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

Business Conditions

1953 August

Contents

THE Trend OF BUSINESS

THE VIEW that business activity will not again measure up to second-quarter totals in the foreseeable future is attracting an increasing number of adherents. Such a stand may prove to be correct but is not necessarily substantiated by the probable 3-5 per cent decline in industrial output in July. For the most part, this merely reflects the usual summer lull in activity, which has been intensified in recent years by the growing practice of taking plant-wide vacations.

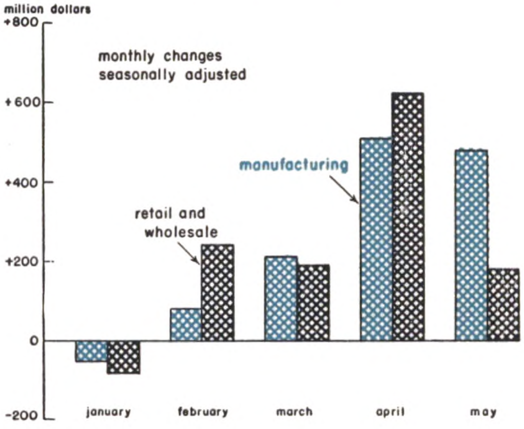
Basically, business appears to be holding close to the high plateau reached in early spring. Industrial production remained unchanged in June, and unemployment was at a postwar low for that month. Department store sales have been running above those of a year ago, and indications are that retail sales over-all have done as well.

Manufacturers' new orders increased moderately in April and May to a level 7 per cent above that of the previous year. Steel mill order books for the third quarter are filled to overflowing, although the demand for premium-cost conversion steel is reported to be waning rapidly. Business spending for new plant and equipment is expected to continue in record volume during the third quarter. Government expenditures for national defense have edged upward in recent months and are scheduled to continue at or near the current high level for the balance of the year. These factors of strength would seem to assure a very good, although perhaps slightly lower, level of business in the months ahead, despite signs of weakness which are appearing in some areas.

Business inventories rose sharply in April and May, after having increased only moderately in the first quarter of the year. Seasonally adjusted, the rise amounted to 1.8 billion dollars and was the largest two-month advance since the spring of 1951. Increases occurred at both producer and distributor levels and in both durable and soft goods lines, but, as in earlier months, a major part of the gain was shown by durable manufacturers. Despite the rise in stocks, however, the ratio of total business inventories to sales is still slightly below that of a year ago and significantly lower than in the summer of 1951.

Output of durable household goods has fallen by about 15 per cent since the February peak. Although sales of most durables have been in good volume, substantially higher levels of production have led to a build-up in inventories. Thus far, the decline has been confined to radio and television sets and major appliances, with output of furniture remaining

Business inventories rose sharply in April and May



strong. The summer homefurnishings shows at Chicago and Grand Rapids were reported to be disappointing in both attendance and orders, but manufacturers anticipate a good volume of bookings from the field during the fall season.

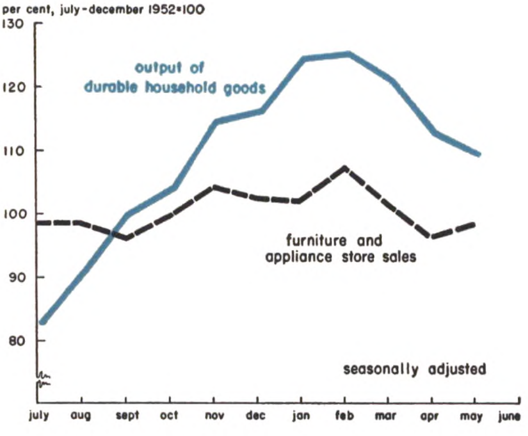
Savings accounts have grown at an accelerated pace in recent months. The net inflow of savings to commercial banks, mutual savings banks, and insured savings and loan associations in the nation has been higher this year than at any other time since the war. Moreover, the increase in April and May was one-fifth greater than in the same months of 1952, as compared with a year-to-year gain of only 10 per cent during the first quarter. At Seventh District institutions, the jump in savings inflow was even sharper (see chart). Such disposition of funds tends to limit current spending of consumers and, if continued, could have a depressing effect on retail sales. So far this year, however, the rapid rise in consumer credit has offset the higher rate of financial saving.

The farm situation clearly is the major trouble spot which has developed in the economic picture to date. Wholesale prices of farm products dropped 3 per cent in June and at the end of that month were 14 per cent lower than a year ago. Most farm products have shared in the decline, including important commodities supported by the Government. Serious leaks have developed in the price support mechanism owing to large supplies, reduced exports, and inadequate storage facilities.

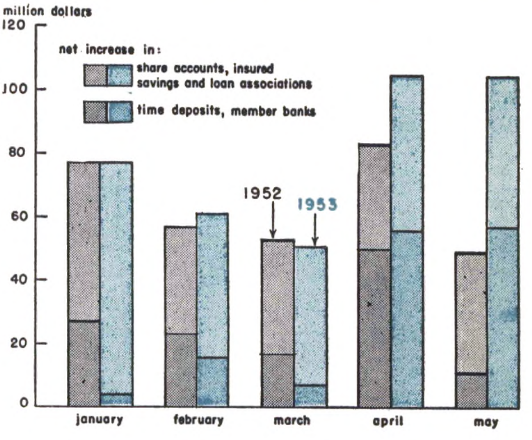
Farm receipts have declined less than farm product prices due to an increased volume of marketings. Cash receipts during the first five months of this year were only 3 per cent below 1952. Net farm income dropped considerably more than this, however, since production costs did not decline proportionately. Both cash receipts and net income are expected to drop further below year-ago levels in coming months.

The decline in farm income has been reflected in the industries for which farmers comprise the principal market. Tractor sales in the first four months of this year were down 15 per cent from 1952, and trade reports suggest that sales of other types of farm equipment have dropped even further. A similar situation has developed in trucks, for which farmers provide about one-third of the potential market. Truck production in June was 30 per cent below last year, with most of the decline occurring in small trucks—the type bought by farmers.

Output of homefurnishings drops as retail sales fall off moderately



Savings growth at District institutions accelerated this spring



Factory pay sets wage pattern

End of price inflation means that new wage gains add to real buying power.

As in seven previous postwar years, new wage agreements are calling for further gains in money wages and other benefits as they come up for renewal. But now that the cost-of-living argument has lost its effectiveness, the increases in hourly rates have become moderate compared with the 18½ and 12½ cent jumps which were popular a few years ago. This year the steel workers settled for 8½ cents per hour and the automobile workers for about the same.

Factory wages have continued to rise slowly all through the three years of the Korean conflict. Until last fall, however, these gains had been largely offset by higher prices and heavier tax payments. Since September, over-all consumer prices have been stable, and no new taxes have been imposed. As a result, this year's wage increases can be translated into a proportional hike in purchasing power so long as weekly hours are maintained.

So far in 1953, the average manufacturing worker has earned more than 71 dollars per week. This is about *three times* the 1939 figure. Even after adjusting for the rise in living costs and income taxes since the prewar year, it is calculated that the factory worker with a family is *50 per cent* better off than he was at that time. Not only is the individual's position greatly improved, but a much larger number of persons are sharing in the higher earnings of today. Employment in manufacturing is now 70 per cent above 1939, and tight labor markets in most manufacturing centers have taken the place of widespread unemployment which prevailed at that time.

Manufacturing dominant in Midwest

Of the states comprising the Seventh District, only Iowa is primarily agricultural. The others, Illinois, Michigan, Indiana, and Wisconsin, all can be characterized as industrial although they also contribute importantly to the nation's farm output. In each of these states manufacturing accounts for a larger percentage of total nonfarm employment than it does in the nation as a whole:

U. S.	34.2%
Illinois	38.3
Indiana	46.4
Michigan	52.2
Wisconsin	42.8

The four industrial states account for less than 15 per cent of the nation's population, but they produce almost 24 per cent of its manufactured goods. This fact has much to do with the high income of the area. Income per capita in the four states is more than 14 per cent greater than the national average.

District states in a high-pay area

Workers in the manufacturing centers of the Midwest generally receive higher wages than the average for the nation. In Illinois, Indiana, and Wisconsin, weekly earnings in manufacturing were about 6 per cent above the national average in 1952, while Michigan was almost 20 per cent greater. Part of these earnings resulted from more overtime, but most of it stemmed from higher straight time pay.

The factors responsible for this situation are varied and interdependent; tradition, locational advantages, higher living standards and costs, and intensive unionization all play a part. Perhaps most important, however, is the prevalence of durable goods manufacturing in this region.

Weekly earnings in Michigan manufacturing plants are the highest in the nation. The automobile industry, of course, is largely responsible for this fact. Hourly earnings of motor vehicle workers averaged about $2.15 before the recent increase—about one-fifth greater than the average for all manufacturing. As a result of heavy overtime, factory workers in Flint and Lansing, Michigan, have been earning almost 100 dollars per week.

Other manufacturing industries important to the Midwest which have done better than the average for all industries in recent years are steel, machinery, and electrical goods. Wages in these industries run at least 50 per cent more than in such fields as textiles and tobacco manufacturing, which are not important in this area.

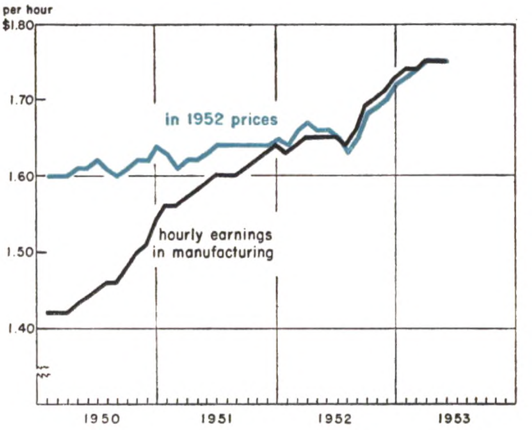
Blue collar vs. white

Competition from high-wage manufacturing firms has increased the difficulties of personnel managers in mercantile, financial, and service establishments. In recent years the ready availability of factory jobs, together with attractive wages and improved working conditions, has dimmed the traditional appeals of the white collar job—prestige, steady employment, and pleasant surroundings. Hourly earnings in manufacturing average $1.75, compared with $1.38 in retail trade.

Manufacturing workers, moreover, are now granted a growing list of "fringe benefits" which are not counted in money earnings. Until recent years many of these provisions applied most commonly to office workers. They include pensions, hospitalization and life insurance, subsidized lunch rooms, sick leave, and a host of smaller items. In some plants these benefits may be worth a total of 35 cents or more per hour, perhaps 15 per cent of the base rate. The term "fringe" is really a misnomer.

Other gains made by manufacturing workers in recent years include more liberal vacations and an increased number of paid holidays. Almost all plants now grant at least one week's paid vacation after one year's service. However, a relatively small number of plants—10-20 per cent in most centers—allow two weeks'

Real wages gain as prices stabilize



vacation after one year's service. Vacations and holiday time are one of the remaining strongholds of superiority of the office job. The great majority of office workers receive two weeks' vacation after one year's service. In addition, they usually have a larger number of paid holidays.

Factory wages set the pace

Currently, about one in every three jobs in nonfarm activities is in manufacturing. The fact that manufacturing employment expands faster than total employment in times of rising activity causes manufacturers to compete actively for the available labor supply. Moreover, the sheer size of the manufacturing category means that factory wages exert a strong influence on employee compensation in other fields.

Each year the union-labor negotiations in key industries such as automobiles, steel, and coal are watched carefully for evidence of the development of wage patterns generally. Reverberations are first transmitted to union-management agreements in other fields. But the process does not end here. Nonunion shops must equal or better union requirements in order to maintain a capable work force. In a tight labor market, employers in nonmanufacturing lines are also affected.

The lack of objective standards for determination of negotiated employee compensation has long been a trouble spot in labor-management negotiations. Samuel Gompers, long-time head of the American labor movement, once replied to a question concerning labor's desires by the single word "more." There were no "ultimate" demands, only a determination to improve current wages and conditions.

It was this lack of absolute standards which led to the inclusion in certain wage agreements, starting with the 1948 General Motors contract, of provisions for automatically changing wage rates according to movements in the Consumer's Price Index and improvements in output per man-hour.

At least 3.5 million workers are now covered by cost-of-living adjustments. Almost 3 million are entitled to yearly "productivity" increases. The first of these provisions is well known; the second may require a word of explanation.

Output per man-hour is extremely difficult to measure because of changing products over the years and other factors. Nevertheless, it has been calculated that the output gain per man-hour for the economy as a whole has averaged about 2 per cent per year during the twentieth century. It can be reasoned that, unless prices fall by this rate, consumer income will have to rise if the worker is to be enabled "to buy his product." Otherwise an inadequate level of consumption and resulting surplus capacity may bring on a recession.

Wages and prices

In the first half of 1953, about 56 per cent of the selling price of all finished goods and services produced in the United States was represented by compensation of employees. This proportion, which includes wages and benefits paid to executives and administrative employees as well as production workers, has tended to rise very gradually over the past quarter century.

Manufacturing firms pay out about one-fourth of their sales dollar in the form of wages and salaries of all kinds. Of course, wage costs are also incorporated in purchased materials. Altogether, the wage bill for manufactured products is something over half of the selling price, about the same as for the aggregate for all goods and services.

Midwest manufacturing pay tops nation's, January-May 1953

	Weekly hours	Hourly earnings	Weekly earnings
		(average)	
Illinois	41.5	1.84	76.37
Indiana	41.5	1.87	77.61
Iowa	40.9	1.68	68.90
Michigan	42.1	2.06	86.83
Wisconsin	42.3	1.79	75.82
U.S. average	**40.9**	**1.75**	**71.38**

Wage costs vary greatly from one industry to another and among firms within particular industries. In 1952, major meat packers such as Armour and Swift had a wage bill equal to about 11 per cent of sales. Office equipment producers near the other end of the scale paid wages amounting to 50 or 60 per cent of sales. Automobile producers averaged about 25 per cent, but individual firms ranged from 19 per cent for Chrysler to 27 per cent for General Motors.

A low wage bill relative to sales is not necessarily an indication of an employer's ability to increase compensation. Wages will appear small relative to sales if a firm is highly mechanized or if a large part of the firm's sales dollar is paid out for raw materials, either because of the nature of the industry, as in meat packing, or because parts are purchased which might be made within the firm. It should also be noted that the proportion of wages to sales will fall as output drops below capacity for a given firm, since overhead costs ordinarily will not fall proportionately with direct outlays for labor and materials.

Continuous demands for greater employee compensation in the form of wages or other benefits has raised the specter of never-ending price inflation resulting from the push of higher costs. Rising wages affect the price level by increasing purchasing power as well as through their influence on costs. But the "wage-price spiral" becomes a major problem only in times of high-level activity and employment. Therefore, fears of continuous inflation must be accompanied by the belief that serious business recessions are a thing of the past.

Unions and the cost push

Opinions vary as to the importance of unionization in the increase of factory worker earnings during the postwar years. A substantial increase in wage rates might have been expected because of the extremely low level of unemployment which has prevailed during most of this period. In the past year the number of idle workers actively seeking employment reached an almost negligible figure. Under these circumstances rising wage rates were virtually assured. Whether worker income would have increased faster or slower if more individual bargaining between employer and employee had been substituted for collective bargaining cannot be answered categorically.

Rigid wages

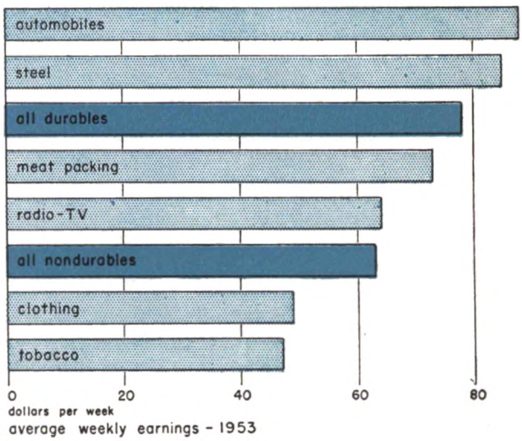
Regardless of whether or not wages are now higher than during the late Thirties because of unions, it is highly probable that wage inflexibility on the downside has been increased. During 1949 when unemployment appeared to be growing to serious proportions, wage rates rose, although not nearly so fast as in the preceding year. Moreover, it was in 1949, when the rising cost-of-living argument lost its force, that union demands shifted to pensions and other benefits rather than higher take-home pay. The belief that wages have become more inflexible in periods of declining business has been given added weight by the recent "freezing in" of most of the cost-of-living raise now incorporated in auto workers' hourly rates.

Inflexible wage rates during a business recession have been the subject of endless controversy. Many observers would agree with ex-President Hoover that wage cuts should be avoided at the start of a downturn to maintain purchasing power. Others hold that more flexible costs and prices will enable the economy to adjust to changing conditions and regain a prosperous level of activity.

From the standpoint of an individual producer, the fact that wage rates may be inflexible during a period of declining demand for his product does not necessarily mean that unit costs will remain constant. Overtime pay, bonuses, and commissions drop automatically. Moreover, the least efficient employees will be laid off first in most cases, and those who keep their jobs are likely to put forth additional effort.

To the extent that wage costs remain high in the period ahead, management will be provided with a strong incentive to speed the introduction of new labor-saving equipment and methods. Further gains in the wealth-creating potential of the economy will follow as a matter of course. The resumption of the rise in real wages during the past year indicates that wage earners will continue to share in the benefits of improvements in productivity.

High wages paid by hard goods firms



Bank reserve requirements cut

Eased bank reserve positions facilitate seasonal financing.

JULY, a month of leisurely summertime overtones for general business, brought a special burst of activity within the nation's banks. The reason: a billion dollar release of bank reserves as the Federal Reserve System reduced the legal minimum which its member banks were required to keep on deposit with the Reserve Banks. Bank balance sheet totals climbed as bankers moved to deploy the released funds in servicing demands for credit.

The reductions, first since 1949, pared reserve requirements on demand deposits from 24 per cent to 22 per cent in "central reserve city" banks in New York and Chicago; from 20 per cent to 19 per cent in 322 other "reserve city" banks; and from 14 per cent to 13 per cent for the remaining "country" member banks. Because of the higher level of reserves required of central reserve city banks, the cuts were approximately proportional for the smaller banks and the largest banks in the leading financial centers. On the basis of the new requirements, the reserves released will support a bank credit and deposit expansion of roughly 6 billion dollars.

In announcing the reductions, the Board of Governors of the Federal Reserve System stated: "This step was taken in pursuance of Federal Reserve policy, designed to make available the reserve funds necessary to meet the essential needs of the economy and to help maintain stability of the dollar. The reduction, releasing an estimated $1,156,000,000 of reserves, was made in anticipation of the exceptionally heavy demands on bank reserves which will develop in the near future when seasonal requirements of the economy will expand and Treasury financing in large volume is inescapable. The action is intended to provide assurance that these needs will be met without undue strain on the economy and is in conformity with System policy of contributing to the objective of sustaining economic equilibrium at high levels of production and employment."

The funds freed by the reductions on July 1 and 9 approximately offset the volume of reserves drained from the banking system during the seasonal financial contraction in the first half of the year. Between December 30 and July 1, total Federal Reserve credit (a major source of reserves) had been reduced by over 1.2 billion, and total member bank reserves had shrunk nearly a billion dollars. In comparison, the recent reduction in requirements frees a little more than half of the reserves absorbed by the last increase in requirement percentages in January 1951.

Seventh District member banks in effect received over 190 million in additional reserves as a result of the July action. Over one-half accrued to large Chicago banks, which hold roughly 40 per cent of the District's reserve balances. How these released funds fit into the details of District bank reserve positions is indicated in the charts on the opposite page.

Putting the funds to work

Needs for the released funds were obvious. In the offing was the usual fall loan expansion, with its long line of seasonal borrowers. The most immediate credit demand, however, came from the U. S. Treasury, itself forced to be the country's largest seasonal borrower because of the fall dearth of tax receipts. To carry the bulk of an estimated 8.8 billion second-half cash deficit, the Treasury offered 5.5 billion of eight-month 2½% tax anticipation certificates, to be paid for by purchasers on July 15.

—continued on page 10

In Seventh District member banks, reserve cuts free . . .

MAJOR MOVEMENTS in District bank reserve positions over the past three years are compared with the recent reductions in reserve requirements in the accompanying charts. The general rise in reserve needs has been partly matched by increased borrowing from the Federal Reserve. This was least true of country banks, which habitually carry reserves in excess of requirements; but in Chicago banks borrowing became substantial, capped by peak totals this spring reflecting April 1 tax date pressures.

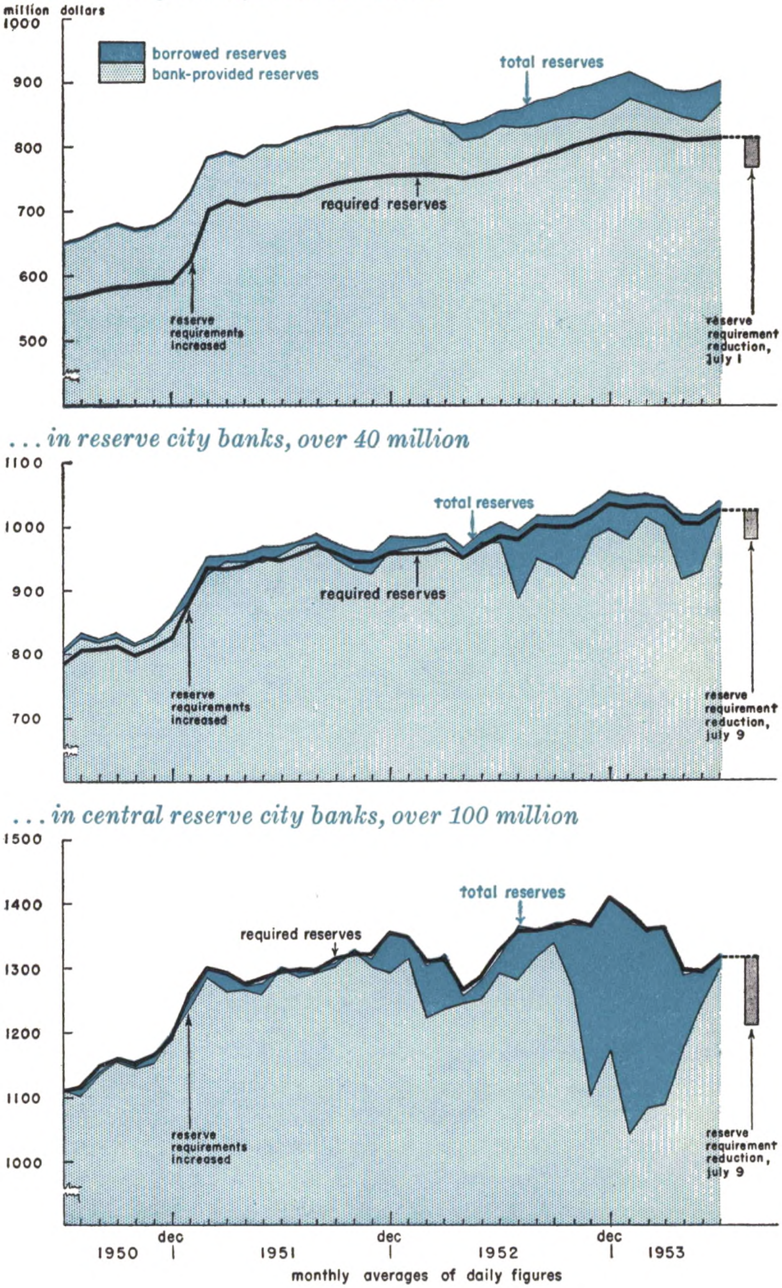
Reserves were more easily obtained in May and June, as indicated by the declining level of borrowings. With additional ease stemming from the reductions in requirements, final July figures are expected to show a further drop in borrowings and a rise in excess reserves.

To an increasing extent, however, the funds released will be reabsorbed in required reserves as loan and investment expansion places new deposits on the books of the member banks.

. . . in country banks, about 45 million

. . . in reserve city banks, over 40 million

. . . in central reserve city banks, over 100 million



The issue was especially appealing to banks, since they could make payment by increasing Treasury deposits on their own books, thus immediately tying up only a volume of reserves equal to the reserve requirement against the increased deposits.

As a result, larger banks particularly held a substantial portion of their freed reserves idle until July 15, with the intent of acquiring large blocks of the 2½% certificates. Preliminary figures suggest that weekly reporting banks in Chicago and New York alone were allotted nearly 1.4 billion of the new issue. In addition, these banks by midmonth had employed over 500 million of funds in the purchase of Treasury bills. Many of these purchases were from nonbank institutions which used the proceeds to buy the new certificate.

Other banks, not so quick to invest in the short-term Government securities market, continued to hold some of their released funds as excess reserves and transferred substantial amounts to correspondent balances. Many institutions, both large and small, took the opportunity to reduce further their modest indebtedness to Reserve Banks, in continuation of the pay-down which had absorbed around 1 billion of reserves since year-end. At the outset, at least, there appeared to be little rush by banks to commit themselves in "permanent" and longer-term investments.

One evident result of these first bank actions is the preservation of a fair degree of the potential liquidity represented by the reduction in reserve requirements. Accordingly, accommodation of the forthcoming seasonal rise in private credit demands will be easier than was earlier expected, with smaller banks drawing reserves from their enhanced correspondent balances and excess reserve positions and leading banks recovering funds by resale of newly acquired short-term Governments to nonbank buyers. A key operation for the larger banks promises to be future sales of the new certificate to corporations, to be used in payment of taxes next March 15.

Farm businesses expanding

More capital required, especially for equipment and operating expenses.

PHYSICAL OUTPUT per farm in the U. S. has increased about 50 per cent since 1940. In the states which include the Seventh Federal Reserve District—Illinois, Indiana, Iowa, Michigan, and Wisconsin—the increase was almost exactly the same as the national average. One-half of the increase in output per farm came from an enlarged size of farm (*more acres*). The remainder came from greater crop and livestock production *per acre*.

Along with this increase in output, the capital needs of the average farm business have also grown; in fact, it was the use of additional capital that permitted output to expand. The increasing size of farm business and the accompanying expansion in capital requirements have important implications for farm finance.

The acreage per farm has increased about 25 per cent. This has resulted primarily from a reduction in the number of farms, as the total amount of cropland in the nation is now only 4 per cent larger than in 1940 and in District states the increase has amounted to 9 per cent. Even if land values were at their 1940 levels, the average farm would now require about one-fourth more real estate capital because of the increased acreage. And real estate capital is only one part of the farm business.

Mechanization releases hired workers

In the last dozen years the mechanization of agriculture has proceeded at a rapid pace. The number of family workers *per farm* increased slightly in both the nation and the District states, but the number of hired workers declined about 10 per cent for the nation and 15 per cent for the District. Since hired workers comprise only a small part of the farm labor force, the increase in family workers maintained the total labor force *per farm* about constant. Of course, since the number of farms declined about 12 per cent, the District's total farm labor force declined by approximately the same amount.

It is possible for the workers on most farms to handle the much larger volume of business, largely because of the labor-saving mechanization that has occurred. The number of farm tractors in the U. S. is now 2½ times as large as it was in 1940. The number of combines is almost 4 times as large; corn pickers, 4½ times as large; milking machines, more than 3 times as large; and the use of electricity is up about 7 times. Farm use of all types of power and machinery is now some 75 per cent greater than in 1940. On a per-farm basis the increase amounts to almost 100 per cent.

This represents a very important addition to the average farm's capital needs, both capital invested in the equipment and capital to cover its current operating costs. Of course, the increased operating capital requirement from this source is offset to some extent by the decline in the number of hired workers per farm.

Larger production per acre

Larger crop and livestock production *per acre* accounted for about one-half of the increased output per farm that has occurred in the last dozen years. The greater crop production per acre was achieved not only because of better tillage and more timely operation resulting from the use of more power and machinery, but also through expanded use of hybrid seeds and commercial fertilizers. For example, the national acreage of hybrid corn is now 6 times as large as in 1940. Also, more than twice as much fertilizer is now being used. The output of livestock products was increased by means of better quality stock and improved feeding and handling methods.

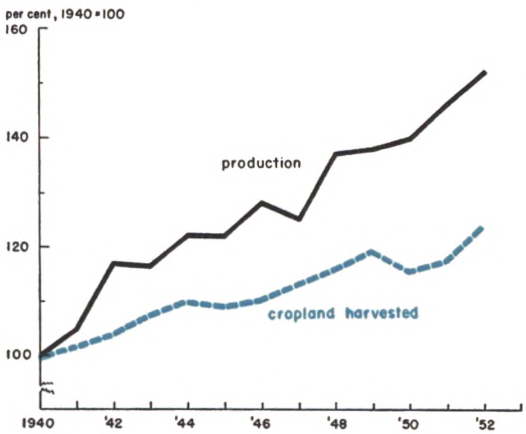
Obviously, cash outlays are required for the purchase of hybrid seed, fertilizers, commercial feed supplements, and the like. Consequently, as the use of these products has risen, the operating capital requirement of the average farm business has expanded.

Thus, the following changes have occurred in the capital needs of the average farm business since 1940, *excluding the influence of price changes* since then: real estate capital, up some 25 per cent; equipment capital, up about 100 per cent; operating capital, up between 75 and 100 per cent.

Credit for best managers

An especially difficult problem is posed for beginning farmers. The smaller number of farming units will, in a sense, be rationed to the potential operators who have, or can obtain, the larger amount of capital that is now required. This is not necessarily a bad thing—if the credit system works effectively. Ideally, the system should channel farm credit to the more efficient farm managers so that the nation will have its most efficient agriculture. In the long run, increasing efficiency within agriculture, accompanied by a continued flow of workers out of that occupation, holds the best promise of

Cropland harvested per farm in the U.S. has increased less than production



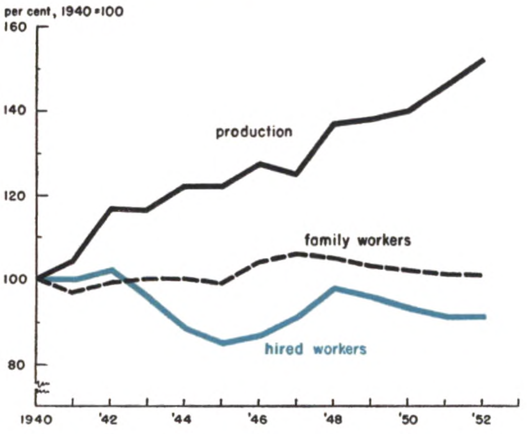
achieving the goals of an economical food supply and equitable incomes in agriculture.

Channeling credit to the best farm managers is desirable not only from the standpoint of social welfare, but also for the protection of the lending institutions. The larger and more complex farm business requires more astute management. But by the same token, it provides more opportunity for an astute manager to utilize his talents profitably.

The quality of management always has been one of the most important variables governing the profitability of a farm business. The importance of this managerial variable has increased greatly since 1940, and it will continue to increase in the years ahead. Meanwhile (other things being equal) the profit opportunity for a good farm manager will be in proportion to the amount of resources he uses.

Herein lies one of the difficult problems in farm finance. Many capable managers, especially young men, have only limited access to credit since they have accumulated few assets. To obtain the use of enough agricultural resources to take full advantage of their management skill will frequently require extensive use of rental and lease arrangements as well as a maximum use of credit. Also, the extension of adequate credit service to such borrowers will require an intimate knowledge of modern agriculture.

Decline in hired workers per farm in the U.S. accompanies increased production



Equipment and operating capital

While the real estate capital requirement has increased for the average farm, capital requirements for equipment and operating needs have increased by a much larger percentage. In other words, the average farm business is becoming progressively less a matter of land alone and progressively more a matter of what the farmer does *to* the land and *on* the land. In turn, this means that short-term and intermediate-term credit have increased in importance compared to real estate credit. As a result, creditors may do well to pay relatively less attention to land and relatively more attention to an appraisal of the opportunities of the whole farm business.

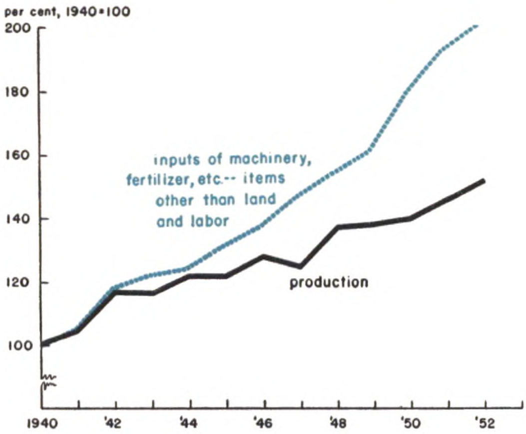
To say that farm operating capital requirements have risen is the same as saying that cash operating costs have increased. The "cost-price squeeze" is currently a popular topic of discussion in agricultural circles, and proposed remedies frequently mention cost reduction. But the enlarged size of farm business, especially the greater crop and livestock production per acre, is directly dependent on the increased use of materials and services purchased in commercial channels.

Thus, if prices paid by farmers remain about at present levels, the possibilities of cost reduction are very limited unless the size of the farm business is contracted. Since the larger business typically is more efficient, it usually is unprofitable to contract. Hence there are strong forces tending to perpetuate the trends that have been in evidence since 1940. With a further growth in use of purchased supplies, cash costs and, consequently, operating capital requirements are likely to continue high.

Future prospects

However, the trends that have been in evi-

Use of materials other than land and labor has increased much more than production per farm in U.S.



dence since 1940 will be affected by many forces. With farm incomes declining and ample job opportunities at record wages available outside agriculture, it would seem that the movement of labor out of the farming occupation should be accelerated. But this would imply a step-up in the rate of mechanization of farm work, whereas manufacturers' shipments of farm machines and equipment in 1952 were 12 per cent below the 1951 level. Preliminary reports for 1953 indicate a further reduction.

It would appear that much of the machinery now on farms is not being utilized to capacity. That is, it is capable of being used more intensively. Thus, the acreage of the average farm may continue to increase even if the rate of mechanization tapers off while the loss of farm labor continues.

The 1940-52 rate of increase in farm purchases of operating materials (like fertilizer, hybrid seed, etc.) may taper off somewhat as a result of declining farm income, but the change probably will not be as great as in the case of equipment. Unlike equipment, operating materials do not possess excess capacity. Thus, they are not capable of being utilized more intensively in the way that machinery can be. A cutback in the use of operating materials would be reflected in a decline in farm output which would, in most cases, reduce cash receipts more than the initial cut in costs.

Furthermore, as time goes on, new methods, techniques, and technologies will be developed and incorporated in new types of operating materials. By using these materials, farmers will be able to reduce their per unit cost of production, but in so doing their total cash costs and working capital requirements will rise.

In summary

In summary, the near future seems to hold the following prospect for the average farm business' capital requirement, in real terms. The acreage per farm will continue to increase, perhaps at a more rapid rate than in the past. The needed equipment will increase somewhat, but at a rate lower than the 1940-52 average. The use of operating materials will continue to increase, probably at a rate near that experienced in the recent past.

In other words, farm businesses will continue to grow, and the finance problem will become even more challenging, especially for those who wish to become established in the business. But the "family farm" as a national institution is not threatened. There probably will be fewer farms in the near future, but the family aspect has thus far been strengthened by the trend to mechanization and the decline in number of hired workers per farm.

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Banks and municipals

Despite general money tightness, banks have provided a big market for record municipal flotations.

MIDWEST BANKS in the first four months of the year bought more municipal securities than in any equal postwar span. These purchases, coming in a "tightening money" environment, were partly additions to the trading positions of banks which are dealers in municipals; but in greater measure, the acquisitions went directly into bank investment portfolios. This is in sharp contrast to the close rein which banks have held on their over-all earning asset position. Midwest loan totals have remained fairly stable, while holdings of Governments have been cut substantially since the beginning of the year.

Actually this latest bulge in holdings of state and local government obligations caps a buying trend which has proceeded almost uninterruptedly since shortly before the end of the war. In this process the proportion of municipals in Seventh District bank investments has jumped from 4.1 per cent at the end of 1945 to 13.1 per cent today.

Municipals vs. Governments

A startling contrast appears between the roles played by banks as postwar lenders to the two levels of government—Federal as against state and local subdivisions. Since the end of 1945, Federal Government securities held by all commercial banks in the country have shown a net decline of over 35 per cent, while municipal holdings have expanded by an unprecedented 160 per cent. Even bank loan expansion has not matched this latter pace.

The change in bank investment patterns in part reflects the availability of these two types of securities. The Federal debt has declined by some 5 per cent since the end of the war. State and local governments, on the other hand—following a sharp wartime curtailment in borrowing due to the unavailability of materials and labor to carry out improvement programs—have gone into debt at a record rate. As a result of the postwar development of countless new communities and the vast expansion in state and local facilities—particularly schools, highways, and housing—outstanding obligations of state and local units are now about double their 1946 low of 15.9 billion dollars.

These flotations have, for the most part, found a willing market among several classes of investors—fire and casualty insurance companies, business corporations, relatively high income individuals, and taxable trust funds. Bidding aggressively against such competition, however, banks have acquired almost half of the post-1946 net increase in municipal outstandings. As a result, banks are now a more important participant in the municipal bond market than in the Government security market, as indicated by the proportion of total outstandings they hold:

	Municipals	Governments
1952	34%	27%
1945	23	36
1940	21	46

To some extent this participation is not determined by the banks, however, since varying proportions of Federal and municipal debt are either "special" or bank-restricted issues and hence unavailable for bank investment.

The primary appeal of municipals lies, of course, in their tax exemption feature. Unlike Federal Government securities offered since 1941, municipals are exempt from Federal income taxes. As tax rates have risen over the past decade, tax exemption has become a progressively greater attraction. Today, for example, a taxable corporation buying a new 2¼ per cent public housing bond (which the Attorney General has officially labeled a legal obligation of the Federal Government) receives an after-tax return greater than that on a 4½ per cent taxable security, even without taking excess profits taxes into consideration. Many municipal issues, moreover, are currently available at tax-exempt yields well over 3 per cent.

There are additional characteristics of municipals which have contributed to their popularity with commercial banks and which, in fact, rated them a position of some importance as a bank investment medium in the Twenties and the Thirties: (1) they are more easily disposed of on the open market than any other bank asset except Governments and well-known corporate bonds; (2) they are available in maturities suitable for bank investment—probably the bulk of bank holdings mature in from a few months up to 10 years; (3) contrary to some impressions, they have had a good record of prompt payment over a long period of years; even during the depression defaults or delays were relatively few; (4) there is considerable inducement for banks to invest in the obligations of their own communities since they are familiar with such securities and their backing and feel some responsibility to support them.

Buying patterns vary

Judging from the buying record, municipals have appealed most persistently to country banks. Banks in larger cities are more erratic buyers. Such banks, however, are apparently coming to look with greater favor upon a substantial municipal portfolio. One indication is the fact that those city banks which had the smallest fraction of their funds invested in municipals at the war's end have since made the biggest additions. By far the sharpest postwar increase among Midwest centers occurred in Detroit. Member banks in that city currently hold over 250 million dollars of municipals as compared with 22 million at the end of the war. Member banks in Milwaukee and, to a lesser extent, in Indianapolis and Des Moines have also sharply expanded their municipal holdings.

Despite bank buying, the last year has brought declining market prices for outstanding municipals. In part this reflected generally "tightening money." A complementary factor, however, has been the pouring of new issues into the market at a rate well in excess of 4 billion dollars a year. Actually, the high point in municipal prices was reached in 1946, and prices have receded almost steadily as offerings of new issues mounted.

This rise in rates has led to some postponement of offerings recently. New bond issues, however, are being proposed constantly. It is expected that by year-end, 1953 will have seen a record volume of new issues, with still further increases possible in 1954.

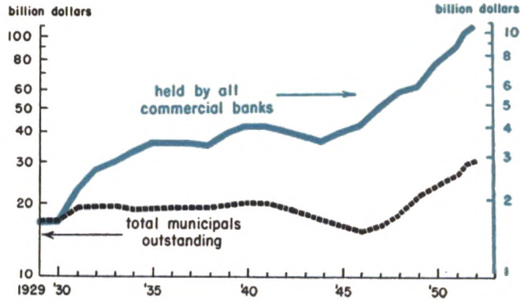
Whether such flotations will continue to be buoyed by willing bank purchases is subject to some question. Regardless of changing tax incentives, it has been suggested by some analysts that tight reserve positions and depreciation in bond accounts will brake the rate of bank buying. But "tight money," for all its restraint on bank asset expansion, has historically been a fairly short-lived phenomenon. In periods when banks have found themselves in eased positions, they have been quick to turn to municipals as an outlet for investible funds—witness the 1949 upsurge in holdings of banks in the largest financial centers and the even greater increase of all banks combined in the early Thirties.

A longer-run deterrent to easy placing of municipals may appear in the form of investor concern with the quality of securities as issuing authorities take increasing debt burdens relative to revenues.

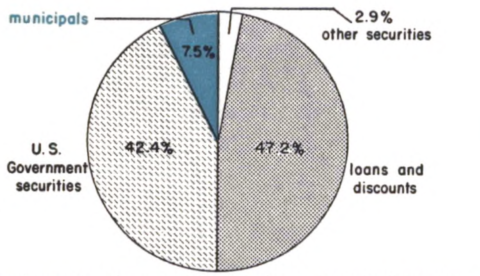
Highlights in municipal movements in District and U.S. banks are pictured in charts on the following page.

Bank holdings of municipals . . .

have expanded far more rapidly than the total volume of outstanding municipal securities. In 1929, the nation's commercial banks held only 1/10 of the total; today they hold over 1/3—more than 10 billion dollars—of all tax-exempts.

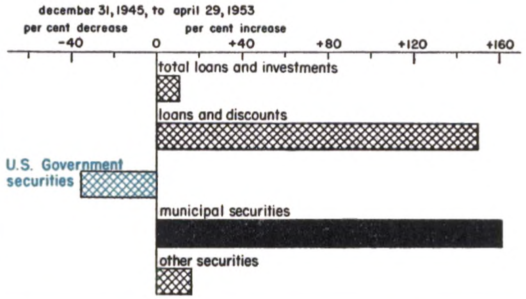


Although still a minor part of bank loan and investment portfolios . . .

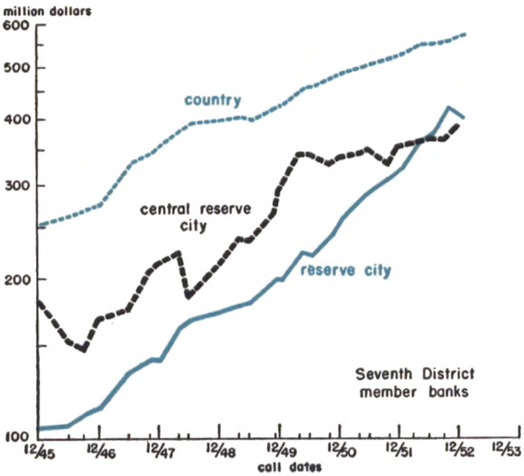


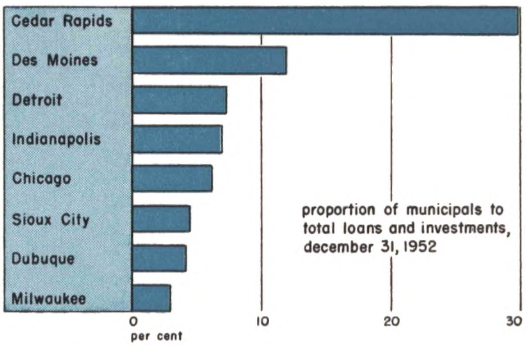
total earning assets—all commercial banks in U.S.—april 29, 1953 = $138.4 billion

. . . municipals have had a sharper postwar growth than other commercial bank earning assets.



Among member banks in the Seventh District, country banks have had the steadiest postwar increase in holdings of tax-exempts, but banks in reserve cities showed the largest gains . . .





Popularity of municipals as a bank investment outlet, however, varies widely from city to city. For all banks in the District combined, municipals amount to slightly over 7 per cent of total loans and investments; in Cedar Rapids they amount to almost 30 per cent, while in Milwaukee they are less than 3 per cent.