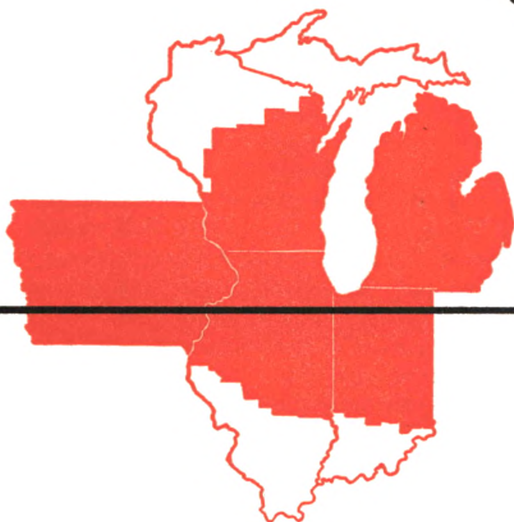
*A review by the* **Federal Reserve Bank of Chicago**

# Business Conditions



**1952 July**

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**The Trend of Business 2-5**


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# The trend of business— midyear review and outlook

*High-level business without inflation marks first half of 1952. The tempo of activity seems likely to pick up during remainder of year, but ample supplies will hold back upward price pressures.*

For many months now, the nation's economic machine has been operating on a very high plateau of activity. Personal income, employment, industrial production, consumer spending—in fact most over-all measures of business have been maintained at or near record levels. At the same time, however, wholesale prices have edged gradually downward, and some business lines, notably textiles, television, and household appliances have continued to restrict production due to inadequate demand.

This seeming paradox is explained largely by the diverse movements of the major forces which have dominated business activity during the past year. Strong support has come from the steadily rising level of defense spending and record business outlays for plant and equipment. Personal income after taxes has leveled during this period, on the other hand, and a larger share has been diverted from consumption expenditures to saving. Faced with lower than expected sales, merchants have worked down burdensome inventories, thus intensifying the drop in demand at the manufacturing level. Consequently, a rough balancing of weaker civilian demand in some important areas with heavier military and business capital spending has resulted in over-all economic stability.

In recent weeks, work stoppages in steel and petroleum refining have adversely affected business activity. The immediate effect has been to reduce both industrial output and incomes of the workers directly and indirectly involved. In the case of steel, the loss in production may prevent as much easing in restrictions on use as had been expected earlier. Nevertheless, near capacity operations in both industries during the remainder of the year now seems assured. Demand for these products is strong, and inventories will have to be rebuilt. Moreover, the wage increases granted will tend to raise incomes, particularly if they spread to other industries.

Most current evidence points to a continued high and probably rising tempo of business activity during the remainder of 1952. Manufacturing order backlogs have been maintained at a record level of about 63 billion dollars since last November, reflecting heavy military ordering. Defense spending is scheduled to rise gradually through the end of this year. Residential construction has increased more than seasonally this spring and may be stimulated further by the recent relaxation in mortgage credit terms. Liquidation of inventories at retail will be a less serious drain on demand in the months ahead and may even give way to net reordering in some lines. Finally, the gradual rise in consumer spending which has taken place since the spring of last year seems likely to continue.

Barring a sudden and dramatic worsening in the international situation, however, a serious inflationary threat is not likely to develop during the second half. Production of raw materials and foods is expected to increase to record or near-record levels this year. Moreover, supplies of most metals have been improving in recent months, and the ability of industry to increase output has been boosted significantly



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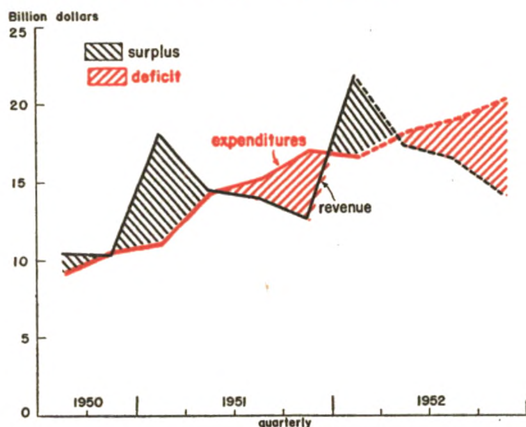
through heavy investment in new plant and equipment. Where demand is sufficiently strong, higher wage rates and other costs are likely to be passed on to buyers. Supplies of most types of goods, however, will be ample to meet anticipated demands with little upward pressure on prices.

### Defense spending a major prop

As has been the case for the past two years, defense spending will constitute a major upward force in the economy during the remainder of 1952. Total national security expenditures rose 20 billion dollars last year to an annual rate of 44 billion in the final quarter. Due to the stretch-out in defense goals, the rise this year will be smaller. Defense outlays increased about 8 billion at an annual rate in the first half (most of which occurred in April and May) and may well rise an additional 6 billion by the end of the year. At that time, expenditures are expected to level out at an annual rate of about 58 billion dollars.

Although defense spending will increase less rapidly in coming months than in the immediate past, a larger proportion of total expenditures will represent demand on durable goods manufacturers. The size of the armed forces is nearing its peak, with the result that pay and maintenance costs have stabilized in recent months. Deliveries of armaments and military construction, on the other hand, continue to expand rapidly. Expenditures for these "hard" goods rose from an annual rate of 7.5 billion dollars in early 1951 to 24 billion in the first quarter of this year and are expected to reach a rate of about 36 billion by the fourth quarter.

*Government cash expenditures to exceed revenue by a large margin in second half 1952*




An equally important change in the effect of Government spending on the economy will stem from the shift from a cash surplus in the first half to a substantial cash deficit in the second half of this year. Government cash expenditures are expected to outrun revenues by an estimated 8 to 9 billion dollars, as compared with a 5.5 billion deficit in the July-December period last year and a surplus of about 5 billion in the first half of this year. To a substantial extent the change during the year reflects a seasonal movement in tax payments, particularly in corporation taxes. In addition, however, it evidences the failure of increases in tax rates to yield revenue equal to the projected rise in spending. Calendar 1952 will show the first substantial cash deficit since the end of World War II.

The significant point in the shift from surplus to deficit financing is that the higher Government spending will not be offset by tax drains on the purchasing power of the civilian sector of the economy. If the deficit is financed through bank borrowing, total purchasing power (and probably spending) will tend to rise. Private demands for funds promise to continue heavy in the second half of this year, and thus direct or indirect placement of a substantial portion of the forthcoming deficit with the banking system seems likely.

### Business investment leveling

Business outlays for new plant and equipment have been a strong factor of support for the economy during the past year and a half.



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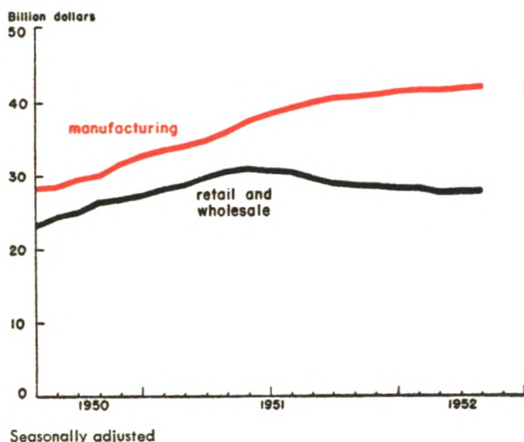
*A continued rise in manufacturing inventories about offset liquidation of stocks at the distributor level*




Total expenditures rose sharply in late 1950 and 1951 as business firms expanded capacity in anticipation of increased activity. Much of this spending has been closely connected with the defense build-up. Because of rising military requirements, expansion in such industries as steel, aluminum, electric power, machine tools, and aircraft has been promoted as a matter of public policy. Tax relief in the form of accelerated depreciation has been granted for over 21 billion dollars worth of defense and defense-supporting projects.

According to a recent Government survey, business invested in new facilities at an annual rate of about 24 billion dollars during the first half of this year. This is 10 per cent more than during the same period last year. Plans for the second half, however, pointed to a leveling out in expenditures. Moreover, most defense-connected projects are now under way. As the bulk of these reach completion toward the end of this year and especially in 1953, heavy downward pressure will be exerted on total business capital outlays.

Business inventories, the second major type of investment, rose rapidly from the Korean outbreak through the spring of 1951. Since then, total stocks have held steady at a seasonally adjusted level of around 70 billion dollars. Within the total, however, significant changes occurred in the latter period. Retail and wholesale inventories have undergone a gradual but steady liquidation, as merchants sought to adjust heavy stocks to lower than expected sales. During the same period, manufacturers' inventories continued to rise, largely in response to heavy military ordering, but also because of inability to induce retailers to take larger quantities of finished goods.

The retail inventory liquidation appears to have about run its course. In relation to current sales, stocks in many lines are at a relatively low level. Retail inventories rose more than seasonally in April, and further net rebuilding is likely to take place in coming months, thus adding to demand at the producers' level. Manufacturers' inventories probably will not increase much further, however, since most firms appear to have accumulated the necessary stocks of materials to carry on their defense business. Thus any expansion of total inventories in the second half of this year will be relatively moderate.

Although well below the boom levels of 1950, residential construction has been relatively strong so far this year. Housing starts exceeded the 1951 volume in March, April, and May. The recent easing of mortgage credit terms under Regulation X may provide some stimulus to building, particularly in the middle price range. Present indications are that the level of housing activity in the second half is likely to exceed that of a year earlier, both in terms of housing starts and in the value of new construction work put in place.

### Consumers' position strong

By far the largest single area of demand for the nation's output of goods and services is at the consumer level. Consumer spending last year accounted for more than 60 per cent of



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total national expenditures. Thus the financial position of the consumer and his attitude toward buying are of major interest in any evaluation of the business outlook.

The financial position of consumers as a group is strong. Employment is continuing at a high level, about equal with that of 1951 and well above any previous year. Unemployment, on the other hand, is near the peacetime low. Average weekly earnings of manufacturing employees have increased moderately over the past year, although hours worked per week have dropped slightly, and total personal income is at an all-time high. In addition, consumers have added substantial amounts to their accumulated savings in the past year. Total holdings of such resources as currency, bank deposits, and Government securities now amount to more than 200 billion dollars.

Despite stable to higher personal incomes, consumer spending has lagged somewhat over the past year. Sales of such things as automobiles, television sets, household appliances and furniture have been well below the 1950 highs. This is not to say that demand for all or even most types of products has been weak. Purchases of food and of many kinds of nondurable goods and services have increased, while sales of apparel have been maintained at a relatively high level. In fact, total consumer spending regained the peak level of early 1951 in the first quarter of this year.

## *Total retail sales near 1951 peak, but individual lines vary widely*

| Type of store | January—April total sales, per cent change, 1952 from 1951 | 1950 |
|---|---|---|
| All stores | −2 | +12 |
| Food | +6 | +21 |
| Apparel | 0 | +11 |
| General merchandise | −3 | +10 |
| Building materials and hardware | −10 | +18 |
| Automotive | −14 | −2 |
| Homefurnishings | −15 | −1 |

The outlook for consumer spending appears to be relatively favorable. Personal income probably will rise moderately in coming months, reflecting higher wage rates, expanding requirements for workers in defense industries, and an improved demand for goods in some currently depressed lines. Consumer buying is likely to be stimulated by any rise in income which occurs, by eased credit terms on instalment purchases, and moderately reduced prices for many kinds of merchandise as well.

### Production base expanding

If the increases in demands for goods and services discussed above materialize, the inflationary implications might be serious except for one thing. Most goods are currently in ample supply. Moreover, the nation's ability to produce even larger quantities of goods is rapidly improving. Business capital outlays totaled a record 23 billion dollars in 1951 and are expected to amount to an additional 24 billion dollars this year. It is estimated that total manufacturing capacity will have increased by one-sixth between 1950 and the end of this year. Since early 1951, however, industrial production has remained virtually unchanged.

Some industries, particularly those which fall in the defense or defense-supporting categories, have been operating close to full capacity all along. These industries have been expanding most rapidly, however, and even in such critical areas as aluminum, machine tools and until recently, steel, there are indications that the supply situation is easing.

Production of food and most raw materials also has improved. Barring especially unfavorable weather, agricultural output this year is expected to be at or near an all-time high. Combined with expanding industrial capacity, the improving materials supply picture indicates an increasing ability to turn out finished goods. This ability to produce will provide a strong antidote for any inflationary pressures which develop on the demand side of the national balance sheet.



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# Commodities—up and down again

*Commodity prices have eased down from post-Korea highs, but some leveling is again in evidence.*

Unusual stability has marked the over-all price picture during the past 15 months. Wholesale prices have been edging downward—but very moderately—since March 1951. Consumers' prices, on the other hand, only recently leveled after a gradual increase of nearly two years' duration.

The relatively modest changes in the composite indexes, however, are more the reflection of a balancing of divergent price trends than of a uniform stability of all prices. Commodity prices particularly have varied widely as a result of changing supply and demand pressures. For some industrial raw materials and farm products, price declines have completely wiped out the increases recorded after the outbreak of hostilities in Korea in June 1950 and have sent these commodities to the lowest levels in several years. For many manufactured goods, however, prices have increased or remained virtually constant at post-Korea peaks.

In the months immediately ahead, the outlook for prices appears to be one of relative over-all stability. Higher wage rates and other costs may lead to price increases in some finished goods lines, but level to lower agricultural prices and continued ample supplies of most raw materials promise to about offset these increases in the aggregates. Nevertheless, should buying rise sharply, as might happen if the international situation were to take a sudden and dramatic turn for the worse, a rapid upward movement in prices could quickly develop.

### Wholesale prices reviewed

Prices of many commodities were advancing slowly in the first half of 1950, prior to the outbreak of hostilities in Korea. Following this, however, a strong upsurge in demand caused a sharp acceleration in the price movement. Consumers, business, and Government, all seeking ownership of goods, forced aggregate wholesale prices up to a level in February and March 1951 about 16 per cent above that of June 1950. Behind the anticipatory buying of consumers and business was a widespread expectation of shortages and rising prices. This stemmed from the belief that the Korean activity meant war, and that the associated expansion in defense spending, increased capital outlays of business, and rising level of disposable personal income would result in a far greater demand for goods than could be produced.

In general, as usually occurs in periods of expanding demand, prices of raw materials, both farm and nonfarm, underwent far greater increases than did finished products. Farm prices, for example, jumped 24 per cent between June 1950 and March 1951, compared with a 15 per cent rise in commodities other than farm products and processed food. Industrial raw materials also moved substantially higher in price during this period. Many commodities are traded on organized exchanges, where prices adjust promptly in response to the increased demand for stocks at all levels of fabrication and distribution. Prices of most manufactured products, however, advanced less sharply. Their output could be adjusted more rapidly in response to demand changes and, being largely brand items, their prices are less sensitive to rapidly changing market conditions.

Government stockpiling of certain strategic raw materials was an important aspect of the early defense program and added to the upward pressure on prices of these commodities. For raw materials such as tin and rubber, which



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are largely imported, American stockpiling practices after Korea contributed to sharp speculative price rises in world markets.

### Price trend reversed

In March 1951 the upward climb of aggregate wholesale prices halted abruptly. Prices leveled in that month, and thereafter began a gradual decline. During the last five months of 1951 prices leveled once again, but resumed a slow downward course early in 1952. The slowness of this fall is indicated by the fact that only about one-fourth of the post-Korea rise in the composite index has been canceled to date.

The modest downward readjustment of some 4 per cent in aggregate wholesale prices since March 1951 reflects primarily sharp declines for a few commodities, notably certain farm products and industrial raw materials. Significantly, these are the commodities which previously had increased the most. Wholesale prices of most finished goods, on the other hand, have receded little from last year's peak.

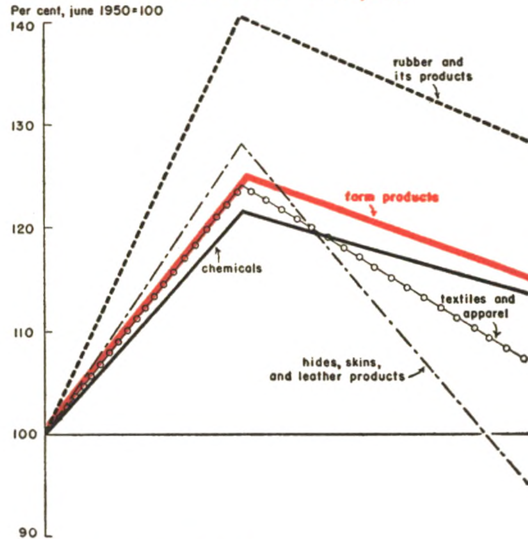
In cases where labor, transportation, fixed costs, and other nonmaterial factors comprise a large proportion of product costs, prices generally have continued firm or even increased in recent months. The commodity group which includes machinery, equipment, and motor vehicles, for example, has edged up about 3 per cent since March 1951. Prices of hides, skins, and leather products, on the other hand, dropped 26 per cent in the same period. Wholesale prices of hard goods generally have been markedly firmer than soft goods, reflecting, in part, the extensive use of metals in most phases of the defense program as well as in the record level of business capital investment.

### Some price controls suspended

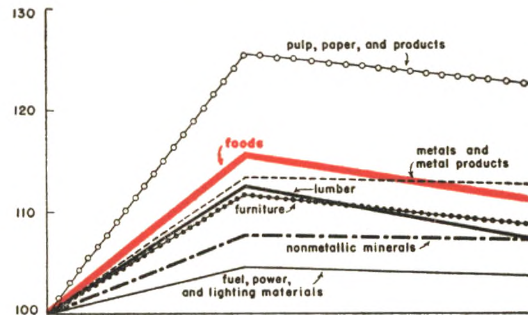
Many raw materials prices had dropped to levels well below their ceilings by early 1952. As a result, price controls were suspended on April 28 for a number of commodities, principally fats and oils, hides and skins, and certain fibers. Such suspension orders were re-

## *Components of wholesale price index show varying trends—*

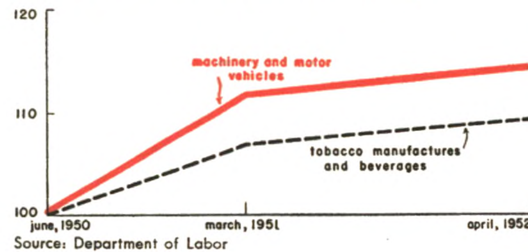
*some commodities rose and fell,*




*some rose and leveled,*




*and some rose and are still rising.*




Source: Department of Labor



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cently extended to a few nonferrous metals and to raw cotton and most textile products. Further suspension orders are expected for other commodities where abundant supplies currently are available. In all cases, however, provision has been made for restoring price ceilings should prices rise to given recontrol points.

It must be kept in mind that these commodities are extreme cases. Many important commodity prices have not declined at all; some probably would rise if all ceilings were removed. Significantly, in recent weeks there has been a rise in some raw material prices. Products such as wool, fats and oils, and some foodstuffs are experiencing varying degrees of price firmness.

### Consumers' prices level

Following a gradual rise of 22 months' duration, consumers' prices leveled in January 1952 at a point 10 per cent above June 1950. The largest post-Korea price increases were in food, up 14 per cent; housefurnishings, 13 per cent; and apparel, 11 per cent. Rent and utilities increased by smaller amounts.

Consumers' prices currently are only slightly lower than in January 1952. Some items, notably rent, have continued to rise. The chief declines have been in commodities whose raw material prices are significantly lower—for example, some food and apparel items—and in products in abundant supply, such as radio and television sets.

Whereas average consumers' prices ordinarily move in the same direction as wholesale prices, these two over-all indexes moved in opposite directions during the major part of 1951. This is largely attributable to the effects of rising wage and other costs in offsetting lower prices of raw materials. Moreover, rents and service expenditures, largely insensitive to raw material prices, are important factors in the consumer price index. And with evidence of strength now reappearing at the wholesale level, there is little prospect of lower consumer prices this year.

# Farm prospects

***Farmers will gross more dollars this year as they market an increased quantity of products at lower prices, but rising costs may cut net income.***

A MIDYEAR ROUNDUP of the farm situation reveals large volumes of crops and livestock in process, stable to gradually declining prices, and a strong domestic demand for food products. Farm debts are at a postwar high and still increasing, but most farmers are in a strong financial position.

Short-term credit, largely to finance crop and livestock production, experienced a particularly sharp rise in the last half of 1950, and again in 1951. Although there was a slight reduction in outstandings at District member banks in the first quarter of this year, the total continues at a high level and, after some further payoff this summer, may expand to a new high by year-end. Farm assets, nevertheless, have increased more rapidly than debts with the result that owner equities in farms, livestock, and equipment are at an all-time high.

The nation's farms generally are well equipped and are capable of continuous high-level and efficient production. The over-all agricultural situation, therefore, is one of strength but nevertheless one in which high production expenses would cause financial difficulty for those farmers having only nominal reserves should they experience low crop yields or substantial price declines.

### Costs are high

Farmers' cost-price margin is narrowing as farm product prices decline relative to prices of materials used in farm production. But this is not a new experience. Such price trends commonly occur as inflationary pressures ease. A very rough measure of the relationship of farm product prices to costs is provided by "parity."



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At mid-May, the parity ratio stood at 101, compared with 113 in February 1951. However, a ratio of 100 or more is very favorable to agriculture as indicated by the fact that over the past thirty years it has seldom been experienced except in inflationary periods.

Although civilian consumers are by far the major outlet for farm products, other demands cannot be ignored. U. S. exports this year probably will be about 10 per cent below the 4 billion dollar total realized in 1951. The effects of reduced export demand will be most significant, of course, for the major export commodities of which wheat and flour and fats and oils are of direct importance to Midwest farmers. The outlook reflects, primarily, larger domestic supplies in importing countries and improved availability from exporting nations.

The high level of farm production costs has important implications for the financial stability of agriculture. Although farm asset values, as well as owner equities, have about tripled since 1940, production costs are now much higher relative to either assets or equities than in prewar years. In this circumstance, losses can make rapid inroads on farmers' net worth. Agricultural lenders generally have observed this fact in recent years, especially in areas which have experienced poor crops.

### Production at record level

Marketings of farm products have been running about 5 per cent above a year ago, reflecting the high level of production last year. Based on farmers' planting intentions and crop developments to mid-June, total production this year will be moderately larger than last year and will set a new record. An indicated increase of 28 per cent for food grains—mostly wheat—is by far the largest of any important group of farm products (see chart). Although population is increasing rapidly, realization of the currently indicated volume of production would permit a per capita food consumption slightly larger than in 1951 and about 12 per cent above the 1935-39 average. Production of nonfood products—feed grains, cotton, tobacco—probably will increase moderately also.

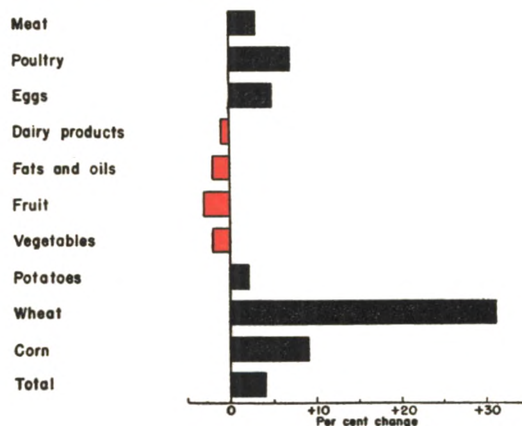
Military requirements for food in 1951 accounted for less than 5 per cent of the total supply and no significant change is indicated for this purpose in the current year. Exports, which accounted for a little over 5 per cent of the total last year, probably will be even less important in 1952. This leaves the great bulk of the food supply, over 90 per cent, for domestic civilian consumers. Civilian demand, therefore, is an extremely important factor in the outlook.

### Lower prices

As indicated elsewhere in this issue, employment and personal income are expected to continue at high levels through the remainder of the year. Thus, consumers would have ample funds to maintain or moderately increase expenditures for food and other products originating on the nation's farms. Civilian demand, therefore, is expected to continue at a high level and be a strong price supporting factor for food products in the months ahead.

Prices received by farmers in the first five

*Food production to exceed 1951, set a new record*



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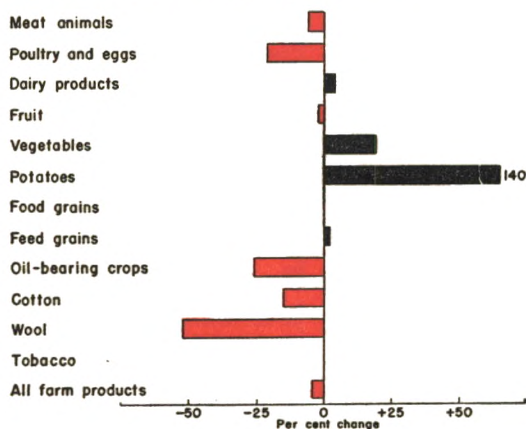
months of the year averaged 5 per cent lower than in the corresponding period of 1951. For the remainder of the year the depressing effects of larger supplies, reduced exports, and a relatively inactive storage demand probably will more than offset the effects of higher consumer income. Only a rapid deterioration of crop conditions or a sharp spurt in demand, such as might result from an intensification of international tension, would be likely to raise prices above the year-ago level.

### Little change in income

Cash receipts from farm marketings this year probably will be moderately larger than the 33 billion dollars received by U.S. farmers in 1951. The income of Seventh District farmers, of course, is tied closely to the livestock situation. Last year more than three-fourths of the cash receipts from farm marketings in this area were realized from livestock and livestock products. This does not indicate, however, that crops are unimportant. Rather, they are for the most part, the foundation upon which the livestock industry exists.

Income from hogs is expected to decline due to low prices in the first quarter of the year, followed by reduced production and marketings. This is the most important source of farm income in Illinois, Indiana, and Iowa. Production and marketings of cattle and calves, an important income source for all District states, probably will be larger than last year but lower prices may reduce cash receipts slightly. Dairy product prices are higher than last year and about the same volume of production is in prospect. For Wisconsin and Michigan farmers, this is the most important source of income. Lower prices for poultry and eggs will limit income from these products. Egg prices at mid-May were 24 per cent below the year-earlier level.

*Farm prices below a year ago, changes vary by product*




Cash receipts from wheat, corn, and cotton probably will be higher due to increased output. For some fruits, higher prices are expected to boost receipts. Income from soybeans may not reach last year's level reflecting large stocks and low prices for fats and oils generally, although some price improvement has been noted in recent weeks.

The trend of farm real estate values provides a general clue to how well farmers are doing. When land values are stable or rising it usually indicates that present owners are realizing quite satisfactory returns. In recent months land values have been generally stable, although they still show more up than down movements. The rapid rise in values, initiated two years ago by the outbreak of hostilities in Korea, was largely completed in 1951. Buyers have become much more selective as inflation fears have subsided and farm product prices have turned down. But distress sales of farm real estate are few and far between.

Large supplies of farm products at stable to moderately declining prices may have a slightly depressing effect on general business conditions in the months ahead, due largely to their effects on business expectations and related inventory policies. Basically, however, abundant supplies of farm products must be assigned to the asset side of the nation's economic balance sheet, especially in periods of international tension.



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# Treasury bills assume new role

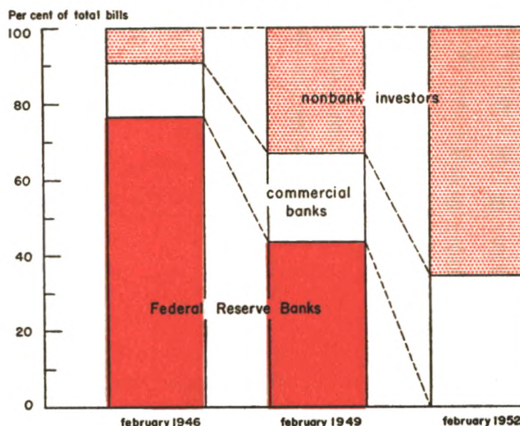
*Larger offerings, higher rates, and increased nonbank purchases now characterize the bill market.*

With Government deficits now materializing, the Treasury's search for "new money" has started in earnest. And while the more novel Treasury offerings have been making headlines, the work horse of the new money program has been the 91-day Treasury bill. Between Korea and mid-June 1952, increased regular bill offerings raised a net of nearly 4 billion dollars for the Government, almost as much new money as has been raised by the widely heralded 2⅜% bond offering. In addition, the longer maturity "tax anticipation bills" sold last year gained the Treasury about 2.5 billion of tax funds several months ahead of tax payment dates.

The bill market today is a far cry from that prevailing at the end of the war. During the war years, with market interest rates stabilized, most of the growing volume of Treasury bills had been pushed into the Federal Reserve Banks. By early 1947 the Reserve Banks held about 90 per cent of the 17 billion dollars of bills outstanding. The remainder was divided between nonbank investors and the banks, with the latter group using their relatively small bill holdings primarily for reserve adjustment purposes. Between 1947 and 1949, the Treasury systematically reduced its weekly bill issues. The net redemption of over 5 billion dollars was concentrated entirely in Federal Reserve holdings, thus helping to extinguish bank reserves which had been created by System support purchases of other types of U. S. Government securities.

After mid-1949, the Reserve Banks continued to sell bills intermittently and by early this year the System had completely disposed of its bill holdings. Commercial banks acquired some of these, as swelling loan portfolios and the "unpegging" of long-term Governments increased their needs for very liquid investments. But the major new development has been the heavy buying of bills by nonbank investors—primarily corporations.

*Nonbank holdings grow . . .*




### Nonbank needs

Much of the nonbank demand for Treasury bills has stemmed from the growing need by corporations for temporary investment outlets for their seemingly ever larger tax accruals. An important change here has been the enactment of the Mills Plan, which substantially shortens the lag between corporate tax accruals and tax payments, and concentrates the payment in the first half of the calendar year. This will further increase the corporate demand for short-term investments in the last half of each year. Corporations have also developed the practice of using bills as an interim investment for the unused portions of loans and funds obtained



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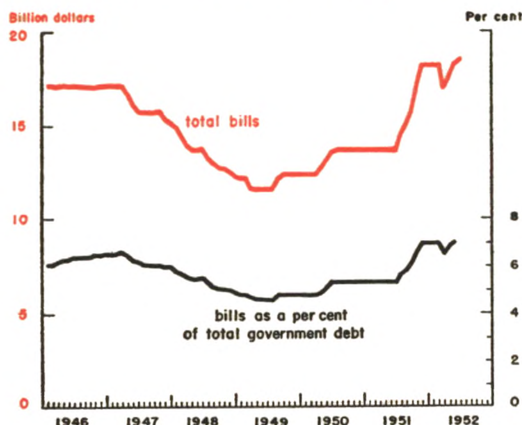
*A new peak in outstandings...*




from the sale of their own publicly offered securities.

With these growing demands evident, the Treasury on four occasions tapped the bill market for new money to meet its cash needs. It gradually increased bill offers by 800 million in the late summer of 1949, 1.3 billion in early 1950, 4.5 billion in 1951, and by 1.6 billion from April to June of 1952. Before some 1.2 billion of tax anticipation bills were turned in on the June 15 tax date, the total outstanding stood at an all-time high of 18.4 billion.

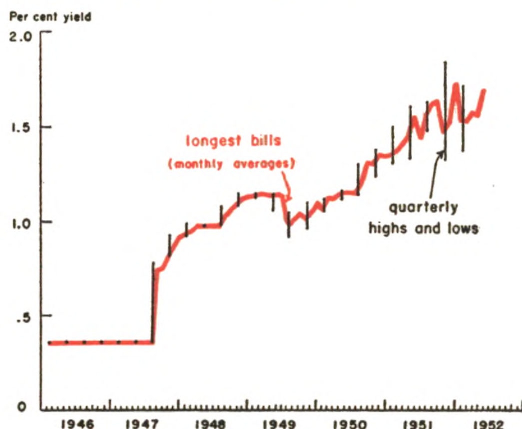
### Rates play their part

Not the least of the reasons for the easy placement of these added bills has been their more attractive yield. Reflecting primarily the anti-inflationary policies of the monetary authorities, the average rate on bills has steadily moved upward to a level now more than four times as high as the fixed wartime rate. The rate rose particularly sharply through the last weeks of 1951. For the weekly offering of January 3, 1952, bills sold at an average rate of 1.883 per cent—the highest since 1933—but yields fell back quickly to a prevailing range 15 to 30 points lower. Along with the higher rates have come greater day-to-day fluctuations in market price, but apparently investors regard the enhanced yield as more than sufficient to compensate for this risk.

This changing nature of the bill market has made it a resilient source of new funds for the Treasury. Paradoxically, although bills tend to be as close to actual cash as any interest-bearing obligation can be, the fact that they have increasingly found their way into the portfolios of nonbank investors has made them appear one of the less inflationary borrowing media open to the Treasury. On the other hand, heavy reliance on bills has contributed to a radically changed debt structure. Currently almost 60 per cent of the total debt is payable on demand or due within one year, a condition requiring constant refunding decisions and thus complicating the problems of the monetary authorities.

Nevertheless, bills give the Treasury flexibility in financing and at present rates should continue to be a useful instrument with wide market appeal. Regardless of any success that other types of debt offerings have in raising nonbank money, fiscal 1953 is likely to see the Treasury continuing to use new bills as a key part of its program for meeting the cash needs ahead.

*Big postwar rise in yield...*



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# Toll roads for the Midwest?

*The turnpike boom, now entering the Midwest via Ohio, offers only limited relief to congested highways.*

Last month's sale of a 326 million dollar bond issue for construction of the Ohio Turnpike marked the first penetration of the toll road boom into the Midwest. Up to now, the spectacular progress of toll superhighway construction has been confined largely to the northeastern states. In fact, in the past eight years several Midwestern states have studied and rejected toll roads. The beginning of work on the Ohio road and toll road studies in Indiana, however, indicate the interest of Midwesterners in the possibility that toll roads offer a dramatic solution to the highway "problem."

Although turnpikes were familiar institutions in the early days of our nation, the first modern toll road was not completed until 1940, when the original 160 mile central section of the Pennsylvania Turnpike was opened to traffic. Since then about 450 miles of toll roads, representing an investment of about one-half billion dollars, have been completed largely in New England and the middle Atlantic states. Toll roads now under construction, or on which construction will begin this summer, total nearly a thousand miles and will cost a billion dollars by the time they are finished. Additional turnpikes amounting to several hundred miles are more or less definitely planned.

### The stimulus—poor free roads

Why the boom in toll road building? The most obvious explanation lies in the highway deficiencies familiar to every motorist. In the first spurt of highway building a generation ago, the main objective was to make as many miles of road passable to motor vehicles as rapidly as possible. This was achieved by confining construction largely to the grading and surfacing of the existing horse-and-buggy roads. This same objective is still the dominant factor in the pattern of expenditures for present-day roads. As a result, most roads are too narrow, too winding, and too hilly to permit rapid movement of the vastly increased number of vehicles, most of which are heavier and capable of higher speeds than their counterparts of twenty-five years ago. Moreover, deferment of needed highway maintenance and reconstruction during World War II aggravated the problem. Worse yet, the earlier emphasis on "getting out of the mud" has left us with formulas for distribution of highway user tax revenues—the gasoline and vehicle registration taxes—which unduly favor local roads serving low traffic volumes, despite the fact that available measurements of traffic densities afford scientific tools for determining priorities.

At the end of the war, an enormous volume of highway construction was needed, both to make up for previous deficiencies and to service the great postwar increase in motor vehicle traffic. However, highway construction costs have increased more rapidly than have the funds available for construction. This is especially so for the main intercity and urban roads, which carry the bulk of highway traffic, for two reasons. First, rebuilding the main roads involves the construction of many expensive bridges and grade separations and the costly acquisition of real estate, particularly roadside residential and commercial properties. Second, the generally unscientific allocation of highway revenues has limited the funds available for the heavily traveled roads.

### The toll solution

If large mileages of good free roads could be built rapidly, tolls would have little appeal,



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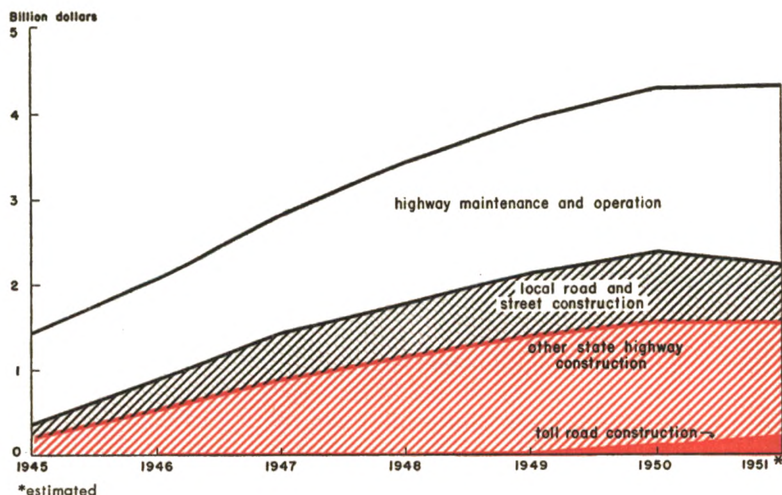
## *Turnpikes rise in share of road outlays*

Last year toll road construction reached a sixth of state highway building expenditures. Still it accounted for less than six per cent of all 1951 highway expenditures, with the remainder divided about equally between other road construction and spending for maintenance, administration, bond interest, and highway police.




since a toll road offers no engineering advantage over comparable free roads. But it has been difficult to overcome the obstacles to rapid rebuilding of the main roads. In contrast, because a toll road is designed to be a self-supporting facility, it can be constructed rapidly via bond financing despite constitutional limitations on borrowing which apply in many states.

Moreover, it seems to conform very well to the generally accepted approach to the distribution of highway costs—that the users of the highways should bear the costs, through gasoline and motor vehicle taxes, in some relation to the extent and nature of their use. Tolls are very precise means of user charging, since only those who use the particular facility pay for it. Some states, like Connecticut, serve as "bridges" for vehicles traveling from the state on one border to the state on the opposite border and are so small in area that the out-of-state motorist can cross the "bridge" without stopping for gas. Generally, construction of a toll road offers them the *only* way to make the heavy out-of-state traffic pay for use of the state's roads.

Finally, the toll road makes possible the construction of additional mileages of expensive superhighways without disturbing the vested interests involved in the existing allocation of user tax revenues between primary highways and local roads.

But this last advantage is not an unmixed blessing. The trouble is that toll financing can take care of only one or two of the many heavy traffic density routes in every state which need rebuilding. In Ohio, for example, the 240 mile turnpike will constitute less than 2 per cent of the 18,000 mile state primary system. However, because a particular toll road can be built without a reallocation of highway funds, it tends to relieve the pressures for a badly needed general revision of the existing allocation. Without such a revision, the basic highway problem —the inadequacies of the heavy-traffic roads— will remain unsolved except for the relatively small mileage of toll routes.

### Urban expressways

Another limitation to toll roads is that they do not relieve what are probably the most urgent needs, better facilities in urban areas. Currently, about two-thirds of the population lives in and near cities. Increased urbanization and increased use of motor vehicles for commuting to and from work have combined in nearly all



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parts of the country to produce tremendous congestion on arterial city streets, few of which ever were particularly adequate for motor vehicle traffic. By and large, urban areas did not participate in the first round of road building thirty years ago. As a result, the original formulas for allocating user revenues largely overlooked the cities and these formulas have persisted. In addition, building urban expressways is extremely expensive, because of the enormous cost of land acquisition in heavily built-up sections of cities.

However, tolls usually cannot be readily adapted to urban expressways because the frequency of entrances and exits would make toll collection facilities a major cost item and because so many parallel free routes are available to those who wish to avoid paying the toll.

### Superhighway standards

Even with respect to the main intercity routes, toll financing has its limitations. Toll roads of necessity are built to the highest standards of pavement width, gradient, curvature, and controlled access. To attract traffic the toll road must be clearly superior to the alternative free roads. In addition, in order to prevent motorists from by-passing the toll gates, no roads must be permitted to cross the toll road, no matter how little traffic they carry.

But a road built to these standards, while pleasant to drive on, is not necessarily the best buy for motorists. Motorists may prefer it to the old and thoroughly inadequate free road it parallels, but they might be a lot better off with a road of somewhat lower standards and considerably lower costs. The typical toll road costs the user a great deal. A toll of one cent per mile, if the vehicle gets fifteen miles per gallon of gas, is equivalent to a fifteen cents per gallon increase in the gas tax. In contrast, most states which have recently inaugurated long-range highway improvement programs have found it possible to do so with increases in the gas tax of two cents or less. These programs usually entail substantial improvement of both intercity and urban roads, although not with the speed toll financing will permit on an individual project.

### Prospects for self-support

Most of the advantages of toll financing of the main rural roads are dependent on their being self-supporting. The prospect of self-support makes it possible to sell revenue bonds where borrowing might not otherwise be approved and thus to build a significant mileage of good roads rapidly. However, there are only a limited number of cases in which toll roads other than those in operation or under construction at present can actually be fully self-supporting.

To be successful, a toll road must follow a route along which very heavy traffic volumes flow, since the toll road itself can attract only a relatively small percentage of the total traffic between any two points. This is because most motor vehicle traffic is short-distance traffic. In fact, in the typical case, a toll road with exits twenty miles apart would exclude about half of the potential traffic simply because motorists traveling short distances would lose more time driving to and from the exits than they would gain during their brief trips on the superhighway.

In general, the most promising toll routes are the limited number which parallel routes with heavy truck traffic and offer substantial savings in time through avoidance of city traffic, mountainous terrain, or unbridged bodies of water.

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# The new 2⅜

On July 1, distribution began of the most "wanted" U.S. Government security since the end of the war. By any but wartime standards, buyer response to the Treasury's June 10 announcement of a 2⅜% six-year bond offering for new money was overwhelming. The Treasury had said it wanted to raise 3.5 billion dollars; subscriptions for the new bond totaled over three times that much. Nearly one-third of these came from nonbank sources, and to accommodate these plus minimum bank allotments the Treasury had to increase the size of the issue to 4.2 billion dollars.

The provisions and market conditions surrounding the new 2⅜ offer assured it a welcome reception. In the first place, the coupon rate it carried was quite attractive. Moreover, its straightforward marketability and fixed maturity date removed some of the pricing uncertainties with which purchasers had to wrestle in appraising nonmarketable and callable issues. Of particular appeal to banks was the fact that the new bond could be paid for simply by crediting Government Tax and Loan Accounts in their own institution instead of by draft drawing down their reserve balances. Moreover, since some banks had already been readying their cash position to purchase the outstanding 2¼% bonds of 1959-62 when they became eligible for bank ownership on June 15, the well-timed offer of the more attractive intermediate naturally invited a substantial diversion of these funds into the new issue.

With this facility of bank payment and the attractive coupon rate, on the one hand, and slackened pressures of loan demand on the other, the 8 billion total of bank subscriptions for the 2⅜ came as no surprise. But the 3.6 billion of higher priority nonbank subscriptions represents a sharp deviation from usual investment relationships. Such purchasers typically do not maintain an important position in the market for intermediate-term Governments. For example, as of the end of March nonbank investors held less than 20 per cent of the combined total of three six- to ten-year taxable bonds then outstanding.

This near-exclusion of bank holders of the new issue, of course, will not continue. Evident strong banker demands can bid up the market price, attracting the bonds from nonbank holders willing to accept short-term principal gains. In fact, the opportunity for such gains from purchase and resale to banks was a major factor contributing to the heavy nonbank subscription. In capitalizing upon resale opportunities, of course, subscribers will find banks less willing to buy the new bonds than the volume of unsatisfied bank subscriptions would suggest. When buying the 2⅜ after issuance from other than their own depositors, bankers will have to pay by cash draft rather than through the more profitable method of Tax and Loan Account credit. In any case, such switches will occur over several months; not until fall will the final division of holdings of the 2⅜ become apparent.

### Bank vs. nonbank holdings

The wide attention given to relative bank and nonbank holdings stems from the inflationary pressures attributed to Governments when purchased with bank credit. Banks buy such securities by crediting the Government's account, and as such balances are later expended the total of bank deposits in the hands of the public is increased. Nonbank purchases, on the other hand, simply transfer ownership of deposits rather than creating any additional "bank account money."

But the case is far from black and white. Even large original purchases by nonbank holders are no guarantee of avoidance of bank credit expansion, for the bonds may be financed by borrowing from banks or may be soon resold to banks. The passing weeks may well confirm that this point is particularly applicable to the latest addition to the family of outstanding Treasury bonds.



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