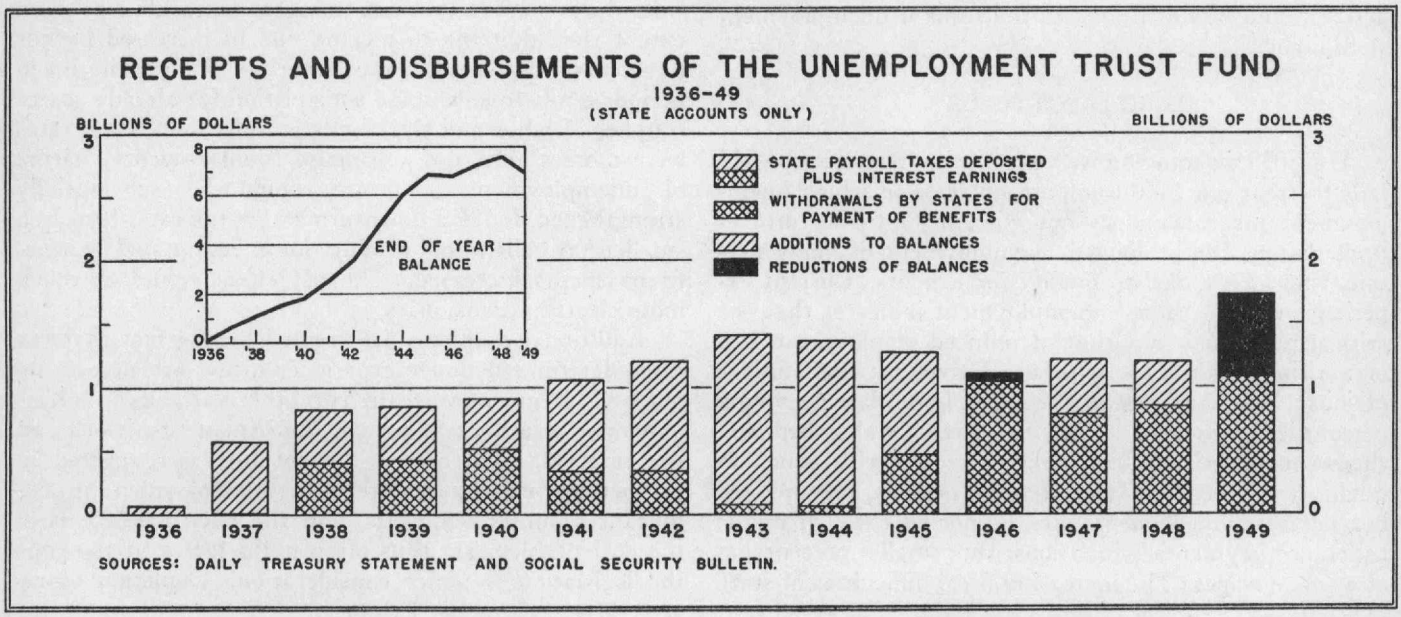
FUTURE FINANCING OF PROGRAM

The difficulties inherent in state experience-rating have generated various proposals for revision of the financing of the program. Perhaps the most obvious is that suggesting the use of a uniform, stable pay roll tax rate, low enough to prevent the unreasonable accumulations of funds that occurred in the 1940's and high enough to avoid the rapid and sizable drains that threaten the reserve position of a few states today. Long-run estimates for a model 10-year business cycle place the cost of a program with 26 weeks duration of benefits at between 1.6 and 2.1 per cent of taxable pay rolls, considering the present size of reserves. This proposal would avoid the more glaring defects of experience-rating, particularly its cyclical "perversity" and its stimulation of competitive rate-cutting.

If a uniform rate were to be established at the lowest level consistent with long-run balancing of receipts and disbursements, there would have to be considerable freedom in transferring unemployment trust fund balances from state accounts less hard-hit by the uneven incidence of unemployment to those which were worse off. Otherwise, the uniform rate would have to be set high enough to maintain the long-run solvency of the state in the weakest position; under current conditions this might mean the difference between a 1.8 per cent rate and a 2.1 per cent rate.

ADMINISTRATIVE STRUCTURE

Another problem to be solved in the future is that of overcoming some of the unique defects existing at present in the administration of the program. The program is administered by state agencies, with administrative costs met by Federal grants. Federal controls over administrative practices are of necessity general and cannot guarantee sound administration. At the same time the fact of Federal financing insulates the unemployment insurance agencies against effective control by higher state government authorities. As a result, the agencies tend to be somewhat independent of both Federal and state governments, but harassed by both.



FEDERAL HOUSING AIDS FOR AGRICULTURE

(*Continued from Inside Front Cover*)

one, one and a half, and two million dollars per year, each for a five-year period, beginning July 1, 1950, 1951, and 1952, respectively, for a total of 25 million dollars. Authority is provided also for the appropriation of funds to make payments on notes or other obligations issued by the Secretary covering loans on "adequate farms" and loans and contributions made to borrowers on "potentially adequate" farms. This is not additional loan authority, but it provides a means of repaying the Treasury from current appropriations the amounts that are not forthcoming from collections because of the contribution provisions of the Act.

Appropriation of additional amounts for loans and grants for minor improvements to farm housing and buildings and for farm enlargement and development is authorized in the amount of two million dollars for the year ending June 30, 1950, increasing by further amounts of five, eight, and ten million dollars for fiscal years 1951, 1952, and 1953, respectively. Finally, such further sums as may be necessary to enable the Secretary of Agriculture to carry out the program may be appropriated.

LOANS ADMINISTERED LOCALLY

Full or part-time farmers with equity in a farm but unable to secure additional credit from banks or other credit agencies are eligible for FHA housing loans. Although tenants are not eligible, they, of course, may receive the benefits of any improvement in housing which results from loans made to their landlords. Loans may be made for new construction and repairs to existing buildings on farms already mortgaged, the FHA accepting a second mortgage or other security.

The term of loans may be from a minimum of five to a maximum of 33 years, the length being suited to the individual borrower's needs but usually ranging from 20 to 25 years. Maximum interest rate is four per cent per year. The Act provides that the borrower shall refinance his indebtedness through co-operative or private credit sources whenever he is able to do so. Loans are not to be made unless it appears that the farm is or can be made sufficiently large or productive to pay for the building improvements requested. Veterans and the families of deceased servicemen have preference in obtaining loans.

Farmers interested in obtaining a housing loan may apply to the local FHA supervisor. Applications are passed on by a committee of three local farmers who determine each applicant's tentative eligibility. The supervisor then secures detailed information on the farm and property and devises an operating plan for the farm. An FHA appraiser then checks both the security and the farm plan. If his report is favorable, titles are then certified and the loan completed. The loan funds are placed in a countersigned bank account to be drawn only for purposes designated in the farm plan by both the borrower and the FHA supervisor.

Funds were first made available on October 14, 1949, when 25 million dollars for loans for construction and repair of farmhouses and buildings and two million dollars for loans for essential land purchases or land development and for grants for emergency repairs were appropriated.

By May 1, 1950, local FHA offices had received approximately 18,000 loan applications. About 1,500 loans totaling 6.5 million dollars had been completed or approved for completion. An additional 5,000 loans had been tentatively approved. It is estimated by FHA officials that 50,000 applications will be received by June 30. A total of about 70,000 farmers would receive assistance during the four years of the program if Congress appropriates the authorized amounts and if loans continue at their present average size of about $4,300.

SIGNIFICANCE OF PROGRAM

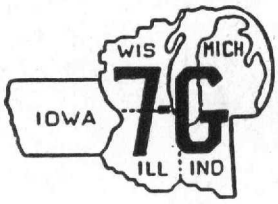
Obviously, the volume of farm loans under the Housing Act of 1949 will directly benefit too few families to provide more than a token solution to the rural housing problem. The Secretary of Agriculture is authorized to conduct research and provide educational and technical services for the construction and improvement of farmhouses and other buildings. These services are to be provided to farmers generally, and in performing them the Secretary may utilize any or all of the agencies under his supervision. In the long run, these activities may have more pronounced effects upon rural housing than the direct financial assistance now provided.

Since the farm housing program is barely under way, it will be several years before any tangible results can be determined. In general, extremely liberal loan policies may prove either detrimental or beneficial to borrowers, depending on their future earning capacity. Under this program, however, borrowers should have little fear of foreclosure as long as they are making a conscientious effort to repay. Nevertheless, increased debts usually mean increased allocation of income for debt service.

The provision of financial aids to farm housing is a rather complex undertaking. Farm buildings, in general, have value because they are part of a farm unit. Although they often provide part of the security for farm mortgages, they seldom are the major portion of it. Since the typical farmhouse is part of the farm plant, financial problems of farm housing differ from those of urban dwellings. It is difficult, if not impossible, therefore, to separate farmhouse financing from over-all farm financing since farm income determines the ability to service debts incurred to remodel or build houses.

There is some question as to the advisability of encouraging individuals with limited funds to invest in buildings on small tracts of land that may be uneconomic farm units. In such cases the greatest benefit might accrue to the recipient of a loan if the funds were invested in machinery, productive livestock, or other working capital. Unless public funds can be used to make present small and uneconomic units more efficient, such financial assistance might better be used to rehabilitate people in a field other than agriculture rather than maintain them as inefficient farmers.

SEVENTH FEDERAL



RESERVE DISTRICT