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

Business Conditions

1952 September

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Life insurance investments

Private demands for funds continue to outrun savings inflow as life insurance company resources pass the 70 billion dollar mark.

ONE MAJOR BENEFICIARY of the average American's desire for economic security for himself and his family is the life insurance business. Reflecting this drive for financial protection, sales of new life insurance policies in the postwar years have been far above those of any earlier period. Total volume has been boosted not only by record purchases of ordinary policies by individuals, but also through frequent use of insurance in the fast-growing area of company sponsored retirement programs.

As a result, the face value of all life insurance in force at the end of 1951 had risen to 253 billion dollars. Although this amount is more than double that of ten years earlier, the gain has barely kept up with other economic measures. When adjusted for the rise in consumer's prices, life insurance in force is one-sixth greater than in 1941; in terms of personal income after taxes, it has actually lost ground. Thus, despite record sales in the interim, the public is little better protected by insurance, but has greater financial ability to buy additional coverage than before the war.

Reflecting the rise in insurance coverage dollarwise, however, life company resources have grown rapidly. Once committed, most people continue their policies in force, apparently assigning the contractual premium payments relatively high priority in their pattern of expenditures. This inflow of premium funds plus investment income has exceeded payments to beneficiaries by steadily growing amounts since the early thirties as policy reserves have been accumulated against eventual repayment. In consequence, life insurance companies have become the largest depositaries of the public's long-term savings, surpassing commercial banks, mutual savings banks, savings and loan associations, and the Series E savings bond program in such holdings. Total assets recently passed 70 billion dollars, an increase of 25 billion since 1945 and 50 billion in the last two decades.

Even more spectacular than this growth in resources has been the volume of private investments made by life companies in the postwar period. Record expenditures for new residential construction and for expansion of business facilities have required large amounts of external long-term financing. Since 1946, life insurance companies have channeled virtually all funds received from increases in resources and repayments on loans into private investments. In addition, they have liquidated over 11 billion dollars in Government security holdings acquired during the war years.

Net selling of Governments has continued in recent months, but in appreciably smaller volume than during 1950 and 1951. This liquidation may even give way to some net rebuilding of holdings in the year ahead. Business needs for outside financing, now at a record high, seem likely to decline as defense-related expansion projects are completed and higher depreciation charges, based on current capital costs, yield larger amounts of funds internally. Requirements for new residential mortgage financing probably will remain below the peak levels of 1950 and early 1951 while repayments of such debt continue to rise.

Government bonds the residual

In common with all financial institutions, life insurance companies are faced with the ever-present problem of promptly putting their money to work. The size of the investment decisions that have to be made are measured

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not only by the growth in resources, but by this amount plus repayments, maturities, and refundings of loans already held.

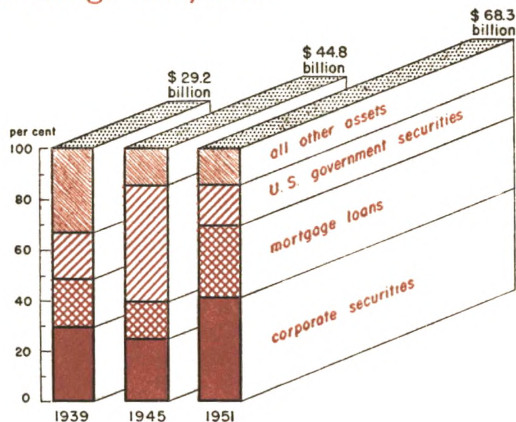
During the thirties the supply of funds which insurance companies had to invest far exceeded suitable opportunities for investment in private enterprises and in housing. Companies turned to Government securities as an alternative outlet for their excess funds with the result that holdings increased from less than 350 million dollars in 1930 to nearly 6 billion dollars at the end of 1940.

Purchases of Governments were further accelerated during the war. During this period, restrictions on residential construction and many types of business spending choked off a large volume of potential life insurance investment. Moreover, resources increased at more than double the rate prevailing in the thirties. By the end of 1946, holdings of Governments amounted to 21.6 billion and comprised 45 per cent of total assets.

This investment pattern was reversed shortly after the war's end as private demands for investment funds became very large. The rate of return on life insurance investments, which reflected the concentration of holdings in Government bonds, had dropped steadily from 3.4 per cent in 1941 to 2.9 per cent in 1946 and 1947. Under these circumstances, the better yield obtainable from corporate securities and mortgage loans was especially attractive. Moreover, the shift from Governments to private obligations could be made at a profit since all longer-term Government bonds acquired at par during the war were selling above that level in the 1945-50 period.

Consequently, insurance companies liquidated a large volume of Government securities in favor of corporate loans and real estate mortgages. From the end of 1946 through 1951 net purchases were made in only four months and total net sales amounted to 10.6 billion dollars. Reflecting this liquidation and the continued growth in resources, holdings as a proportion of total assets dropped from 45 per cent in 1946 to 16 per cent at the end of last year.

Private investment holdings rise faster



Sales of Governments since the middle of 1951 have been considerably smaller than during the preceding 12 month period. Several factors account for this. First, long-term Government bonds dropped well below par in the spring of 1951 for the first time in the postwar period, reflecting a change in Federal Reserve support policy. This meant that insurance companies could continue to liquidate these holdings only by taking a capital loss. Second, the decline in prices of Governments was accompanied by a general increase in interest rates. The attractiveness of fixed interest-rate FHA and VA mortgage loans was consequently reduced and insurance companies cut back their heavy purchases of these investments. Third, holdings of Government securities have been cut to the point where many insurance managements believe that their investments are now satisfactorily balanced.

A moderate decline in private capital spending, which has been anticipated for some time, would entail a more than proportionate reduction in outside financing needs. Since the flow of investible funds to insurance companies will

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certainly be maintained and is likely to continue to rise, Government securities may become important once again in the life insurance investment picture as an outlet for residual funds.

Business investments biggest

Investment in corporate securities has constituted one of the major uses of life insurance funds in the postwar period. In the years 1946 through 1951 net purchases of this group of earning assets totaled more than 17 billion dollars. As a result, corporate security holdings comprised 41 per cent of total assets at the end of last year as compared with a peak prewar proportion of 31 per cent in 1941.

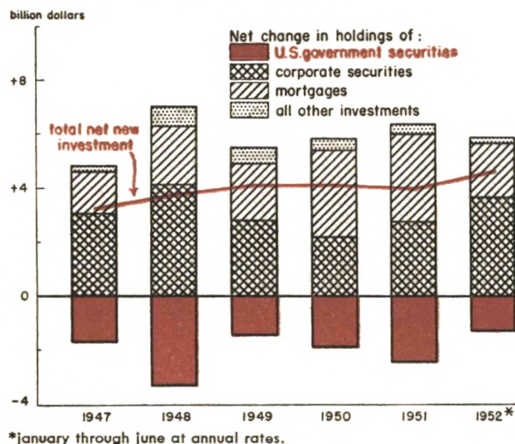
The postwar expansion in corporate holdings has followed a pattern significantly different from that of any earlier period. Railroad bonds, once the most important type of security held by insurance companies, rose only 12 per cent from 1945 through 1951. Reflecting large expansion programs and a corresponding need for long-term financing, on the other hand, holdings of public utility bonds jumped 6 billion dollars, an increase of 155 per cent.

The most spectacular growth occurred in the industrial and miscellaneous bond category, however. Holdings of industrial securities had been relatively small until the postwar period, amounting to only 1.9 billion dollars at the end of 1945. By the end of 1951, insurance companies had 11.4 billion invested in these bonds, an increase of more than 500 per cent. Record expenditures for expansion of industrial facilities forced many companies to seek large amounts of outside financing for the first time in nearly 20 years.

Insurance companies have been the principal buyers of new corporate bond issues for many years. From 1946 through 1951 corporate bond offerings totaled 31.4 billion dollars. In the same period, life insurance purchases of such obligations, including both new and old issues, amounted to nearly 24 billion or three-fourths of total new offerings.

Investment in stocks is one major outlet for funds yet to be tapped in important volume by insurance companies. Holdings of preferred and common stock rose from 1 billion dollars in 1945 to 2.2 billion at the end of 1951. Despite passage of a New York law in early 1951 which permits investment in qualified common stocks up to 3 per cent of total assets, insurance companies have reduced acquisitions in recent months. Major reasons may be the heavy demand for funds from other sources and the historically high level of stock prices currently.

Net purchases of private investments have been financed in part by sales of Government securities



*january through june at annual rates.

Mortgage loan boom

Life insurance companies have always been active investors in mortgage loans. In fact, this was the most important type of asset holding prior to 1935 and accounted for 43 per cent of total resources in the peak years of 1926 and 1927. The dollar amount invested in mortgage loans dropped substantially in the early thirties, however, and recovered only gradually in the latter part of the decade and during the war years. Since life insurance resources were rapidly expanding during this period, mortgage holdings declined in relative importance to the point where they comprised less than 15 per

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Holdings of insured loans on nonfarm properties show the biggest rise

	Billion dollars 1945	Billion dollars 1951	Per cent increase
Total	6.6	19.3	192
Nonfarm:	5.9	17.8	204
FHA and VA	1.4	8.4	531
All other	4.5	9.4	111
Farm	.8	1.5	97

cent of total assets in 1945 and 1946.

The postwar construction boom abruptly reversed this downward trend. Private expenditures on residential construction totaled more than 50 billion dollars from 1946 through 1951; much of this required long-term mortgage financing. Unlike the corporate bond market where insurance companies are in a dominant position, other institutional investors such as savings and loan associations, commercial banks, and mutual savings banks are active and vigorous competitors for mortgage loans. Nevertheless, purchases of mortgages by life insurance companies were so sharply accelerated that total holdings nearly tripled between 1945 and the close of last year. At that time investment in mortgages amounted to 19.3 billion dollars and accounted for more than 28 per cent of total assets.

Most of the postwar expansion in mortgage holdings has been in loans on residential property. These now comprise more than 70 per cent of the total mortgage portfolio as against 55 per cent at the end of 1945. Life insurance purchases of home mortgages have been facilitated by FHA insurance and VA guarantees. In addition to insuring lenders against much of the risk in mortgage investment, these programs assure that minimum construction standards have been met and enhance the marketability of mortgages after purchase. Despite the fact that interest yields range from ½ to 1 per cent lower than on conventional loans, over two-thirds of the postwar growth in residential holdings has been in the insured category.

During the past year insurance companies have reduced their purchases of mortgages substantially. Acquisitions in the first six months of this year totaled only 2.0 billion dollars as compared with 2.9 billion in the comparable period of 1951. In part, this reflects the cutback in housing activity from the peak levels of 1950 and early 1951. In addition, the attractiveness of fixed interest FHA and VA loans has been reduced as a consequence of the general rise in yields on long-term bonds which occurred last year.

Insurance companies may be expected to become more active in the insured mortgage market if other outlets for their investible funds contract in the months ahead. Nevertheless, future increases in mortgage holdings are unlikely to equal those of 1950 and 1951, owing to the reduced amount of new mortgage financing and the steadily growing volume of repayments on debts already outstanding.

What of the future?

Life insurance resources have grown without interruption from 8 to 70 billion dollars in the past 30 years and continued expansion seems assured. Sales of ordinary life policies set a new record in 1951 and have risen further in the current year. Even so, life insurance in force is smaller in relation to personal income after taxes than before the war.

With the further growth in insurance coverage, the problem of keeping life company assets profitably invested is likely to become increasingly difficult. The search for suitable investment outlets will be intensified in this event with greater activity in corporate stocks, small business lending, and direct ownership of real estate showing the most promise at present. Nevertheless, Government securities probably will be the major alternative to corporate bonds and mortgages as an outlet for investible funds for some time to come.

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World Economic Report[1]

Underdeveloped countries continue to devote highest proportion of output to current consumption.

THE PAST TWO YEARS have been marked by great economic volatility throughout the world. Since the outbreak of the Korean conflict, far-reaching changes in the volume, direction, and composition of world trade have occurred. The remarkable boom and later reversal in the world demand for and prices of key raw materials—particularly rubber, tin, and wool—dominate the foreign trade story as reviewed in the UN *World Economic Report* for 1950-51. The reversal in international commodity demand produced a deterioration in the terms of trade and the balance of payments position of the raw material producing areas. Further repercussions resulted in an almost worldwide tightening of foreign trade restrictions, the impact of which has not even yet been fully felt.

These spectacular movements in international trade have partially overshadowed some of the equally important domestic developments which have taken place during these months in many of the world's economies. The UN Report presents a comprehensive review not only of over-all trade patterns but of the less publicized internal situation in a great many nations of the world.

Gross national product compared

In appraising and characterizing selected national economies, the Report uses the familiar concept of gross national product and its breakdown into private consumption, private investment, and government spending. The conventional division of GNP into private consumption, private capital investment, and government spending can be regrouped into consumption and capital investment since the third component, government spending, is comprised of expenditure for both capital investment and for currently consumed goods and services. The countries are dealt with in three broad groups. Predominantly free enterprise economies are divided into those which are highly industrialized and those in which industry is relatively unimportant and living standards are generally low. The centrally planned economies—Russia, the Eastern European nations, and China—are treated separately.

As might be expected, the proportion of GNP devoted to each of these broad categories varies from country to country. In underdeveloped countries a high proportion of total output is used to meet the day-to-day wants of their population. The highly industrialized countries, on the other hand, need large investment to maintain their living standards while ever increasing their capacity to produce for greater future consumption.

In the United States, as indicated in the accompanying charts, somewhat more than two-thirds of total GNP went into personal consumption and about 18 per cent into private investment. The remaining 15 per cent went into Government expenditure. In sharp contrast, the underdeveloped countries used a much larger proportion of total output for current consumption. In Burma, for example, an additional 12.5 per cent of GNP went into consumption with less than 1 per cent going into private investment. In Latin America some countries devoted almost 8 per cent more of GNP to consumption than did the U. S.—Chile and Cuba, for example.

In most of Western Europe a smaller pro-

[1] *World Economic Report*, 1950-51, prepared by the Division of Economic Stability and Development of the United Nations. The 140-page report is the fourth of this series to be published.

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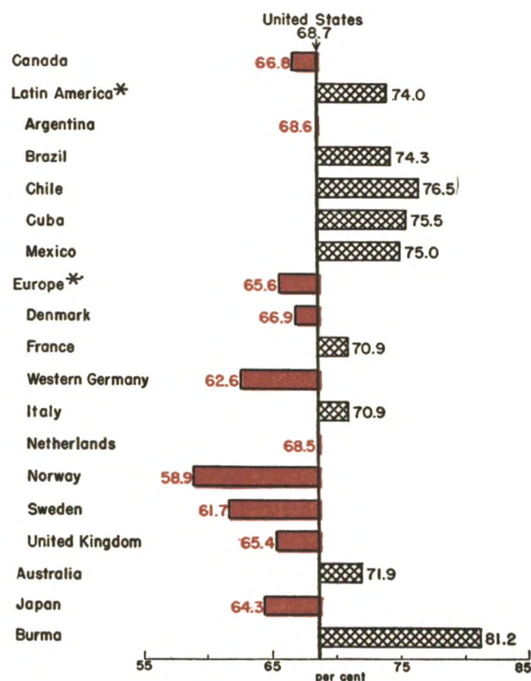
portion of GNP went into personal consumption than in the United States. This does not imply that these countries were "more industrialized" than the U. S. Rather, they sacrificed current living standards in order to allocate more resources into investment. This in turn reflects two conditions. First, although these European countries had reached a high level of industrial development prior to the war, obsolescence and heavy wartime depletion and destruction of plant and equipment as well as housing required substantial replacement of capital. Secondly, and more recently, additional investment demands have arisen as a by-product of rearmament programs which

—*continued on page 15*

National variations in GNP distribution . . .

World Economic Report data show a wide range in the proportion of national output allocated to each of the three major GNP components in 1950. Selected countries are compared with the U.S.

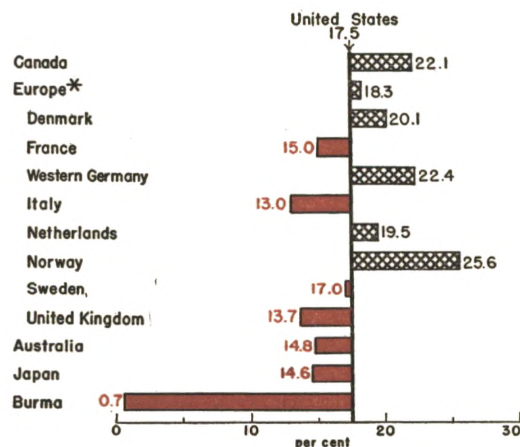
private consumption



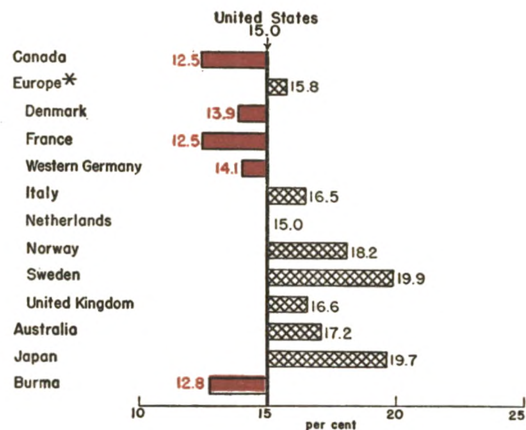
*simple arithmetic average of countries listed

Note—components for each country may not add to 100 per cent because net imports of foreign goods and services are additional to GNP and conversely.

private capital investment



government spending



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THE Trend OF BUSINESS

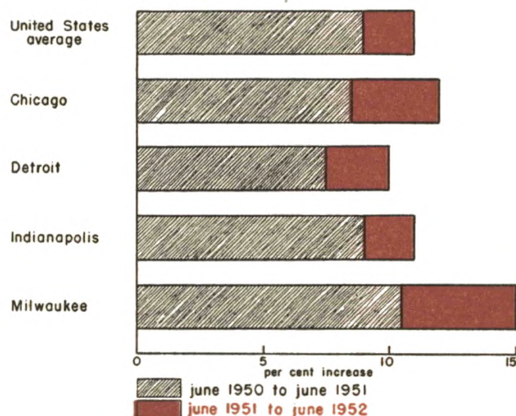
FOR ALMOST 18 MONTHS inflation has been kept waiting in the wings. During that time, good progress has been made in boosting the output of military material and civilian goods have been provided in the amounts consumers were able and willing to buy. Now that the arms program is nearing the maximum contemplated effort, hopes for continued stability would appear to be enhanced. Nevertheless, fears are growing that another general rise in the level of prices is imminent.

Some price increases have been announced in recent weeks and others certainly are in the making. Developments such as the aftereffects of the steel strike and drought in some agricultural areas are difficult to assess. It would be rash, nonetheless, to translate these signs into a forecast of strong inflationary pressures. Barring, as always, a sudden turn in international tensions, the chance for a return to the rapid price rises of the post-Korea months appears remote.

The main forces lined up on the inflationary side at present include the larger proportion of new steel channeled to defense, the attempts to rebuild inventories, the current cycle of demands for higher wages, the weakened price control bill, and the growing Federal deficit. Moreover, lowered stocks of durable goods at both the retail and manufacturing level have placed business in a poorer position to meet a new upswing in consumer buying than at any time in recent months.

Countering these developments are the more cool-headed reactions of businessmen and consumers to cries of "wolf," the wage losses resulting from widespread work stoppages, the tighter grip of general monetary controls now

Milwaukee leads living cost rise



that fixed support prices for long-term Governments have been ended, the heavy tax load, and a greatly expanded industrial plant. Meanwhile, the highest hurdles foreseen two years ago have been cleared successfully, in part as a result of the stretch-out in the defense program. Before the steel strike, arms output had been absorbing strategic materials at a rate close to the expected peak. In addition, the defense-related industrial expansion programs, inflationary before their completion, were over the hump.

Wholesale prices which had been trending downward fairly steadily for almost a year and one-half turned up slightly in July and August. In midsummer the over-all index stood 11 per cent above the June 1950 pre-Korea level—not too bad considering the strains of the intervening period.

Consumer prices in midsummer were also

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11 per cent above the pre-Korea level. A further boost probably is in store for October as rent controls are eased or removed in various localities. In Chicago, authorities have agreed tentatively upon the desirability of a 10-15 per cent rise for controlled dwellings. Similar action may be taken in Detroit and Indianapolis. In that case, cost-of-living indexes for other District centers will move closer to the level of Milwaukee where rents were freed two years ago.

Fruits and vegetables, fresh and processed, were among the items decontrolled in the amended Defense Production Act. A shortage of tin cans will reduce the size of this year's pack and some price increases are doubtless in prospect as a result. Decontrol will not be a major factor in developments immediately ahead, however, since in most cases canned goods have been selling below ceiling.

Another round of wage increases apparently is afoot and is contributing to inflationary pressures. Rubber, meat packing, and electrical workers and soft coal miners already have made their bids or are expected to do so soon. Price increases will accompany the higher business costs in most instances. Auto industry contracts are good until 1955, but most of these workers are covered by cost-of-living escalator clauses.

Post-Korea inflation; United States and elsewhere

Drought stricken crops are mainly cotton and tobacco; food costs are unlikely to be much affected. Midwest farmers, in contrast to those in the East and South, have continued to enjoy favorable weather conditions and have large harvests in process.

Consumers have changed their attitudes toward high prices, according to the Survey Research Center of the University of Michigan. Between January and June more individuals decided that current price levels are relatively permanent and buying need not be deferred in anticipation of better bargains later on.

Instalment credit began to rise swiftly soon after controls were lifted on May 7. The ending of the curbs apparently had a considerably greater effect than had been generally anticipated. Outstandings jumped almost 600 million dollars during June to a record total of 14.4 billion. In June 1951 during the control period the rise was only 35 million dollars. Home appliance dealers have continued to report better than anticipated business throughout the summer but supplies of household durables are expected to continue to be fairly adequate.

Most auto workers were back on the job by September 1, but some steel strike-induced unemployment will continue for several weeks. It is possible that the extent of production lost because of steel shortages has been exaggerated. Many firms which use steel in small quantities relative to the value of their products had sufficient stocks on hand prior to the strike to maintain operations until regular deliveries can be resumed. Some District firms profited as a result of timely ordering of supplies from Belgium and Austria. Furthermore, a number of manufacturing concerns in this area ceased operations before steel supplies were exhausted in order to maintain inventories and facilitate a return to full-scale production.

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Department stores hold their own

Sales position maintained relative to competing stores, but share of total retail business has fallen.

DEPARTMENT STORES have been accounting for a smaller share of total retail sales in recent years than in the period prior to World War II. In the three years 1949-51 total retail business exceeded the average of the 1939-41 period by 195 per cent. During the same years department stores' sales were higher by only 170 per cent.

Available data does not suggest that the department store is a fading institution, however. Rather, the relative drop in their sales from prewar stems largely from the fact that a larger portion of consumer income is being spent on automobiles and food, lines in which department stores are relatively unimportant.

Compared with stores handling similar products, department stores have held their competitive position. In each year from 1939 through 1951 sales of department stores and those of competing stores have followed a remarkably parallel course (See Chart). It is the shifting pattern of consumer spending rather than weak merchandising which has changed the role of department stores.

Spending grows—pattern changes

Personal income after taxes more than tripled between 1939 and 1951. During that period prices of goods sold at retail doubled and the population of the United States rose by 34 million. Even after adjusting for prices and population, however, the average person had command over 40 per cent more goods last year than he had in the years before World War II. As might be expected, higher real income has been accompanied by modified individual spending habits.

During the postwar period consumers have been laying out a larger fraction of their income on food and durable goods—autos, furniture, appliances, and TV sets. They have spent less, relatively, on nondurables and services such as shoes and clothing, rent, and electricity and gas. Over-all, 46 per cent of all consumption dollars have been spent on food and durables in recent years compared with 40 per cent prewar.

Sales at retail stores have amounted to 70 per cent of all consumption spending compared to only 60 per cent in the 1939-41 period. Not all retail categories gained in the same degree, however. Biggest increases, of course, were recorded by the types of stores handling those goods in greatest demand.

The main beneficiaries of the shift in buying have been the automobile dealers. Their share of total retail sales increased from about 13 per cent in 1939 to 17 per cent in 1951. As a result of the construction boom, retail sales of building materials outlets rose during the 1940's from 5½ per cent to 7 per cent of the total. In addition to the expanded demand for building materials, the housing boom brought with it more than proportionate increases in sales of home furnishings.

Nondurable goods stores, in general, accounted for smaller proportions of retail sales in the postwar period. Department stores slipped, relatively, along with the other types of merchandizing in this class, but sharper drops were recorded for jewelry stores, apparel shops, and drug stores. The variety of goods sold by department stores helped to maintain their proportion of retail sales relative to some of the more specialized shops.

Fluctuations in the sales of the automotive group have been most important in causing total retail sales to move contrary to depart-

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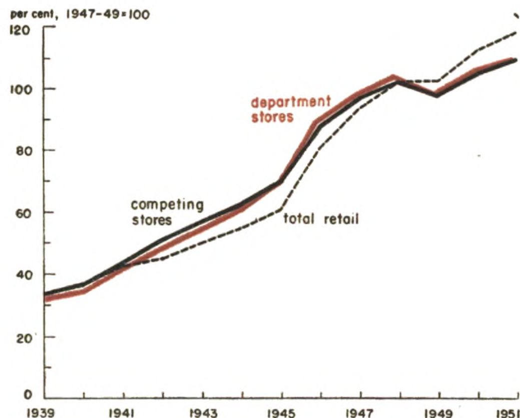
ment store results in the postwar years. This component of total sales is highly volatile and is second only to the food group in over-all importance. Backlogs of demand for automobiles kept these sales rising during 1949 when most other types of retailing were adversely affected. Since 1950 car production has been hampered by availability of materials which were under allocation.

Department store sales an indicator

Although department stores typically account for only 7 or 8 per cent of total retail sales, they are watched closely by business observers. There are two main reasons. First, these stores handle a wide selection of goods although not necessarily in the same proportion as the national totals. Second, department stores are relatively few in number and their sales results can be collected and tabulated quickly.

For almost 35 years the Federal Reserve System has published sales and inventory data for a large group of department stores in each of the 12 Federal Reserve Districts. Weekly sales changes from the previous year and sales indexes are released on the Thursday following the week in which the sales were recorded. Monthly and yearly indexes are also available.

Department store sales match competition



Dividing the retail dollar

In the years ahead it is quite possible that department stores will regain their prewar slice of retail sales. More than that, their position relative to competing stores may improve. Certain movements now in progress point toward these conclusions.

The first consideration is negative in nature. Building materials and automobile sales in recent years were of boom proportions. The nation is now better housed and more adequately supplied with vehicles than ever before. Under these circumstances it is probable that a larger proportion of retail buying will be directed toward other lines such as those handled by department stores.

The competitive position of department stores will be bolstered in some degree by the new price maintenance law insofar as its provisions are applied to household durable goods. If price floors under refrigerators, washing machines, TV sets, and the like are more rigidly enforced the consumer will have less incentive to patronize the "discount houses."

More important, department stores are now engaged in a movement toward the suburbs where the large population increases have occurred in recent years. The building of department store branches on the periphery of cities and in the suburbs has been handicapped by material shortages, but is now proceeding more swiftly.

In most large cities in the nation, including Chicago, Detroit, and Milwaukee, a number of large shopping centers located outside the city proper and offering adequate parking facilities either have been completed or are in the planning or construction stage. Most of these projects contain one or more department stores, usually branches of enterprises with head offices in the heart of the city.

In the thirties there was considerable discussion of the "maturity" of the department

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City-financed new factories

Controversy over plans for public financing of industrial development in South and New England highlights limitations.

THE GROWTH OF AMERICAN INDUSTRY has had widely divergent impacts on American communities. Most have grown and prospered. But some have not. In general, these communities have been areas where such natural resources as coal and timber have been exhausted, where industry has migrated to more suitable locations, or where industry has simply failed to catch hold. These underdeveloped or depressed areas are characterized by income levels perhaps only one-half or two-thirds as great as in the more successful industrial sections. Usually they suffer from chronic unemployment or underemployment, high public welfare costs, and out-migration by people in the most productive age groups.

Thus, there is much interest both locally and as a matter of state and even national policy in job and income creating programs for these areas. The employment stimulating device currently in the limelight is the use of municipal or state government credit to build or buy new plants to be leased to private operators.

It's not new

State and local government aids and subsidies to private business are a part of our early history. In the nineteenth century, canal, turnpike, and railroad promotions were the principal beneficiaries. Some of these programs were spectacular failures and led to restrictions on the use of public funds for private benefit and on state-local borrowing in general, many of which persist to this day in the laws and constitutions of states, particularly in the Midwest.

In the pioneer period, the principal advantage of public financing of industrial development lay in the fact that capital was generally scarce and private credit unavailable. Public borrowing often seemed the only effective method of developing the resources of the frontier. Today most companies can raise funds at reasonable rates on their own in accessible capital markets. Why then the revival of interest in the use of public credit for business development? One answer is that there are still many firms which experience enough difficulty raising funds privately so that the offer of public credit can attract them to an underdeveloped or depressed community.

Probably the most important attraction, especially for established companies, is the fact that the use of public credit offers substantial savings in interest and taxes. Current high Federal income tax rates allow the issue of tax-exempt state and local securities at very low rates of interest. Since the occupants of publicly financed plants pay rentals based upon the costs of debt service, most of this advantage accrues to them. In addition to lower interest costs, most of the existing and proposed programs offer exemption from real estate taxes or payments in lieu of property taxes on the new plants.

Moreover, the public borrower assumes a large part of the risk involved in the investment. If a new publicly financed plant fails to earn enough to meet the rental payments, an underdeveloped or depressed community ordinarily will forego insisting on the company's meeting its lease obligations rather than force cessation of operations and unemployment. In total, these factors may be a great inducement for an expanding firm to locate new facilities in a locality which offers such advantages.

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Programs adopted

The oldest of the existing programs for industrial development through use of state and local government borrowing powers is Mississippi's "Balance Agriculture with Industry" program, inaugurated in 1936 and re-established in 1944 after a wartime lapse. Mississippi cities are authorized to issue general obligation bonds secured by the municipal taxing powers for new construction.

Two-thirds of the voters in the locality must approve each project and the State Industrial Commission must agree that the new firm is suitable to the city's economy. Moreover, contractual rental payments must be sufficient to service the debt and there must be a guarantee of a specified payroll, usually for five years. In the prewar period, about one million dollars in bonds were issued under the Mississippi plan. In the first few years of the postwar program, bond issues totaling nearly five million dollars, mostly for textile and apparel plants, were approved.

Three other Southern states permit the sale of revenue bonds by cities to finance construction or acquisition of factory buildings. In these cases, the rentals paid by the firm constitute the only backing for the bonds. Kentucky authorized such a program in 1946 and Tennessee and Alabama did so last year.

Proposals in New England

Proposed programs considered in Massachusetts and Rhode Island earlier this year provided for state rather than local government sponsorship. The securities would be issued by intermediaries and presumably would not be exempt from Federal income taxes. This arrangement was designed to meet the argument that this type of borrowing by state and local agencies, if it becomes widespread, might induce Congress to lift the tax exemption from *all* state-local bonds. The Massachusetts and Rhode Island proposals also provided for additional rental payments in lieu of real estate taxes to be remitted to local governments. Both proposals were rejected, at least for the time being.

The attraction that these programs have for communities which are underdeveloped industrially or suffer from unemployment because of out-migration is obvious. As long as the company lives up to its bargain—that is, continues operations and meets the required rental payments, the income of the community is increased. Additional wages are paid to the workers in the new plant and local utilities, stores, and service establishments benefit by supplying the needs of the new plant and its employees. Usually, the increased state and local tax receipts will far exceed the costs of the additional public services required by the new factory and the influx of population.

Losses could be large

But what if the company fails to meet the terms of the contract? This can happen even though a firm is reputable and well managed. Any one company is always vulnerable to national, regional, or particular industry recessions. Unless the plant can be converted for use by another prospective tenant, if rentals are not forthcoming, local taxes will have to be increased to meet debt service requirements on general obligation bonds. And even if revenue bonds were the source of funds, many cities, particularly the smaller ones which appear to be most interested in programs of this type, might decide, if they could legally do so, to increase general taxes to service the bonds because a default, even on revenue bonds, could have long-term adverse effects on the city's credit standing.

If, in addition to failure to meet its rental payments, a company finds itself forced to shut down or drastically reduce operations, the community will be back where it started or even worse. In the short run, the unemployed workers and their families are not apt to leave their new homes and look for work elsewhere. The community may face not only reduced

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levels of income, trade, and tax revenues, but even higher levels of governmental costs in the form of relief and other public assistance payments. Of course, these are risks involved in any new enterprise, whether publicly or privately financed, risks of which the community should be aware.

Inefficiency may result

For the country as a whole, the effects of public financing of industry may be "good" or "bad," depending on the circumstances in each case. In communities with unemployed workers and unused factory buildings, or in areas where the labor resources are inefficiently utilized on farms with relatively low productivity, a financing plan with a comparatively small element of subsidy may have greater leverage in increasing output than any other possible use of the funds equivalent to the value of the subsidy.

On the other hand, output and income may be increased in a particular community at the expense of other communities and even of the country as a whole. In most cases, the expansion of production would have taken place even in the absence of a municipal financing plan. Firms normally would locate their expanded operations where over-all costs are lowest. However, a city offering a public financing scheme may attract firms from other locations where costs would be lower were it not for the subsidy element.

In such a case, costs to the firm will be lower in the subsidized community, while costs to the economy will be higher, since the company's costs plus the value of the subsidy are greater than the total unsubsidized costs would have been in alternative locations. Moreover, these programs may interrupt an established trend in the migration of the underemployed rural labor supply to the larger low-cost industrial centers in both the North and the South. On balance, there are probably many more potential cases in which industrial subsidization would operate to make the economy function *less* efficiently than there are opportunities for "inexpensively expanding national output" via subsidy.

Competitive bidding for industry

One dangerous possibility is that the extension of industrial financing programs will result in cities bidding against one another in their efforts to attract new plants. To outbid rival cities, they would tend to expand the degree of subsidy. This would expose cities to even more adverse effects in the event of unfavorable economic developments. In the most likely event, the competitive subsidies would tend to cancel out and firms would locate where they would have gone without any public aids.

Another drawback of these programs is that the tax abatement features involve redistribution of the tax burden. If the new plants do not pay property taxes, other property owners in the community face heavier tax burdens than they might otherwise bear. Similarly, the income tax exemption of the bonds sold to build new factories can mean, if these programs are more widely adopted and used, a shift in state and Federal income tax burdens from taxable interest income to other sources.

Finally, widespread defaults on bonds issued for new plants, such as could easily occur in a major economic downturn, could impair the financial capacity of states and their local governments to deal in future years with problems that are uniquely their own.

Department stores *continued from page 11*

store as an institution. Inroads, apparently, were being made upon its domain by specialty shops with less overhead and more merchandizing vigor. Since that time managements have been successful in adapting to a rapidly changing environment. Current expansion programs indicate that equal success will be achieved in the years ahead.

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Economic report *continued from page 7*

many of these countries have undertaken.

Although GNP is the value of a nation's total output, a country may increase its consumption or investment by importing more than it exports. This factor partially accounts for the relatively high proportion of private investment to total output in both Canada and Norway.

GNP figures reveal some but not all national differences in economic structure. In some free enterprise economies such as the U. S. and Canada, the allocation of GNP between private consumption and investment is the result of countless independent consumer and investor decisions. The government may, of course, influence these decisions indirectly through fiscal and monetary policy. In countries such as Britain, Norway, and Sweden, government policy to a much greater degree determines levels of consumption and investment, either via investment controls and subsidies or through government spending itself. To the extent that a government provides goods and services for current consumption, the Government share of GNP increases while the share going into personal consumption appears limited.

The variations among countries in the relative share of government spending are not as great as might be anticipated. For example, in the United Kingdom government spending accounts for only 1.6 per cent more of GNP than in the U. S. One major explanation for this is that business type government operations, such as nationalized railroads or factories, appear in the government sector of GNP only to the extent that they have net losses or profits. This is because, like private businesses, nationalized industries sell their products rather than distribute them as government services. The bulk of their transactions thus appear in the GNP accounts as consumption or as private investment. In consequence, a country with numerous nationalized industries which operate without government subsidy need not show any more of its total output in the government section than does a country such as the United States.

Differences in GNP distribution reflect not only variations in basic economic structure, but also to a limited extent lack of uniformity in national income accounting practices[2]. Despite such problems in comparability, however, GNP data provide a useful gauge for assessing broad differences in over-all national economic development.

The Report emphasizes the fact that those countries that are in greatest need of productive capital are still least able to provide it. Yet, if these underdeveloped areas are to make substantial progress toward higher living standards, they must obtain additional investment. If such investment comes from the more industrialized nations, the benefits are not confined to the underdeveloped countries alone. They provide a market initially for machinery and other productive equipment and, as the underdeveloped countries progress, a demand for more and more consumer products is created. Before these goals can be achieved, however, many of the obstacles to the free flow of capital—such as foreign currency restrictions and fear of possible nationalization of industry—remain to be surmounted by international organizations as well as by the individual countries themselves.

2 For example, in Norway and Sweden expenditures on maintenance and repairs are included as a part of gross private investment; in the United States this does not enter into GNP. Norway, as well as Western Germany, includes investment in public enterprises in the investment sector, rather than in the government's share.

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Loan trends

DURING THE SIX MONTHS ENDING JUNE 30 total loans outstanding at District member banks changed little. Total outstandings, however, hid divergent movements of particular loan categories. Moreover, over-all loan trends showed a marked contrast with the corresponding period of 1951 when a 6 per cent gain was recorded.

This year's six months stability of loan totals reflected an easier tempo of economic activity. Prices changed little, many business firms marked down inventories, farmers reduced feeder loans, and fewer houses and business construction projects were begun.

Less intense demand for bank credit was only part of the answer to the end of the loan rise, however. Many bankers began to consider themselves "loaned up" as outstandings moved up in relation to deposits and capital. In addition, the Federal Reserve System policy of limiting the supply of reserve funds available to banks in a period of precarious price balance served to restrict some lending.

During the rapid loan rise in early 1951 all cities participated in the trend. This year, however, a decline in loans at the District's big city banks offset a rise for banks located in smaller towns (See Chart). As usual in a period of transition the large centers led the way. Business loan totals are particularly sensitive to changes in rates of activity and these loans are of lesser importance in smaller cities.

All major types of loans showed increases for the District as a whole in the first half of 1951. No such uniformity existed in the January-June period this year. Business loans and loans to banks fell. Consumer loans, on the other hand, rose at a faster rate.

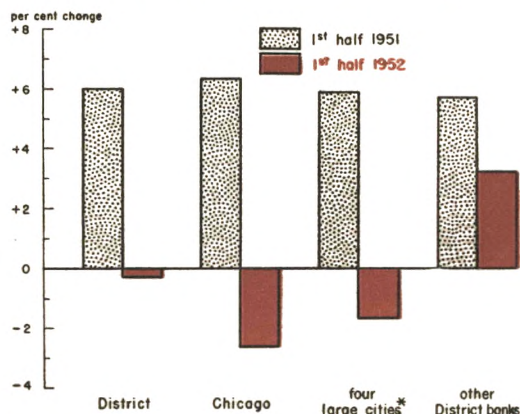
Commercial and industrial loans declined 4 per cent in the first six months of 1952. The 135 million dollar drop, although less than might have been expected seasonally, contrasts with a 9 per cent advance last year.

Agricultural loans outstanding at District member banks declined 5 per cent during the first half of 1952 compared to a slight advance in the same period last year. Most of this year's decrease was represented by a fall in non-real estate loans to farmers.

Real estate loans rose at a slower rate during the first half of the year. This smaller increase reflected a lower volume of home construction than in early 1951 and an increased reluctance on the part of bankers to make fixed interest bearing FHA and VA loans. Almost all of the net increase in real estate loans occurred in banks outside the large cities.

For the remainder of 1952 outstanding loans in most categories may be expected to rise. Seasonal trends will be reinforced by other developments. Business loans of weekly reporting banks reversed their downward trend in July; depleted inventories in many lines following the steel strike coupled with some higher prices will result in further demand for credit. Sizable crops in District states foretell a rise in commodity loans. Moreover, if mortgage controls are relaxed, real estate credit will be stimulated.

Loans decline at large city banks —continue rise in other centers



*Des Moines, Detroit, Indianapolis, and Milwaukee.

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