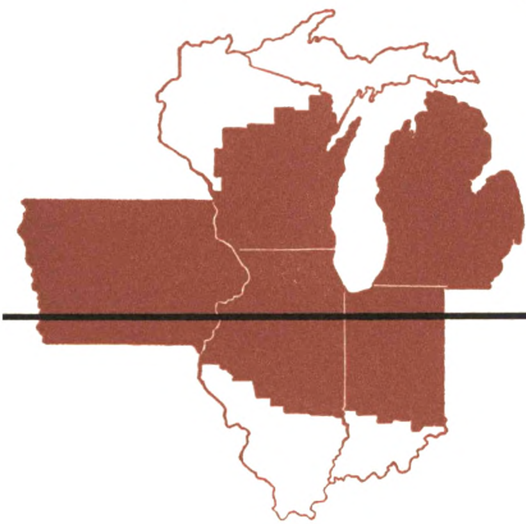
A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1953 March



Contents

THE Trend OF BUSINESS

Price ceilings lifted but ample supplies indicate only nominal effects for most goods.

After more than two years of troubled existence, price controls are rapidly fading from the economic scene. Some price increases already have occurred, but the possibility that the demise of controls will bring advances on a broad front appears remote. However, lifting the lids will reveal upward pressures in some parts of the economy.

Piecemeal decontrol had begun well before the State of the Union message on February 2. But after the President's decision "not to ask for a renewal of the present wage and price controls", the process was greatly accelerated. By April 30 when the present legislation expires, the price-wage control mechanism will be largely dismantled.

As early as last September only 75 per cent of all wholesale market transactions were covered by ceilings, and many of these items were selling below allowable levels. Since then further price declines have taken place, principally in farm products. Most imported raw materials which spurted dramatically after Korea have been deflated rather thoroughly. Moreover, business trade publications are filled with warnings of the "hard selling" necessary to move the larger production made possible by expanded facilities and easier material supplies.

Wholesale vs retail

Stabilization officials have a large backlog of applications from firms desiring price adjustments. Nevertheless, the full effect of releasing goods which have been pressing against ceilings will be realized only gradually. The announced policy has been to decontrol product groups selling below ceiling first. In addition, many firms will deliberate carefully before deciding upon new price policies.

Some types of machinery, electrical equipment, sulphur, cement, steel, copper, and aluminum are not in adequate supply at present prices. Removal of controls doubtless will bring sizable hikes for some of these goods. In other cases increases will be moderated by a desire to avoid adverse public reaction and to forestall wage demands.

A glance at a chart of average wholesale prices shows a gradual falling trend for two full years. Closer analysis, however, reveals that the lower average price level has been almost entirely the result of adjustments in farm products and certain industrial raw materials. Cotton, zinc, and meat animals, for example, are selling for substantially less than at the start of Korean hostilities.

Wholesale prices of processed goods which are not strongly influenced by the costs of raw materials, in most instances, have been holding firm or rising during the two year decline. Markets, in general, have been strong and many business firms, finding that margins were pinched by higher taxes and other costs, attempted to increase prices during this period.

Among consumer goods, cigarets and gasoline have been mentioned most prominently as likely candidates for price increases. The vast majority of consumer goods producers, however, appear to be apprehensive of the market reaction to price boosts under present conditions. These attitudes could be changed by the cost push resulting from wage increases and higher prices of industrial goods.

In the meantime, housewives are enjoying substantially lower prices for foods, particularly meats which are 15 to 20 per cent below previous highs. Also, costs of apparel and homefurnishings are less than a year ago. The 1 per cent rise in the "cost-of-living" index which occurred during 1952 was, in the main, a result of increases in rents and services.

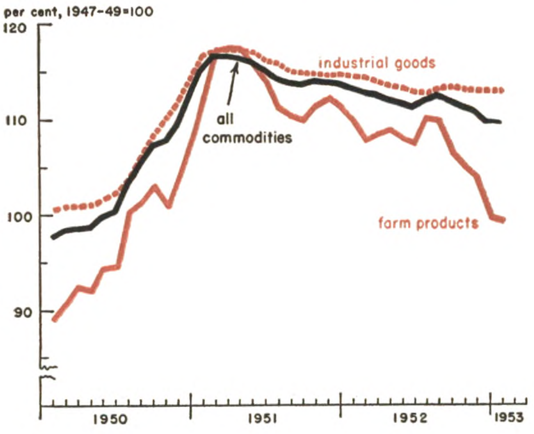
Wages bear watching

By executive order on February 6 all wage and salary controls were eliminated. In contrast to the situation prevailing for many types of goods, the supply of civilian workers has not increased appreciably in the past two years. Recent months have witnessed the tightest labor markets since World War II.

Although labor of human beings is not a commodity, pay check size is obviously subject to forces of supply and demand. Many wage boosts have been prevented or delayed during the control period, despite wide publicity given to certain breaches in the dike. At the present time, important union contracts are coming up for review and attempts are being made to reopen agreements having one or more years to run. Some firms operating nonunion shops are already raising wages in order to compete more successfully for available workers.

A general round of wage boosts coupled with increased costs of supplies could push certain retail prices to higher levels or prevent cuts which otherwise would have occurred. Moreover, the greater purchasing power resulting from larger take-home pay may help to sustain higher price policies. Should labor-management disputes over wages result in extended work stoppages, the resultant loss of production would introduce an additional force tending to strengthen prices.

Wholesale prices in two-year decline



Toward freer markets

The American economy has never taken easily to a harness of direct controls. This has been true even in time of full-scale war when patriotic motives inspire cooperation. Governmental restrictions applying to millions of business firms will always be fraught with difficulty.

The outlook for price stability has vastly improved since January 1951 when the general freeze was first invoked. That month was the blackest of the Korean crisis. American forces were in retreat from the Yalu River and General MacArthur's command was faced with "an entirely new war."

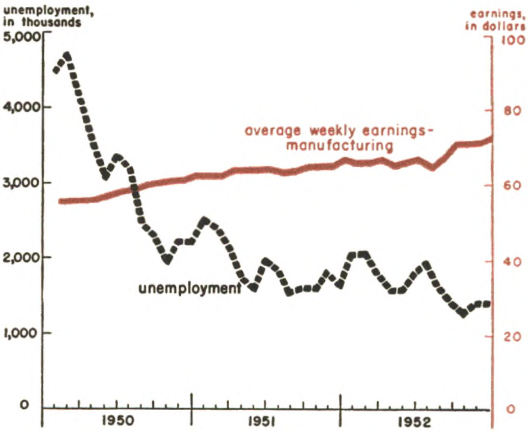
Programs for military and industrial expansion, launched two years ago, are well along the road to fulfillment. Military outlays have doubled during this period, and the armed forces have been greatly strengthened. Moreover, the Korean battle line has been stabilized and no hostilities involving American troops have begun elsewhere.

Under these circumstances it has been considered feasible to "stretch-out" the original timing of the rearmament plan—thus lessening the impact upon civilian activity. The task of price controllers during the past two years also has been eased by a tighter national credit policy and the increased flow of goods from expanded productive facilities. In short, direct controls over prices and wages, which according to President Eisenhower have "a role to play . . . in times of national emergency," now appear unnecessary.

The Administration apparently intends to place primary reliance upon fiscal policy and general monetary controls as bulwarks against a possible resurgence of price inflation. Initial steps have already been taken to lengthen Federal debt maturities and to allow higher interest rates. The Administration also has taken a stand against tax cuts which would prevent budget balancing.

It should not be supposed, however, that all economic curbs are a thing of the past. At the present time, bills are under consideration to provide "stand-by" controls so that price and wage ceilings could be reimposed quickly should international tensions worsen. Moreover, military priorities and allocations for some scarce materials doubtless will continue beyond their present expiration date, and rent controls in particularly tight areas are likely to be retained.

Tight labor market raises wages



Aid through trade

Increased foreign trade essential to reduction of foreign aid and maintenance of world economic stability.

THIS IS A PARTICULARLY CRUCIAL MOMENT for American foreign economic policy. Events combine to make the next few months a time for decision. In the first place, we have a new administration in Washington. Secondly, a world-wide shortage of dollars still exists despite the progress achieved through our foreign aid program, and thirdly, the Trade Agreements Act, under which our tariffs have been revised in recent decades, expires in June. Thus, the issue that now confronts us is the adoption of a policy appropriate to this nation's position of leadership in the world economy.

For many years, we have been what is called a surplus or creditor nation. In the postwar period, our exports have outrun imports at the rate of about 5 billion dollars. At the same time, from July 1945 to June 1952 foreign economic aid amounted to about 34 billion. In short, our export trade has in large part been financed by the American taxpayer. Public opinion will not permit an indefinite continuation of foreign aid. The Europeans themselves have no wish to continue as recipients of charity. We must, therefore, look anew at the facts and formulate a long-run policy that makes sense in light of these facts.

Some progress already made

We all agreed that after the war the reconstruction of Western Europe was of prime

---

Excerpts from a speech by John S. Coleman, Chairman, Board of Directors, Federal Reserve Bank of Chicago, before the Chicago World Trade Conference on February 18, 1953. Mr. Coleman is also president of the Detroit Board of Commerce and of Burroughs Adding Machine Company.

interest to the U. S.; and to this end we supplied billions of dollars of aid to the countries of Western Europe to develop their industries to the point where they could stand on their own feet and pay for the dollar imports they needed. Yet, some failed to see that this implied more U. S. imports, more foreign competition in our own markets.

In order to carry out the rehabilitation program in Europe, we needed a program of domestic action. It was incumbent on us to clear away those obstacles that prevented European industries, so carefully nursed back to life, from earning dollars by fair competition in our markets. This action was required not only to complete the logic of the Marshall Plan, but also by that philosophy of free enterprise and free competition whose virtues we so often proclaim to the world as the foundation of the American way of life.

We have made some strides toward implementing this aspect of the European Recovery Program. As a result of bilateral negotiations under the Trade Agreements Act and as a result of multilateral negotiations under the General Agreements on Tariffs and Trade (GATT), the average ad valorem equivalent of U. S. duties on dutiable imports has decreased from 25.8% in 1934 to 13.3% in August 1951. In fact, by 1949 concessions had covered about 95 per cent of our dutiable imports.

Much room for improvement

This may seem to be a creditable achievement, and it is. Yet, it is not enough. Much more remains to be done. Today, there are more than 3,500 duties still in effect. Of these, some 492 exceed 50% of the value of the import while several hundred are of 25% or more. Many rates, such as those on coal tar dyes, are virtually prohibitive. It is astonishing to discover that we have duties on valuable raw materials not available at all or in insufficient quantities in the U. S. There is, for example, a duty of 20 cents per pound on manganese, 50 cents per pound on vanadium, 60 cents per pound plus 40% of its value on tungsten.

At a time when we are spending large sums in order to stockpile important raw materials, we are, at the same time, placing obstacles in the way of their importation. Moreover, much important machinery and essential chemicals not available in the U. S. must be imported over a tariff barrier.

Even the progress that has been made rests on very shaky ground. The tariff reductions have never been enacted into the law of the U. S. They rest on the weak foundation of trade agreements which can be easily overturned, indeed almost at a single stroke.

On June 12 of this year the Trade Agreements Act will expire. Even if that Act is renewed, however, it should be remembered that in its present form it is a very imperfect instrument. Tariff changes are limited to 50% of the rates in effect on January 1, 1945. Furthermore, the peril point amendment can be used by interested parties to prevent tariff reductions. If that pressure is not successful, they can later seek withdrawal of any tariff concession by means of the escape clause which made injury to a domestic industry sufficient reason for withdrawal or modification of a concession.

In other words, we grant a tariff concession, and as soon as our friends overseas take advantage of it and by fair competition expand their market, we then threaten to withdraw the concession.

Tariff barriers are not the only obstacle to free trade. The uncertainty of our tariff policy as well as the actual level of duties, combined with the terrifying complexities of custom procedures and packaging requirements, discourage many foreign manufacturers from venturing into the U. S. market. For example, it is now possible to import an article, pay its duty, and distribute it at a certain markup, only to be presented sometime later with a bill for supplementary duties. A later decision that the article was classified or valued incorrectly may wipe out all the profit and leave the importer in the red. It seems that only too often our declared policies of promoting trade are thus denied by day-to-day practices which critically add to the already serious risks involved in international trade.

Transition period necessary

The most compelling argument for protection is to maintain an industry which can be proved essential to national defense. But even then the degree of protection must be strictly limited to the needs of security.

We must, of course, consider the effects of tariff reductions on existing industries. Investors have made investments in good faith and many workers depend for employment on protected industries. A specific program would be needed to deal with the problems of adjustment. Though there is no simple prescription, several possibilities have been suggested.

Tariff reductions must be gradual in order to make the adjustment as painless as possible. We are not advocating giving a violent shock to the protected areas of our economy. Rather, we are proposing that, just as competition brings about shifts from less to more profitable lines of business in the case of unprotected industries, so industries now insulated from competitive stimulus must also be prepared to move from less to more productive operations. There is nothing new or unusual in this. The adjustability of the American economy to changing conditions has always been the key to its progress. The final result has been, as we have often told the world, incomparably greater productivity and a higher standard of living.

U. S. must assume lead

These are reasons enough to warrant the most energetic action in the field of trade policy. But there are others just as compelling. Important as the achievements of the European Recovery Program have been, international economic stability still eludes us. The central purpose of American foreign policy is to build a community of nations strong enough to meet the Soviet threat. Though we have taken important steps to bring that community into being, it is clear that we have failed to provide it with a solid economic foundation. The free world cannot be strong while its components barricade themselves against each others' goods. Yet, if these economic compartments are to be broken, the U. S. alone can give spectacular and decisive leadership.

The magnitude of the American economy, its great resources, its high productivity, and rapid technical progress together create a basic tendency for our exports to outrun our imports. Though the world catches up in this or that field, industrial America develops even more new or improved products to tempt the overseas consumer. And even when other countries share the pioneering work, as in the jet engine or atomic energy, it is American technology which puts these products into mass production. Thus, the shortage of dollars is likely to be persistent, inasmuch as it is basically due to the growing superiority of the U. S. in the production of many of the goods essential to continued economic development.

In this situation there is no room for half measures. They simply will not do the job. The world can earn the dollars necessary to maintain international trade at a high level only if we practice the principles of free competition that we preach.

The free world must have arms, trained armies, and modern weapons. But it still will not be strong while economically it staggers along from crisis to crisis. Our hopes have not as yet been fulfilled. But our objective is not unrealistic—it can be achieved. We are in a position, quite apart from free gifts, to give great help to the rest of the world by policies which will at the same time enhance our own welfare. If we follow enlightened trade policies, and our friends overseas follow monetary and fiscal policies appropriate to deficit countries, we can together do the job.

Land values pass peak

Declining farm product prices have halted the boom in farm real estate; a slow settling of values is indicated for most areas.

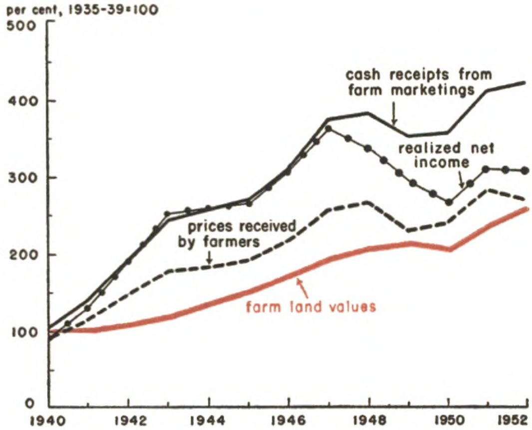
THE CLOSING OF THE CHRONICLE FOR 1952 noted that the post-Korea upsurge in farm land values had lost its steam and that the boiler, no longer being stoked with rising farm income and waves of inflation fears, was growing cold. Country bankers in Illinois, Indiana, Iowa, Michigan, and Wisconsin report few farms changing hands and small declines in selling prices.

Buyers take their time

The dull market in farm land finds both prospective buyers and sellers waiting for more positive indications of future developments before moving ahead. Those owning land, for the most part, continue to realize favorable returns and see little reason to shift their investment into some other type of asset. The number of farms offered for sale is in marked contrast to the dearth of offerings a year ago, with sellers showing no urgency to dispose of their holdings and offering little in the way of price concessions. Prospective buyers, on the other hand, are pretty well convinced that the upsurge in land values has run its course and are in much less of a hurry to buy than had been the case in most of the preceding two and a half years.

The inflation-generated demand which drove prices up sharply on two occasions in the postwar years has disappeared. Inflation fears have been put to bed for what may be either a long sound sleep or fitful cat naps, but in either event the effect for the present has been to slow the flow of money into farm real estate as an inflation hedge. And with farm product prices trending downward, the pressure on net farm income provides little content for a "buy before prices go higher" sales slogan.

Land values respond to changes in farm product prices and income

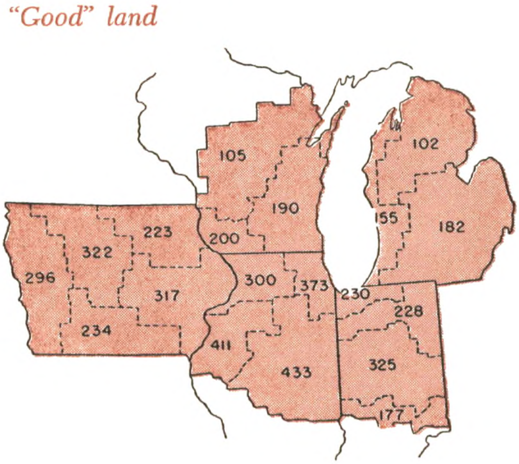


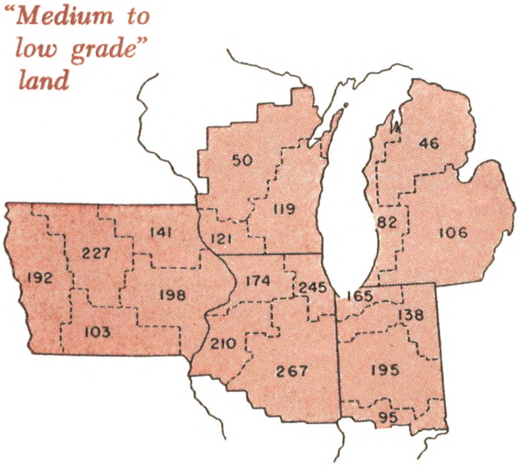
Thus, important changes from the current level of farm real estate values are likely to occur only in the wake of a further accumulation of farms for sale and a step-up in urgency of present owners to conclude sales or from some incident, probably international, which would touch off another upsurge in farm product prices and farm income.

The postwar rise

Farm real estate values responded to the general inflationary pressures which spread through the economy in most of the war and postwar period. Interestingly enough, the widespread concern over the 50 per cent rise in land values during the war years receded as fears of an early postwar recession evaporated. The World War I aftermath of farm mortgage foreclosures was recalled less and less frequently in farm outlook discussions as were prewar prices and land values. Farmers as well as

Average selling prices of farm real estate, dollars per acre





lenders and farm real estate appraisers were cut adrift from their previously well established concept of "normal" prices for farm products and land where "normal" depended mainly on historical price levels and relationships.

In this atmosphere, and supported by a very sharp rise in farm product prices and farm income, land values increased nearly 40 per cent from 1945 to 1949. The upsurge was terminated, as usual, about a year following the downturn in farm product prices that got under way in 1948. Relative to usual rates of change in farm real estate values, the 1949 decline was sharp and caused some concern.

But the downturn in land values was very short lived; it lasted only about a year and lopped off about one-eighth of the 1945-49 rise. By the end of 1949 there was some indication that the downtrend in farm product prices had run its course. Farm real estate values turned slowly upward again. But what appeared to be the beginning of a restful period of moderate up and down fluctuations was again short lived, being terminated by the outbreak of hostilities in Korea in mid-1950.

Here was war again. And following their recent experience with inflation, farmers and city investors alike turned promptly to farm real estate as an appropriate hedge. The prospects for windfall profits to agricultural producers were, of course, an additional attraction. In areas adjacent to large population centers—possible targets for globe circling carriers of atom bombs—the demand was intensified by a scramble to "obtain a place in the country" to which one might retreat and subsist in case the worst should happen.

Values too high in some areas

The combination of these forces caused farm real estate values to rise at an unprecedented rate and, of course, to unprecedented levels. The increase from mid-1950 to mid-1951 averaged 17 per cent for the U. S. and the uptrend continued, although at a slower pace, to mid-1952. Most important, the rise in farm income during this period failed to keep pace with the result that values in some areas reached a level that probably will not be maintained by current or prospective levels of farm income.

Historically, the percentage increase in land values during periods of sharp price rises is only about half as large as that in gross farm income. Thus, a stabilizing of farm product prices at current levels would be expected to result in some easing of land prices, especially in light of the growing pressure of high production costs.

Not all areas will have the same experience, however. The rates of increase and decline vary in response to the differing impacts of the factors affecting land values. And it does not necessarily follow that those areas which have experienced the greatest rise would suffer the greatest decline in a recession.

There is growing evidence, however, that the U. S. agricultural economy at this time has more than adequate productive capacity for such things as wheat, cotton, tobacco, and fats and oils. These commodities have experienced, in addition to an active domestic demand, a very large export demand over the past decade. It is not accidental, therefore, that land values in the winter wheat and tobacco areas have increased more than two and a half times above their 1935-39 levels, and that land in the cotton area has increased by about two and one-fourth times. In the Corn Belt and general farming areas, values increased nearly twofold while dairy, spring wheat, and northern cutover areas showed less than the U. S. average increase of about one and one-half times.

The District states

Land value increases in Seventh District states fall into the pattern indicated above for general type of farming areas. For individual states the percentage increases for selected periods were as follows:

	1935-39 to 1952	1950 to 1952
Illinois	202	32
Indiana	232	32
Iowa	169	25
Michigan	176	24
Wisconsin	100	17

Michigan values have been influenced relatively more than those of the other states by city workers' purchases of small farms for country residences. Wisconsin values, of course, reflect the less favorable returns from dairy than from other types of farming in most of the war and postwar years. In part, the lesser rise in Wisconsin land values also reflects the greater stability of dairy income in contrast to other types of farming. Consequently, Wisconsin farm land was relatively less depressed in the prewar years than that in other District states.

There is some doubt that this historical pattern of relatively stable land values in established dairy areas will continue to hold true. The tremendous improvement in the competitive position of vegetable fats and oils in recent years has an adverse effect on the outlook for some dairy products. Expansion of dairy production in other areas also promises to provide increased competition with present areas. This, and other technological developments may affect land values markedly in some areas in the next decade.

Export demand will have an important effect on land values in areas specializing in the production of products which have enjoyed large foreign markets in recent years. Within District states, soybeans are the major example. Unlike much of the wheat, cotton, and tobacco acreage, however, most soybean land has a very close alternative use.

Changes in population, consumers' food preferences, export requirements, real estate taxes, transportation costs, and weather will also influence U. S. land values, the impact of each varying by area. But the net result of all these forces probably will not result in large over-all increases or decreases. The major swings in farm real estate values in the U. S. have been closely associated with large changes in the "general price level"—the value of money. This will continue to be true. In the absence of important overriding developments of this nature, a gradual settling of values is indicated, at least for the year ahead.

Price problem in wheat

FARMERS ARE WATCHING with keen interest the Washington negotiations between wheat exporting and importing nations. As the 1953 harvest gets under way, the carry-over of wheat from previous crops will be nearing the 600 million bushel mark, more than double the year-earlier figure and nearly a full year's domestic consumption. In this situation, declining exports are alarming to wheat farmers.

An important crop

About one-fifth of U. S. cropland is planted to wheat. The annual harvest, given favorable weather, regularly exceeds a billion bushels. The value of the crop varies with changes in output and price but has hovered at about the 2 billion dollar mark in recent years, although it exceeded 3 billion in 1947 and approximated that figure again in 1952.

While production has dropped below a billion bushels only once since 1943, and ranged up to nearly 1.4 billion in 1947, domestic uses of wheat add up to only about 700 million bushels a year. Thus, one-third of the crop is available for export. With importing countries clamoring for wheat in most postwar years, exports have figured importantly in the unprecedented prosperity of wheat farmers.

In the absence of governmental interference, the price received for exported wheat would largely determine domestic prices. But since the adoption of "parity" as a price goal for agriculture and the initiation of price support programs for "basic" crops, the domestic market for wheat need have only an arms-length relationship with prices in other countries, except in periods when the "world price" exceeds the domestic support level as it has in much of the postwar period.

Exports subsidized

Since 1948 a large part of our wheat exports have been under the International Wheat Agreement. The announced objectives of the IWA are "to assure supplies of wheat to importing countries and markets to exporting countries at equitable and stable prices." Briefly, the Agreement provides that exporting countries supply agreed amounts of wheat to importing nations at no higher than the "maximum" price set in the Agreement while the latter guarantee to buy such amounts at prices no lower than the "minimum." The maximum price is $1.80 a bushel, equivalent to about $1.50 at U. S. farms. The U. S. is required to provide at least 255 million bushels a year at this price if member nations request it. When the "world price" is above the Agreement maximum, such requests are, of course, made. Should prices drop below the Agreement minimum of $1.20, equivalent to about 90 cents to U. S. farmers, the U. S. could insist that importing countries accept 255 million bushels of our wheat at the minimum price.

The wheat price and export picture, complicated even in its most simple form, has been taking on more and more of the characteristics of a jigsaw puzzle. Wheat prices are supported domestically at 90 per cent of parity through a loan program carried on by the Commodity Credit Corporation. This now averages about $2.20 a bushel at farms and provides a fairly rigid floor under U. S. wheat prices at that level.

United States' compliance with the Agreement over the past four years, therefore, has involved export subsidies on wheat shipped to member nations. These have run much higher than was expected when the Agreement was negotiated, averaging 63 cents a bushel and totalling about 600 million dollars in four years.

Agreement expires

The four year old Agreement will expire July 31. Unless renewed, the 1952 harvest will be the last one covered. A month-long siege of negotiations pointing to the renewal of the Agreement was held in London last April but ended in a deadlock between exporter and importer interests. More recently, representatives of the 46 member nations have met in Washington to re-examine possibilities of continuing the present Agreement or negotiating a new one.

The major difference between these negotiations and those which go on daily on used-car lots across the nation is that one involves individuals dealing for themselves, while the other involves representatives of the governments of nations. Also, insofar as negotiated prices depart from the "free market price" at which wheat would be traded, government action is implied to make the agreement effective.

United States and Canada—the major exporting nations—are insisting on a higher maximum price than the $1.80 provided in the present Agreement. Their objective is to reduce the amount of subsidy now required to reconcile export prices with domestic support levels.

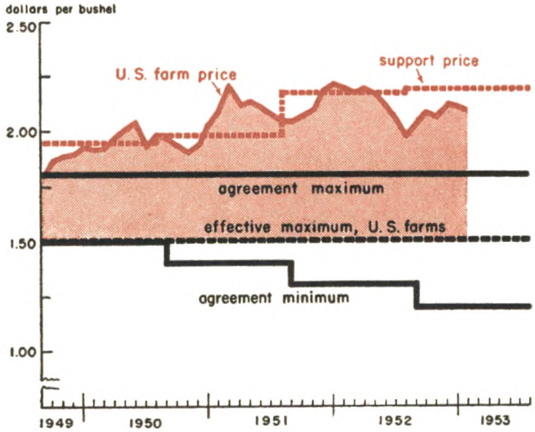
England, the major importing nation, accounts for about 30 per cent of all pact shipments. Along with the other 41 importing members, she would like to retain the current maximum price. While the negotiations are conducted in secret, it is generally known that in the London conference the U. S. asked for a $2.50 maximum while importers stood fast for the current $1.80 figure.

To eliminate subsidies on U. S. exports to agreement nations currently, the maximum price (quoted in terms of Ft. Williams, Canada) would have to be about $2.50 a bushel—30 cents above the domestic farm support level which now averages about $2.20. This support level, according to present law, will remain at 90 per cent of parity through 1954.

Prospects

The U. S. negotiators are working in the shadow of a very large 1952 harvest, an indicated large addition to carry-over stocks as the 1953 harvest gets under way, and a serious shrinkage of foreign demand generally. Furthermore, domestic markets have been very soft, sagging well below support levels. The need for moving surplus stocks by export is becoming increasingly urgent. Thus, the U. S. might be inclined to ease up a bit on its demands in the interest of getting a new agreement. Similarly, importing nations, who have had a very advantageous deal indeed from the Agreement thus far, may be willing to shift their position rather than see the Agreement expire.

Wheat exports subsidized—domestic price exceeds agreement maximum



Important wheat states may be expected to urge their representatives to press for a new agreement even though it involves substantial appropriations to implement it. But it is very doubtful that funds for export subsidies of the scale used in recent years will be anticipated.

The key issues in the current negotiations were turned over to a committee of the International Wheat Council for detailed study and bargaining early in February. With England and the U. S. playing such important roles in the importer and exporter camps, it is difficult to conceive of an agreement being concluded without a blending of the views of these nations. Similarly, if these nations agree, it is likely that the other member countries would fall into line promptly. There has been the usual flow of speculative reports of the negotiators' positions. Although these have shown some narrowing of the area of disagreement, it still is not clear that a unity of view will be reached.

A possible ground for compromise, in addition to a higher maximum price, would be to incorporate some degree of flexibility into the agreement maximum and minimum prices so that they would adjust up and down with changes in the level of other prices. This move is supported, for example, by the American Farm Bureau Federation.

The present International Agreement, in effect, provides a two-price system for U. S. wheat: one near the support level for domestic consumers, and a lower one—the Agreement maximum—for foreign consumers. Much of the criticism of the Agreement stems not from its two-price feature, however, but from the use of public funds to implement it.

In this connection, the National Grange has proposed a more general use of two-price systems for farm products. But it suggests primary reliance on private rather than public financing of the programs. Such a practice, if extended to a number of commodities, could be expected to arouse resentment from domestic consumers. Also, U. S. producers of competing products might be somewhat incensed at this type of "monopolistic competition"—wheat competing with corn for livestock feed, for example. Furthermore, producers in the countries where U. S. surpluses are dumped might be much less tolerant of such a program than recent discussions of "food shortages" might indicate.

Export or restrict production

Wheat farmers can readily see the need to "export or cut back." After all, there obviously is a limit to the amount of wheat that can be accumulated under price support loans. And with the domestic support level above that at which surplus stocks are likely to flow freely into world commerce in the years ahead, the problem falls into clear focus.

Retention of the present level of support price for wheat promises to drive foreign buyers to other suppliers, unless we continue to sell more cheaply to consumers outside the U. S. than to those at home. The International Wheat Agreement provides such an arrangement but at a cost which is vigorously challenged. Even with an international agreement, the current support program may bring forth larger supplies of wheat than can be readily disposed of in domestic and foreign markets. The ultimate choice, therefore, may be between production controls with prices supported at high levels or freedom by farmers to use their land and other resources as they wish, but with U. S. wheat prices relatively free to adjust to world supply and demand conditions.

The former probably means acreage allotments and marketing quotas—a system of dealing out the privilege to produce and market wheat in accordance with the past use of the land one controls, while the latter necessitates acceptance of a larger degree of price flexibility This situation lays bare the mutually incompatible goals of high domestic price support and maintenance of a huge volume of exports. They can be reconciled only with a considerable degree of government intervention and control in both domestic and "world" markets.

Business Conditions *is published monthly by the* FEDERAL RESERVE BANK OF CHICAGO. *Subscriptions are available to the public without charge. For information concerning bulk mailings to banks, business organizations, and educational institutions, write: Research Department, Federal Reserve Bank of Chicago, Box 834, Chicago 90, Illinois. Articles may be reprinted provided source is credited.*

Britain turns to monetary discipline

Bankers impressed by results of new policy. Weapons long in disuse revived in struggle against internal inflation and balance of payments crises.

HIGHLIGHTED BY SHARP BOOSTS in the Bank of England discount rate, British economic policy, with a dramatic flourish, returned last winter to "monetary orthodoxy." The potency of this all-but-forgotten weapon came as a great surprise to those people who, as the British *Banker* put it, "would formerly have dismissed suggestions of a change in Bank rate as merely foolish and irrelevant."

The 1952 annual reports of the "big seven" British banks, in reviewing the first year's results of this new monetary policy, unanimously concluded that it has proved outstandingly successful. Mr. A. W. Tuke of Barclays Bank points out that the "inflation of credit through bank advances" had continued since the end of the war until the "old-fashioned remedy of the interest rate was applied, when the tendency was quickly reversed." Lord Burleigh of Lloyds Bank has welcomed the return to orthodoxy because he feels that it restores to the economy a much needed flexibility which the plethora of physical controls had deprived it of; he thus sees in the new monetary policy a relief from what Mr. Tuke calls a "holocaust of controls and controllers, with a few shovelsful of snoopers to make the flames burn more fiercely."

The revival of monetary weapons represents a major shift in Britain's official policy. Unlike countries such as Belgium, Italy, and Western Germany, which had adopted a "scarce money" policy to combat the postwar inflation, Britain had hewed to a program which kept interest rates at low levels and placed its main reliance on direct controls and fiscal measures. As the London *Economist* noted rather wryly, the Bank rate was "kept unchanged and wholly ineffective for so long that it had come to be regarded by some people as a kind of museum exhibit from an obsolete system."

First glimmering

The first glimmering of a policy shift came in November 1951 when the discount rate was increased from 2 to 2½%. This was one of the first moves in the efforts of the Conservative Government, upon its return to power, to cope with a resurgence of a serious balance of payments crisis. The balance on current account had shifted violently from a modest but heartening surplus in 1950 to a large deficit in 1951. The result was a dangerous drain on Britain's already low hoard of gold and dollar reserves.

To meet the crisis, imports and tourist allowances were slashed; nonessential building (other than housing) was suspended in order to release material for defense and export industries. But past experiences had shown that cuts in imports added fuel to domestic inflation, which in turn depressed the all-important exports. This was because the money that would have been spent on imports could bid away home goods that might have been exported.

The decision was thus taken to revive monetary weapons as a reinforcement to the existing direct controls. Although there was some feeling at the time that monetary policy would play second fiddle to other measures, this view was quickly dispelled with the taking of "decisive action" by the Chancellor at the time the Budget was introduced in March 1952.

Bank rate raised to 4 per cent

This action was a further boost in the Bank rate from 2½ to 4%, with corresponding adjustments in market rates. Thus, in one dramatic move, "orthodox" finance was swept up to a key spot in official policies.

Only in five instances in the venerable history of the Bank of England had the rate been moved up by more than 1% in a single move—and these were in moments of crisis, such as the outbreak of the two World Wars and the breakdown of the gold standard. By choosing this "dramatic process", the Chancellor made it quite plain that there were no more inhibitions about monetary policy and that this newly acquired weapon would be brandished with full vigor when needed.

The occasion called for drastic action. As the Chancellor explained in his Budget speech, the dangerous drain on Britain's gold and dollar reserves still continued, despite measures taken earlier to reduce the balance of payments gap by cutting down imports and tourist allowances.

The Budget outlined a program to stop this debilitating drain on the reserves and to turn the tables on the balance of payments crisis. The principal objective was to divert plant, machinery, and other capital goods from domestic industries into export markets. "The use of the Bank rate," stated the Chancellor, "can make an important contribution toward the right economic climate, particularly toward the diversion of resources from investment, above all, to export." A tighter money market, by dampening the over-all credit inflation, would make it easier for banks to channel their lending in accordance with the wishes of the Chancellor.

The London *Economist,* in commenting on the Budget message, suggests that "perhaps the greatest merit of the Budget speech was that it rejected—one would like to be able to say for good—the easy delusion that there is no connection between the economic policy pursued within this island and the state of its external reserves."

The decision of the authorities to rely on a sharp boost in the Bank rate to lead Britain out of its crisis probably stemmed from the unexpected effectiveness of the first Bank rate change, modest as the increase was. The Labour Government had tried to curtail domestic investment by physical controls and fiscal measures, but, according to Chancellor Butler, "they always failed in the face of the overwhelming monetary demand." As Mr. A. W. Tuke of Barclays Bank points out, "In the early months it was at least proved that the machine which had been out of action for so many years was still capable of working efficiently," though he goes on to point out that "the relatively small increase in the price of money did not enable the country to reap the full benefits from the change of policy, especially so far as its external effects were concerned."

Monetary discipline

At the time the new monetary policy was adopted, there were some doubts raised as to its efficacy, particularly since the latest move did not tighten banks' liquidity ratios. However, proponents of the new monetary policy argue that the essence of monetary discipline, insofar as restraints on the lenders' side are concerned, stems from the threat of further vigorous action which would affect the reserves and earnings of banks. Even without an actual tightening of liquid asset positions, therefore, the mere possibility of even tougher moves, posed ominously overhead like the sword of Damocles, leads to a tighter lending policy.

As an example of the potency of monetary policy, the London *Economist* points to the American experience in the past year, noting "that comparatively small movement in interest rates in an advanced industrial economy can work disinflationary wonders—not (at least not primarily) because it dampens down borrowers' eagerness to borrow, but because it reduces lenders' willingness to lend."

In the year or so that active monetary policy has been in effect, results have appeared which seem to bear out the optimism of those who have advocated monetary discipline. As the annual reports of the "big seven" banks have indicated, there was a marked decline in bank advances and in commercial bill portfolios during the year. This was attributed largely to the workings of this new policy, though a fall in world prices of raw materials was also cited as a factor. Total bank advances in 1952 dropped for the first time since the early part of the war.

The effect of the policy is also seen in other areas where the public is affected more directly. For those who had found the labyrinth of physical controls to be galling, or who like Lord Burleigh of Lloyds complained loudly and bitterly that the planning lacked imagination and was too timid to do much good, the return to monetary orthodoxy raised a hope that the movement toward increasing controls would be stemmed.

In this they had occasion to rejoice. For not only did further physical controls fail to materialize, but there was actually a lengthening of the list of items decontrolled and restrictions abandoned. "The important point to realize," the London *Economist* points out, "is that it is financial policy that has created the circumstances . . . . The reason why the Conservatives can remove controls is not because they do not believe in them, but because they do believe in monetary policy . . . . Except for the abolition of identity cards, it is difficult to think of a single one of their relaxations which does not go back to this cause." However, when related to the barriers that still remain, the road back to a freely functioning economy is a long one and the progress made thus far quite small.

Deposits continue growth

Unfortunately, the advances made in tightening credit in the private sector have been more than offset by increased governmental borrowings from the banking system. As Lord Burleigh of Lloyds Bank has stated, "During the summer for every pound of credit that the banks were in process of withdrawing they were required to extend nearly two pounds of additional credit to the Government." The net result was a rise in bank deposits, instead of a fall.

An attempt was made by the government in October to reduce bank liquidity by converting their borrowing from Treasury bills into short-term funding stock; however, owing to the low level of bank borrowings, over-all liquidity ratios still remain high. As Lord Burleigh has warned, "There can be no hope of keeping a tight rein on the supply of money unless the Government is able to keep its own finances in order."

Externally, however, the combination of monetary, fiscal, and other measures adopted have helped in stemming the drain on gold and dollar reserves; there was in fact a net inflow in the fourth quarter of 1952. Moreover, the over-all current account for the first half of the year showed a surplus of 24 million pounds. Although these short-run achievements are promising, Britain can expect to suffer further recurrences of the crisis until more basic adjustments are realized.

The basic cause of England's difficulty stems in part from the vast structural changes that have occurred in the world trade pattern. Lord Burleigh of Lloyds Bank seems to have had this in mind when he stated that Britain's "greatest need" was a "major change in the pattern of production"—one in which there would be a "necessary shift of resources" from consumer goods industries to the engineering industries.

Monetary policy is no panacea; and there seems no illusion about this in official circles. However, a vital step in achieving external equilibrium, as the annual reports of the banks have repeatedly pointed out, is the control of internal inflation; and the recent performance of monetary policy indicates that the metal of monetary weapons can still be honed to a sharp edge.

CCC loans boom

THE CURRENT GROWTH IN AGRICULTURAL LOANS at District member banks reflects primarily the flood of price support loans for corn.

Country banks typically make most of the loans used by the Commodity Credit Corporation to carry out price support programs on Midwest farm products. The loans are nonrecourse so far as the "borrower" is concerned and are guaranteed by the CCC as to principal and interest. Thus, they have little in common with conventional bank loans. For corn, the heaviest loan demand comes after the first of the year following harvest.

District member banks at year end already held nearly 54 million dollars of CCC guaranteed loans, compared with only 4 million last September and 10 million at the end of 1951. Iowa banks, with 32 million of these loans, accounted for more than half of the total. The largest volume of CCC loans ever reported by District banks was the mid-1950 figure of 110 million dollars, following the '48 and '49 crops.

Even though District banks will probably make more CCC guaranteed loans this year than ever before, it is not clear that they will hold as many as usual to maturity. The 2 per cent return to banks on such loans is not particularly attractive. Also, there continues to be an active demand for conventional farm, business, and personal loans. Big city banks, which in past years have been important purchasers of any excess of CCC loans over the amount desired by the originating banks, are largely out of the market this year. Thus, more than the usual amount of price support loans may be passed promptly to the CCC.

The CCC guaranteed loans nevertheless have several attractive characteristics. They are highly liquid in that they may be sold to the CCC at the option of the holder. And being guaranteed both as to principal and interest, they are even more risk-free than Governments. The major objections are the low return, the small average size of the loans, their short maturity, and the amount of paper work required to process them. Most banks, however, prefer to make the CCC loans as a service to their customers, even if they do not hold them to maturity. Furthermore, a loan servicing arrangement is available to them this year.

About 500 million bushels of 1952 corn are expected to go under loan. For the U. S. this would be somewhat less than the record volume from the 1948 crop. In Iowa, however, where an exceptionally large harvest was realized, the volume going under price support is expected to exceed that of any previous year.

Following the 1948 harvest, District banks held only 29 million of CCC guaranteed loans at year end, but the total climbed to 100 million by the following June 30. This year District banks will have an opportunity to obtain all of the CCC guaranteed loans they care to hold. The peak volume of such holdings probably will double the year-end amount and could climb well above the previous record.

CCC loans rise sharply, may pass 1950 record