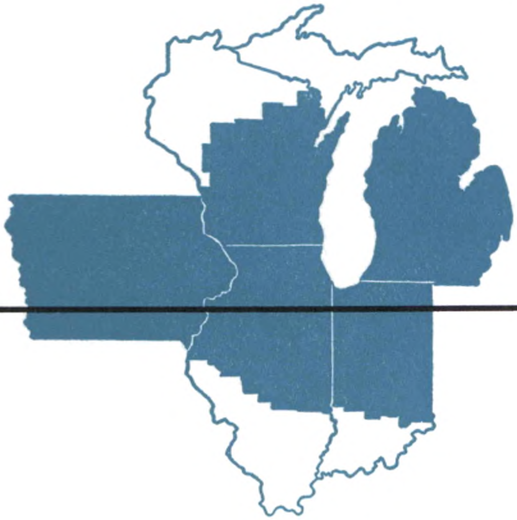
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1953 February

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After 1953—what?

Armament spending hump to be passed this year.
Continuing high-level economic activity depends on private outlays.

In recent weeks several evaluations of the prospects for business stability beyond the period of defense build-up have been offered to the public. Since mid-1950, high levels of employment and production have been virtually assured by mounting arms expenditure. Now that the peak in these outlays appears to be near at hand, attempts are being made to visualize the extent of the recessionary problem which may result from a levelling or contraction in Government spending.

Three surveys completed last December already have gained wide circulation. They include:

"Markets After the Defense Expansion," published by the Commerce Department;
"The Sustaining Economic Forces Ahead," prepared by the staff of the Joint Committee on the Economic Report; and
"The American Economy in 1960," issued by the National Planning Association.

The Commerce Department study is specifically intended as a general guide for business policy making. In fact, Secretary Sawyer's staff was aided in its work by a group of prominent business economists. The materials prepared by the Joint Committee's staff are to be considered by Congress in formulating policy recommendations under the Employment Act of 1946. Perhaps the broadest view is contained in the National Planning Association's effort. The NPA (not to be confused with the National Production Authority) is a private organization of "leaders in agriculture, business and labor" whose research is intended to "strengthen private initiative and enterprise."

Despite differences in orientation and emphasis the goal of the three studies is the same—to provide policy guides for Government and business which will help promote a high and steady level of employment and production without inducing further price inflation.

1953 unlike 1945

Longer-term looks at the future are being made in an atmosphere reminiscent of that which prevailed as World War II drew to a close. Long before V-J Day a variety of organizations were offering suggestions for moderating the violent readjustment which was expected after the inevitable sharp cuts in armament output.

As it turned out, the changeover in 1945-47 was much smoother than had generally been anticipated. No important conversion unemployment developed, and there was little call for extensive programs to relieve distress.

As the Government spigot of World War II was speedily turned down, consumer, business, and state-local government spending increased more than enough to take up the slack. In those years demand was especially vigorous because of the needs which had been accumulated during the war and depression.

Slower rate of gain for national security outlays

	Amount	Gain	Per cent increase
	(millions)		
1950	18.3	....	...
1951	36.7	18.4	100
1952	48.9	12.2	33
1953	55 est.	6.1	12

SOURCE: Department of Commerce

At the present time, some civilian and local government spending is being delayed because of material shortages, but the amount is not particularly large. Most types of activity which were cut off entirely in the 1942-45 period have continued in good volume during the post-Korea period.

Since the war business firms and consumers have greatly increased their holdings of long-lasting assets. There has also been a deterioration in the relative cash position and borrowing potential of the non-Federal components of the economy during this period. Thus, it is feared that a decline in defense outlays might not be readily offset by expansion in other areas.

Predicting and projecting

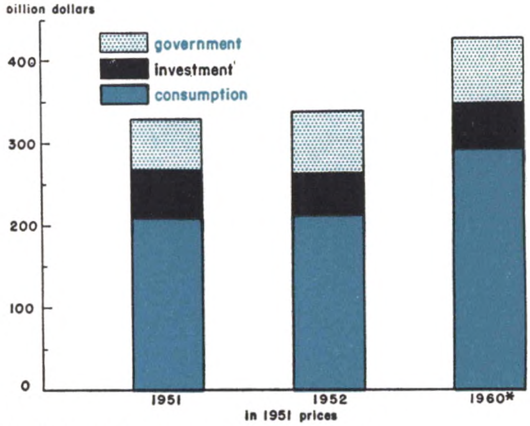
Those responsible for preparing the three studies under discussion have been careful to disavow any direct attempt to "forecast." Rather, the specific figures offered for later years are styled "projections," which *assume* a high level of business activity without inflation or an appreciable change in the temperature of the cold war.

Under favorable conditions, the NPA expects the Gross National Product in 1960 to be 425 billion dollars in 1951 prices—an increase of more than 20 per cent from current levels (see chart). Population is expected to rise at only half this rate.

Analysts realize that "forces exist which could create a downturn" at any time from now on. Generally it is believed, however, that the present year will be a good one, probably the best ever in terms of total output of goods and services. The Commerce study goes even further. Stability is expected for arms spending in 1954 and the case for a business downturn in that year "seems not greatly stronger than can usually be made this far in advance of any date." The real test is expected in 1955.

Six months is often taken as a practical limit for a business forecast since new developments are almost certain to cross the horizon within

A high-employment economy in 1960 would turn out one-fourth more than in 1952



*Estimated by the National Planning Association

this time span. The Commerce study looks ahead to 1955, however, and the others under review make projections for 1960. Readers are warned that "we cannot conclude that a business recession will or will not occur, sometime, or at any particular time, during the next few years." The projections represent desirable levels of output which can be achieved with "some reserve in potential labor supply, capacity, and resources."

Stabilizing factors

The reports point out that institutional bulwarks have been erected by Congress since the depths of the depression to deal with some of the worst problems of recession. Insurance of bank deposits, broadened powers of the monetary authorities, farm price supports, unemployment compensation, and old age insurance and assistance will help to put a floor under income and spending power.

Business firms, meanwhile, have kept themselves in a better position to meet a downturn by closer inventory control, longer-range planning of capital outlays, market and technological research programs, and avoidance of excess debt. These policies help not only the individual firm, but the economy as a whole.

Various developments in the economy, not specifically intended to counter a business downturn, are expected by the NPA to have that effect. The heavy reliance upon income taxes, for example, works toward broadening consumer spending. Moreover, such taxes are automatically reduced as income declines. Unionization may limit mass wage cuts of a deflationary nature, and general use of the amortization principle in loans will help minimize defaults.

A further aid to economic stabilization is recognized in the growth trend which has been strongly reasserted in the past seven years. By 1960 the population is expected to reach 175 million persons and most of the addition will be outside of the 20-64 year working age group. Other growth factors include continuing introduction of new products, and improvement of productive facilities.

It is interesting to note that none of the reports cited express any particular apprehension over the likelihood of continuous price inflation. Rather, emphasis is placed upon demand—needs, desires, and the availability of spending power.

The studies point out that the "new" economy already has withstood two jolts (reconversion and the 1949 dip). Nevertheless, after reviewing the changes which will help promote stability the NPA states, "it would be foolhardy to assume that the changes in economic structure, institutions, and attitudes . . . are sufficient by themselves to insure us against a downswing."

Population rise—a growth factor

	July 1	Gain	Per cent increase
	(millions)		
1920	106.5	....	....
1930	123.1	16.6	15.6
1940	132.1	9.0	7.3
1950	151.7	19.6	14.8
1960*	171.2	19.5	12.9

*Medium projection of Bureau of the Census

Demand: potential and probable

In probing for strengths and weaknesses in the years ahead, researchers are forced to attempt to evaluate needs and ability to pay, sector by sector, through the non-Federal components of the economy. The Commerce report generally follows the procedure of projecting demand based on historical trends and the current relative degree of market satisfaction, whereas the Joint Committee's staff emphasizes the amount of goods which would be required to bring living standards, industrial efficiency, and civilian governmental services to a calculated minimum standard.

Potential demand must be tied to ability to pay—principally current income. And revenues of any economic group are dependent upon income and expenditure of other groups. Nevertheless, some insight into the economic process can be gained by examining each sector.

State and local construction universally is assigned a bullish place in forecasts for several years to come. Backlogs of needed highways, schools, hospitals, and sanitation facilities are very large.

This prop cannot be counted upon too heavily, however. These outlays have been a relatively minor factor accounting for about 2 per cent of all spending. A significant rise in this proportion may depend upon extensive Federal aids and adoption of new financing arrangements by state and local governments.

Business investment, including additions to inventories or new capital projects, involves a high degree of managerial discretion. In the short run, inventory policy will always be extremely important in causing or intensifying business fluctuations. This factor may be in evidence as defense stocks are worked down.

—continued on page 15

Loans to banks

BANK BORROWING bobbed up from the dusty pages of history to become front page news in 1952. Brushing aside their traditional reluctance to borrow, member banks went into debt at the Federal Reserve Banks during the year in a volume unmatched for over three decades. And, furthermore, aside from one brief concession to tradition — "window-dressing" for end-of-year statements—they continued to borrow at a lively pace (averaging 1.5 billion dollars) in the early weeks of the new year.

Seventh District member banks were full-fledged participants in the borrowing boom. They went into debt in 1952 in increasing numbers, for greater dollar amounts, more frequently, and for longer stretches. For the first and most of the fourth quarters of the year, loans at the Chicago Reserve Bank topped those at the New York Fed, typically the center of borrowing activity.

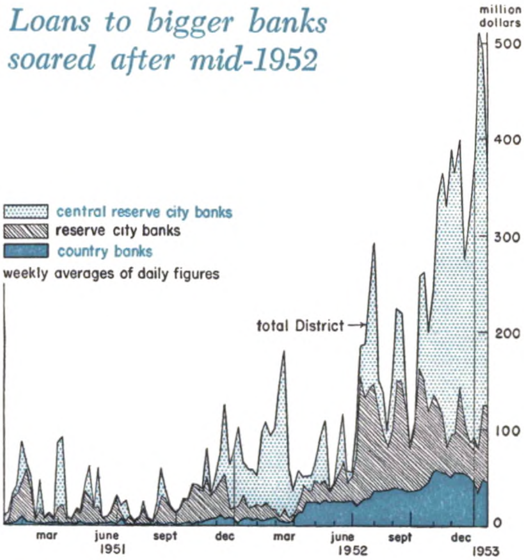
A pickup in business at the Reserve Bank loan and discount window first appeared in the spring of 1951. It reflected in part the withdrawal of Federal Reserve support of the Government securities market. Until that time banks had been able to replenish reserves by selling securities with a minimum of risk and uncertainty. Another underlying factor was the growing awareness by some banks of the advantage of including borrowings as a base when using the invested capital method of computing excess profits taxes. Beginning in mid-1952, however, the borrowing wave went into full swing. With heavy credit expansion under way and the money market tight almost continuously in the second half of the year, member banks stayed heavily in debt through the remainder of the year except for only minor interruptions.

Although the dollar volume of indebtedness grew markedly in 1952, the number of banks actually making use of the borrowing privilege at the Chicago Federal Reserve Bank remained small. Of the 1,008 member banks in the District, only 110 turned to this type of debt—an increase of 12 over the previous year. Included were most of the 13 central reserve city banks, slightly less than half the 74 reserve city banks, and not quite 7 per cent of the country banks.

Borrowings by the central reserve and reserve city banks, as would be expected, accounted for the bulk of the total; but, as the accompanying charts illustrate, they underwent wide and frequent fluctuations. The large money market and correspondent banks, because they typically keep their cash reserves at a minimum and earning assets at a maximum, repeatedly borrowed to bolster their reserve positions. Fairly regular increases in their indebtedness appeared each Wednesday—the end of the reserve week—but these were overshadowed by much sharper peaks around tax dates and other periods of money market tightness.

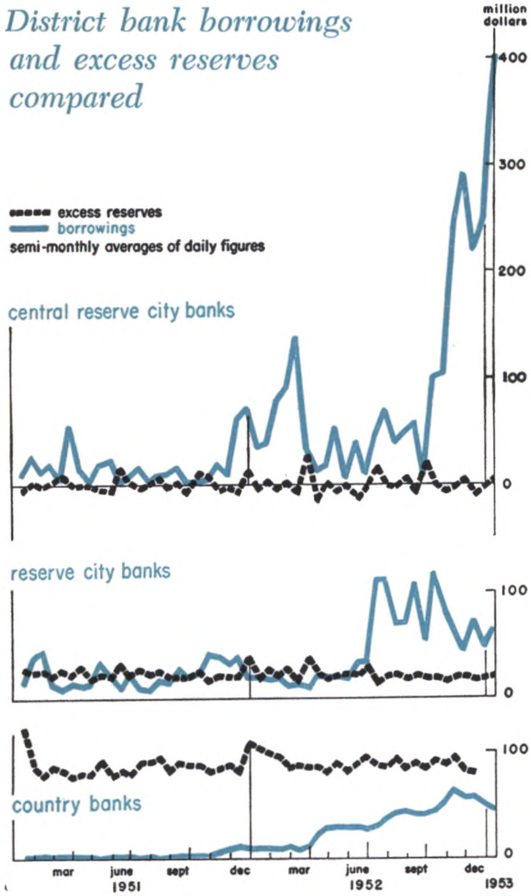
Loans by the Federal Reserve Bank of Chicago to country banks showed the steadiest and most persistent increase in 1952. Starting from almost zero in 1951, their borrowings began

Loans to bigger banks soared after mid-1952



to mount in the second quarter of 1952 and toward the end of the year reached a weekly average of 55 million dollars. Yet these smaller banks traditionally tend to maintain a wide reserve margin—their excess reserves account for three-fourths of the District's total—partly because they are somewhat removed from the Government securities market and also because the yields on short-term securities are too low or the available funds of the individual bank too small to make short-term investments worth while. To the extent that borrowed funds are required, moreover, they generally turn to their correspondent banks.

District bank borrowings and excess reserves compared



This year's budget

The Federal Government is still not seriously in the red despite the rise in defense spending since Korea, but may be in the next fiscal year.

EVERY JANUARY since the outbreak of the Korean war, budget and business forecasts, both government and private, have looked ahead to the following fiscal year as the one in which the big Federal deficits would begin. So far these fears have been disappointed. The January 9 Budget Message indicates that the current fiscal year, which ends on June 30, will wind up fairly close to a balance in terms of cash receipts and cash expenditures, which are more indicative of the Budget's impact on the economy than the conventional "budget accounts."

A year ago the forecast for the current fiscal year 1953, was that cash spending would outrun receipts by about 10 billion dollars. Even as late as August, when the President reviewed the budget outlook in detail, a cash deficit of nearly 7 billion dollars was anticipated. But the Budget submitted last month estimates that the deficit will be less than 2 billion dollars.

The big difference between the current and year-ago estimates is due to a more than 10 billion dollar difference in defense spending estimates. The still lagging defense outlays account for much of the difference between the August outlook and today's, although there is a half-billion dollar higher receipts estimate in the new Budget. And a continued buoyancy in business activity and incomes may result in even higher receipts by June 30.

Thus fiscal 1953 may turn out to be the third straight post-Korea year with no cash deficit, despite persistently contrary expectations. Receipts have generally been nearly as high as or higher than expected, but expenditures have fallen considerably short of plans. In fact, spending this year will be just a little more than what had been estimated for fiscal 1952 in the January 1951 Budget Document. Thus, defense spending has fallen about one year behind the schedules implied in earlier Budgets.

Changing budget policy

The document submitted January 9 is of course the Budget of an outgoing administration, and can and undoubtedly will be revised in many particulars by the new President. However, because any one year's budget is to a large extent the product of prior years' commitments, not too much change in the over-all magnitudes can be expected immediately. About 70 per cent of the estimated spending in fiscal 1954 is for defense activities. Fully two-thirds of defense spending is accounted for by pay and support of military personnel, deliveries of previously ordered military hard goods, and completion of military construction, chiefly Air Force bases, already under way. None of these outlays can be appreciably changed right away.

The nondefense section of the Budget is similarly dominated by longer-range commitments. More than two-thirds of this spending is tied to basic legislation which pretty much determines how much is spent independently of annual budgetary controls. Such enabling legislation may be for long-range programs, for example, the Federal highway aid program; the 1952 Act increased the Federal commitment for grants to state and local governments which must be made in *1955* and *1956*. Or the enabling legislation may be for expenditure programs which depend on social and economic conditions in the years ahead, for example, welfare payments to an increasing over-65 population.

Nondefense spending is expected to be about 3 billion dollars greater this year and next than it was in the fiscal year which ended last June 30. However, the increase is accounted for by increases in farm price support outlays, old-age insurance benefit payments, public assistance payments, and interest on the public debt. Barring drastic changes in the basic statutes, these increases will occur.

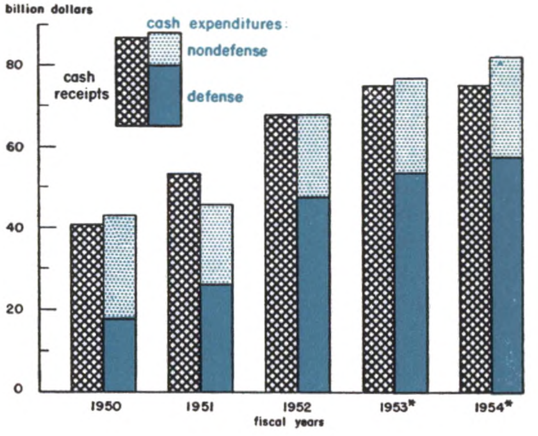
Whatever the new Administration may do in regard to budget policy, the effect of its decisions will be much more apparent in later fiscal years—1955 and after—than in the period to which Mr. Truman's last budget applies.

Large deficits expected since Korea not here yet

	Cash receipts	Cash payments	Cash deficit
	(billion dollars)		
Fiscal 1952:			
Estimate in Jan. 1951	61.3	74.1	12.8
Estimate in Jan. 1952	68.6	72.6	4.0
Actual	68.0	68.0	[1]
Estimates for fiscal 1953:			
In Jan. 1952 Budget	76.8	87.2	10.4
In Aug. 1952 Budget Review	74.4	81.2	6.8
In Jan. 1953 Budget	74.9	76.8	1.9
Fiscal 1954:			
Estimate in Jan. 1953 Budget	75.2	81.8	6.6

[1] 54 million dollar surplus.

Defense spending still rising, but at a slower rate



THE Trend OF BUSINESS

BUSINESS ACTIVITY during the past several months can be characterized only as excellent. Furthermore, no cloud has appeared on the horizon which could mar this picture for the balance of the winter. Business sentiment is very strong. Yet, the failure of inventories and new orders to spurt upward evidences a healthy caution regarding the longer-run outlook.

By almost any measure, in either physical or dollar terms, the nation's economic machine is now running full blast—at a peacetime record rate. Industrial production has advanced to new highs month by month since September and unemployment has remained near the postwar low. Retail sales during the Christmas season were the best ever by a wide margin and, seasonally adjusted, have continued at a good level into January. Business expenditures on new plant and equipment were at a peak in the fourth quarter, and are expected to continue at this level during at least the first half of 1953. In fact, only a few major measures have not been setting new records. Although housing starts, purchases of consumer durable goods, farm income, and corporate profits are moderately below their postwar peaks, all are very good by any other standard.

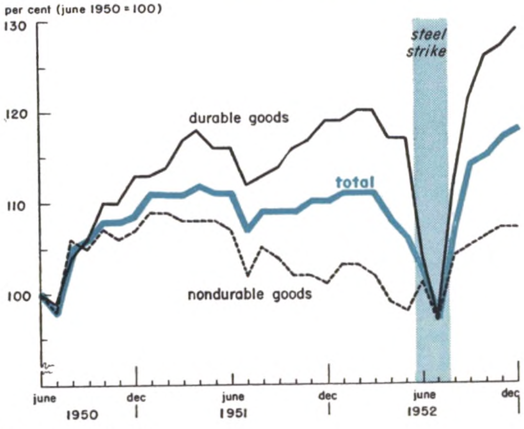
Prices have continued remarkably steady in the face of this upsurge in economic activity. Wholesale prices edged downward in November and December, reflecting declines in farm products and processed foods, while consumers' prices remained virtually unchanged. This stability is the more notable in view of the rapid credit expansion which occurred in the closing months of 1952 (including a Government cash deficit of substantial size).

Important factors helping to mitigate the inflationary pressure of this credit expansion have been the moderate inventory policy followed by business and a further gain in the rate of financial saving on the part of consumers. Basically, however, the principal deterrent to a further rise in prices has been the fact that most products are in ample supply, a situation directly traceable to the capacity of our factories and farms to turn out goods.

Industrial production has continued to climb gradually higher since the initial recovery following settlement of the steel strike last summer. Since August, the gain in over-all output has amounted to 8 per cent, with durable goods leading in the rise, but nondurables also increasing moderately.

The pickup in activity has been especially

Industrial production rises to new peacetime highs, led by durables



Seasonally adjusted

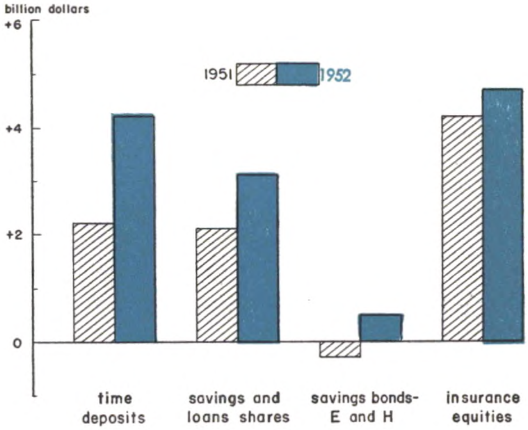
marked in the consumer durable goods industries, which are important employers in Midwest industrial centers. Production of furniture rose 9 per cent between August and November and the volume of new orders at the Chicago Furniture Show in January were reported to be well above those of the previous year. Output of household appliances increased 17 per cent during the same period, while radio and television set production jumped 68 per cent. Automobile production in the fourth quarter was at an annual rate of 5.2 million units, highest since the spring of 1951. Moreover, industry goals point toward an output of 1,400,000 cars in the first quarter, which would be 40 per cent more than were turned out in the early months of 1952.

Farm production continued at a very high level in 1952, topping all previous years by a small margin. Crop harvests were exceeded only in 1948 and livestock production was at a new high. Drouth in some areas forced a sharp increase in marketings of cattle from grazing areas in the second half of the year and Corn Belt farmers had a record number of cattle on feed at year-end. Consequently, larger beef supplies are in prospect. But because of relatively low prices, farmers are making further cutbacks in the production of hogs, with the result that there will be less pork available in 1953.

Declining exports have reduced the over-all demand for wheat, cotton, and fats and oils, with resulting price weakness for these commodities. A large acreage of winter wheat has been seeded but under generally adverse conditions. Current expectations of a reduced 1953 harvest, however, have provided little support to wheat prices in view of the export situation and large stocks on hand. Nevertheless, given reasonably good weather, 1953 is certain to be another year of high-level over-all farm production with an abundance of supplies for domestic consumption.

Business loans at weekly reporting banks declined moderately in the first three weeks of January, following a rise of more than 2,600 million dollars in the last half of 1952. Although loans usually decline seasonally in the early months of the year, some concern had been expressed that such might not be the case this year in view of the rapid expansion which took place in recent months. Banks have continued to borrow heavily from the Federal Reserve Banks, however, and on January 16 the rediscount rate was raised from 1¾ to 2 per cent. This action will tend to dampen any further inflationary expansion of credit which might occur.

Increases in long-term savings of individuals were much larger in 1952 than in 1951



Long-term savings of individuals increased by fully 50 per cent more last year than in 1951. The total gain in the form of time deposits, savings and loan shares, savings bonds, and private insurance equities amounted to about 12.5 billion dollars, the largest increase since 1945. The net effect of this increase in saving was to divert a sizable portion of the rise in incomes which occurred last year away from consumer spending. At the same time, however, consumer credit rose by about 3 billion dollars during 1952, as compared with an increase of only 650 million dollars in 1951.

Lagging state-local tax systems

Insensitivity of state-local revenues to growing demand for public services and facilities makes expansion difficult.

THE REVENUE SYSTEMS used by state and local governments have been called upon to finance a nearly twofold expansion of state-local activities since the War's end. The vast backlog of capital needs insures continuing pressure for revenues throughout the 1950's. Expanding public facilities to cope with increased urbanization, more school-age children, and growing motor vehicle use is causing revenue difficulties even in the midst of prosperity, though more serious problems might arise in a depression. This article discusses the problems facing state and local government if population growth, high incomes, and full employment continue.

The basic difficulty is that the money raising methods used are not sufficiently sensitive to the growth in the economy that underlies the increased demand for state-local government services and facilities. Many taxes and government charges are not even responsive to the increased use of specific facilities or increased demand for particular services. Local governments, if they rely on existing methods of finance, will not find them flexible enough to yield the funds needed to make much of a dent in the backlog of needs (discussed in the January issue of *Business Conditions*).

State-local vs. Federal and business

During the postwar period, industry has financed an increase in outlays on new plant and equipment comparable to the increase in state-local spending. During the War and again since Korea, the Federal Government has had to finance even greater increases in defense outlays. It is hard to imagine how either of these financing efforts could have been accomplished if they had been dependent on the relatively inflexible sources of revenue tapped by state and local governments. Federal financing has been possible for two reasons: its reliance on business and personal income taxes which are extremely sensitive to rising prices, production, and income, and its comparatively unlimited ability to borrow because of its constitutional powers. Industry has been able to finance its expansion because its regular source of income—from sales of its products—responds quickly to greater demand via higher prices or increased physical volume or both.

State and local governments, however, rely predominantly on revenues which respond sluggishly to both increased over-all activity and increased consumption of public services. As the first chart indicates, about one-fourth of state-local revenues depends on sales and income taxes. A little more than a fourth comes from taxes and charges on the users of particular facilities—such as gasoline and vehicle license taxes and tolls on highway users, publicly-owned water, electric, and gas utility charges, and transit fares. Almost one-half comes from property and other similarly unresponsive taxes.

Variations in sensitivity

Actually, even this comparison overstates the sensitivity of state-local revenue systems. For one thing, these figures are totals for all state and local governments combined, and state governments account for about 90 per cent of the income and sales tax collections and almost half of the user-charge collections. Thus, local government revenue systems by themselves are far more unresponsive. For instance, school districts get over nine-tenths of their locally raised revenues from property taxes.

Furthermore, not all the taxes considered to be responsive have the same degree of sensitivity. General retail sales tax revenues have risen about proportionally with over-all economic activity during the past decade, while income tax receipts have risen more than proportionally even after adjusting for rate increases and the reductions in personal exemptions which have affected yields even more than rate changes. Much state sales tax revenue comes from *selective* rather than *general* consumption taxes, such as those on liquor and tobacco. Selective sales tax rates typically take the form of a specified number of cents per unit sold rather than a percentage of the selling price, so they reflect only larger physical volume, not higher prices. This is also true of some user charges like gasoline taxes.

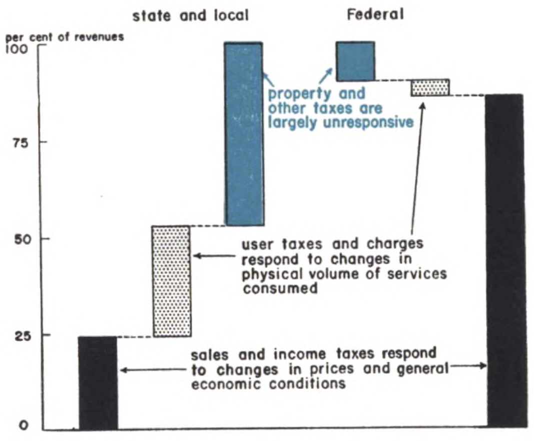
Greater use of sensitive taxes

Not too much relief from the present and prospective demands on state-local revenue systems can be expected from greater use of sales and income taxes. All but four states even now rely heavily on either general sales taxes or personal or corporate income taxes, and half the states use both general sales and income taxes. With Federal tax rates at or near all-time peaks, state governments probably will not raise their own taxes on these same bases.

If, however, the defense spending burden eases and Federal tax rates are cut, some states might increase the rates of their comparable taxes, particularly those on liquor, tobacco, and gasoline. The increased rates of these excises and numerous other rate increases imposed by the Revenue Act of 1951 are all scheduled to expire within 15 months. Increasing the rates of selective excises, however, is no solution to the revenue problem, since they are not very sensitive and their yields are small relative to the needs.

Although local governments, particularly the larger cities, have turned to nonproperty taxes in the past 20 years, the practical possibilities for local use of sales and income taxes are

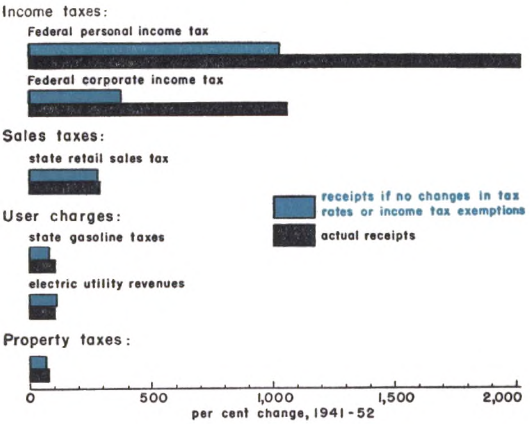
State-local revenue systems largely dependent on inflexible taxes



limited. The main reason is that cities can tax only the sales that occur and income that is earned within its boundaries or received by its residents. The trend toward decentralization suggests that a growing share of the economic activity in a metropolitan area occurs outside the boundaries of the central city. City taxes on income or sales would encourage this trend. Any one of a large number of suburban areas including even unincorporated areas can provide a tax-free haven if rates are high.

Sensitivity in tax bases cuts two ways: revenues increase rapidly in prosperous periods, but they also decline rapidly when economic conditions take a turn for the worse. And the responsibilities of the state and local governments typically expand rather than contract in recession or depression. This is because the relief and public assistance rolls rise sharply, while expenses for public safety activities, the schools, and the mental hospitals decline little, if at all. Under these conditions, even when construction outlays are cut back—and this is often not wise though necessary—borrowing may be necessary to meet current expenses. But state and local agencies, unlike the Federal Government, cannot borrow

Even aside from rate increases, receipts from Federal taxes have increased far more than state-local



at will. Under these conditions, state-local dependence on relatively inflexible tax sources has a certain advantage, although fostering this particular kind of rigidity is not good for the economy as a whole.

Pricing state-local services

Perhaps the most promising financial development for state-local government would be an expansion of the scope and increasing the rates of user charges. Governments provide a wide variety of services and facilities which are essentially commercial-type operations. That is, in these cases, the public agency's objective is to give the users the services they want and will pay for, rather than to provide the service to the entire community regardless of particular citizens' willingness or ability to pay for the service.

If public agencies priced their quasi-commercial services the way private utilities or businesses do, the financial problems would become much more manageable. Growing demand for a specific facility—for example, highways—would be reflected in higher prices or user tax rates and a greater volume of consumption, both of which mean greater revenues. Unfortunately, state and local governments typically have failed to use the price system to the extent possible, and consequently, have also failed to raise the funds to provide the facilities desired by users.

In the absence of a pricing system, users are commonly not aware of how little they may be spending on public services relative to other things. Highways, for example, are cheap relative to the other costs of automotive transportation. Highway user taxes, that is, the cost of highways to the motorist, are typically only about one-twelfth of the total costs of owning and operating an automobile, considerably less than the usual outlays for garaging and parking, or for insurance, or for repair and maintenance. The highway cost component of the average seven cents a mile total cost is only about six-tenths of a cent. Moreover, highway tax rates have risen less than 20 per cent since prewar while other automobile costs have nearly doubled.

The introduction of special charges on users of quasi-commercial facilities has been spreading in recent years. This growth has been most apparent in the cases of sewer service charges, landing fees and rentals for the use of airports and other publicly-owned terminals, and toll financing of roads. Toll road experience, in particular, indicates how much some users are actually willing to pay under a price system for superior facilities, since typical toll charges are equivalent to tripling the usual gasoline tax rate. There is much room for further expansion of user-charge financing, however, especially of highways and water and sewer systems.

More municipals?

Local governments customarily finance their capital outlays by borrowing while most state government construction activity, in particular highway construction, is financed from current revenues, especially in the Midwest. Recently all types of governments have been borrowing heavily for public works projects, even some

Midwestern state governments.

Increased borrowing, however, supplements current revenues only in the short run. Eventually the debt must be paid off from current revenues. So over the longer-run, the expenditures of state-local governments are more or less limited by the yield of their tax systems plus whatever Federal aid they receive. With the large volume of borrowing of the postwar years, debt service requirements are rising sharply and will increasingly offset the additional fiscal resources made available by borrowing.

Federal grants

Federal grants and loans for state and local public works will total about 800 million dollars in the current fiscal year, about two-thirds for highways and the rest for schools, airports, hospitals, and public housing. These funds provide about an eighth of total state-local construction outlays. Under present legislation, highway aids will increase somewhat in the next two years, but most other Federal aids may decline.

The Federal Government's own fiscal difficulties make it unlikely that large-scale increases will be enacted, unless defense spending should decline or economic conditions worsen significantly. In the latter case, the need to improve the state-local capital plant is so great and plans for many worthwhile individual projects are so far advanced that increased Federal aids would undoubtedly again be used to combat recession.

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Consumers spur loan growth

Increased consumer borrowing was a major factor in the more than seasonal fall bank loan rise.

TOTAL LOANS OF BANKS in the nation's leading cities rose 3,160 million dollars between June 25 and the close of last year. This increase was nearly 20 per cent larger than during the comparable period of 1951, and was second only to that which occurred in the months immediately following the outbreak of war in Korea. Many observers had expected the fall loan rise to be somewhat smaller than during 1951 and perhaps little more than would be anticipated seasonally.

Movements in the total of bank loans, of course, conceal a diversity of changes in loans to individual types of borrowers. A rough idea of the magnitude of these fluctuations is provided by reports from a number of big-city banks which classify loans by industry groupings. Changes in outstandings for the categories contributing most to the difference in the total loan rise which occurred in the last half of 1952 as compared with 1951 are as follows:

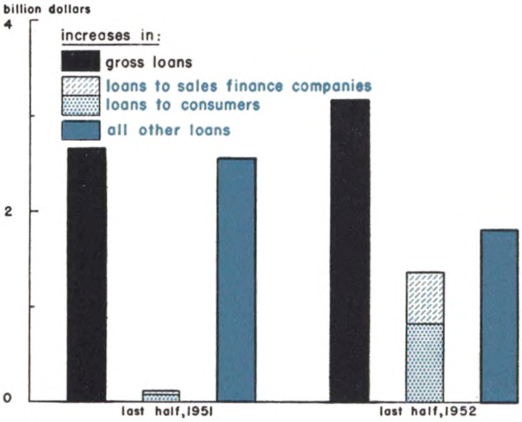
	Net change Millions of dollars 1952	1951
Food, liquor, and tobacco..	+750	+930
Commodity dealers	+660	+720
Metals and metal products..	+5	+870
Utilities and transportation..	−30	+350
Textiles, apparel, and leather	−40	−360
Sales finance companies....	+530	+30
Other (consumer) loans....	+820	+80

These diverse movements appear to fall into three groupings. First are loans which were distinctly seasonal in character. Food, liquor, and tobacco company and commodity dealer borrowings increased by substantial amounts in both years and clearly are in this category. The second group includes loans which were influenced largely by non-seasonal developments. Loans to metals and metal products manufacturers and public utilities and transportation companies remained virtually unchanged in the second half of 1952, in sharp contrast to the rise which occurred in the previous year. The levelling in loans to these industries did not result from declines in output and activity. Rather it reflected changes in financial requirements stemming principally from a slowing up in the defense-related accumulation of inventories and substantial increases in long-term security flotations. On the other hand, loan balances of textile, apparel, and leather firms were maintained last year as against a sizable drop in late 1951. This reflected a basic pickup in activity for these lines of business.

Finally, the more than seasonal expansion of loans at big-city banks last fall can be traced largely to an abrupt shift in the movement of consumer-related loans. Such borrowings take two forms—consumer loans made directly by banks, and loans made by banks to sales finance companies which enable the latter to finance dealers' inventories of consumer durable goods and to increase their extensions of instalment credit to consumers for purchase of these goods. Both loans to sales finance companies and "other" loans (which consist largely of instalment loans to consumers) rose sharply in the latter part of 1952. Together, they accounted for more than 40 per cent of the total loan rise at big-city banks, as compared with 4 per cent during the last half of 1951. The rise in all other types of borrowing combined was 30 per cent smaller than in 1951.

The expansion in direct and indirect consumer borrowing at banks reflected an upsurge in buying on the time payment plan. In the 18 months from October 1950 through March 1952, total consumer instalment credit declined by 200 million dollars. In the following eight

Consumer loans accounted for much of the loan rise at large city banks



months, this type of credit increased 2,700 million dollars, a gain of more than 20 per cent.

Ending of controls over instalment credit terms last spring appears to have been the principal causal factor in the subsequent rise in this type of borrowing. Renewal of the upward movement in instalment credit coincided closely with the ending of Regulation W last May, just as the earlier period of stability had coincided with imposition of the controls in September 1950. The general and substantial relaxation in down payments and especially monthly repayment requirements which followed suspension of controls would be expected to attract new marginal buyers and encourage liberal use of credit. Moreover, the increase in instalment buying has not been accompanied by a basic expansion in the demand for consumers' durable goods. While total expenditures for such goods declined moderately from 1951 to 1952, new extensions of instalment credit for all consumer purposes rose by roughly one-fourth.

Thus, it seems clear that removal of Regulation W played an important part in the more than seasonal bank loan rise last fall.

After 1953 *continued from page 4*

The reports play down the significance of expenditures on new plant and equipment as a causative factor in the business cycle. It is believed that these outlays will remain at good levels if demand for the products of industry remains high. In a sense the findings on capital spending plans are the most encouraging aspect of the report. Nevertheless, a reduction from recent rates is doubtless in store.

Consumer demand, in total, is less sensitive to changes in income than is business investment. But "because of their magnitude, the dollar fluctuations in consumer expenditures often exceed those in all other markets combined." Here then is the real key.

Individuals hold relatively less liquid assets and have more indebtedness than a few years ago, but their financial position is still considered better than in earlier periods. Although household goods and automobiles have been provided at a rapid rate in recent years, the Commerce report states that there is "more reason to anticipate a rise than a decline in the spending-income ratio" of consumers.

The NPA study emphasizes that because of higher living standards under prosperity "a considerable portion of consumer demand has become almost as volatile as business outlays for plant and equipment." This largest sector of demand, moreover, cannot be "planned" by a limited group of persons, but must remain subject to individual decisions of 50 million spending units.

The most important individual decisions affecting over-all activity are those which determine the number of new housing starts. These are currently at an annual rate of about 1.1 million. The Commerce study suggests a decline to about 750,000 by 1955. NPA hopes for 1.1 million per year to 1960, and the Joint Committee report sees a "need" for 1.4 million units each year during the next eight years. The more optimistic projections of housing starts, however, contemplate further Government action to encourage construction.

Congress and full employment

Despite stabilizing factors now present in the economy, it is evident that several important segments of private spending may be headed for a decline within the next two or three years. If this occurs at the same time that military outlays begin to recede, a considerable amount of unemployment could develop. The resultant drop in purchasing power would transmit repercussions throughout the economy.

Such a sequence of developments is recognized as a possibility by the drafters of the reports under review. Some of the effect would be offset by tax reductions. However, stimulus to demand provided by tax cuts might not be sufficient to offset the decline in military and private spending. Each report, therefore, turns to the text of the Employment Act of 1946 which states: "The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practical means . . . to promote maximum employment. . . ." According to the business-sponsored NPA, the "responsibility of Government for general economic stability is no longer seriously questioned."

The Commerce report "deliberately" refrains from considering what steps may be taken, but states that "Continuing Congressional concern . . . gives assurance that any pronounced downturn will be met by vigorous efforts. . . ." The other studies emphasize the need to maintain a "checklist" of desirable Federal spending projects with careful consideration of their relative usefulness so that the desire to offset a business decline could bring real benefits to the nation in terms of urgently needed facilities.

All of these surveys have been based upon the assumption that defense outlays will be lowered in the next few years. If such a course can be followed, it will mean that a much greater danger than business recession—full-scale war or a pronounced step-up in the existing international tensions—will have been averted.

Christmas trade

JANUARY is always a blue month for department stores. Traditional white goods sales and special clearances ordinarily are not enough to prevent the first month in the year from being the slowest in total volume. Usual January gloom this year, however, was brightened by a good level of sales adjusted for seasonal trends and by memories of the extremely favorable Christmas business just past.

Preliminary estimates indicate that December dollar sales of District department stores exceeded those of the previous year by over 9 per cent—a performance probably better than the national experience. Results are especially impressive when it is recognized that prices of goods sold by these stores were lower by about 3 per cent than a year earlier. Lower prices were particularly noteworthy for apparel and household appliances. There also appeared to be a trend toward purchases of less luxurious gifts. As a result physical volume of sales was by some margin the best ever.

Gift sales make the year

Christmas trade strongly colors the entire year's results of merchants whose sales are concentrated in this period. Dollar volume in December at department stores is usually about 14 per cent of the total for a year. This is 40 per cent more than the business done in November, the next highest month, and well over double the usual January sales. The entire Thanksgiving-Christmas season normally accounts for almost one dollar in five of yearly volume.

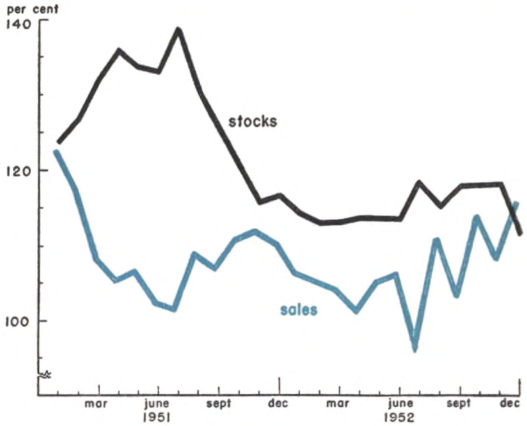
For certain departments, such as men's furnishings, records, books and stationery, jewelry, and toys and sporting goods, one-fourth or more of the entire year's business is done in the month of December alone. These items help swell the total, but the bread and butter of department store trade at Christmas time, as in other seasons, is apparel and accessories of all types. These departments account for half of total volume through most of the year.

Homefurnishings strong

The strongest sales trends during December aside from the usual gift items were noted in the apparel and homefurnishings departments. Appliance sales were particularly encouraging following a generally mediocre fall. Early reports suggest that sales of most types of "plug-in" items continued active into January. Inventories of these goods on January 1 were lower by about one-fourth than at the start of 1952.

Total stocks were reduced more than seasonally during December with the result that goods-on-hand at the start of 1953 were about 4 per cent less than a year earlier. Inventory policy of department stores was conservative throughout 1952 and seasonally adjusted holdings had remained steady during the September-November period. Cautious pre-Christmas ordering meant that stocks of many types of goods became scanty during December. Hurried reordering was undertaken by many stores but some sales were lost because of inadequate supplies of merchandise.

District department store sales boomed at year end, stocks declined



Seasonally adjusted, 1947-49 = 100