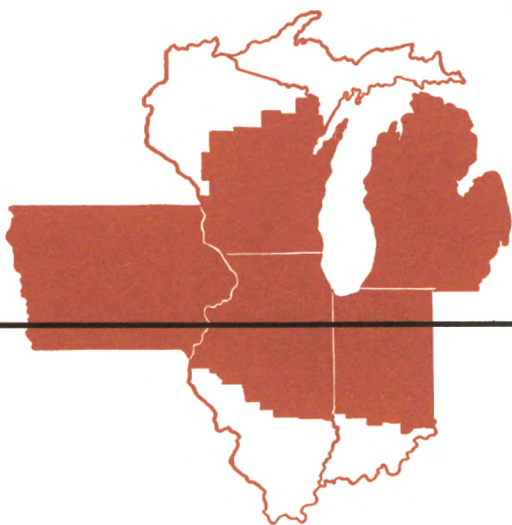


*A review by the* **Federal Reserve Bank of Chicago**

# Business Conditions

**1954 July**



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# THE Trend OF BUSINESS

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C Current measures of business activity show a mixed pattern, whereas a few months ago most were pointed downward. Total business sales, for example, have risen gradually since February, following a decline of six months' duration. Industrial production, which has been running about 10 per cent below last summer's peak, held steady in April and rose slightly in May. On the other hand, nonfarm employment has continued to decline, and total unemployment—at 3.3 million in mid-May—has dropped less than seasonally from the March peak.

Conflicting signs also characterize the important area of private investment. The most recent SEC—Commerce Department survey of business intentions indicates a gradual downtrend in expenditure for new plant and equipment. At a projected annual rate of 26.8 billion dollars in the third quarter, such outlays would be 7 per cent below the same months of 1953. Construction expenditures, however, have held at a record pace through the spring, and new contract awards have continued well above the year-ago volume. Private housing starts also have strengthened considerably since last summer, allowing for seasonal variations, but the acid test for this year will not come until later in the summer when the large volume of speculative spring starts reaches the market.

Uncertainties as to the direction of business activity from this point are intensified by the inventory situation. (See article beginning on page 4.) Seasonally adjusted business stocks were reduced by nearly 500 million dollars in April, the largest drop since November. Although the liquidation has proceeded steadily since last September, the total decline has been relatively small—only about 3 per cent. More-

over, the ratio of inventories to sales still is near its highest postwar point. Whether this means that stocks will be further reduced or whether the liquidation will be slowed or halted by the recent pickup in new orders and sales is the question.

Under the circumstances, any pronounced change in the international situation would play a crucial role in the future course of business. Declining defense outlays have been an important weakening factor in the business situation since last summer, and present budget estimates call for some further cutback in the fiscal year ahead. If a reappraisal of the "new look" in the light of present conditions should bring a step-up in defense activity, the consequent rash of new military orders would buoy up business confidence all around—even though deliveries and thus actual outlays did not increase for several months.

**Manufacturers' new orders** have risen substantially from the lows reached at the turn of the year. After seasonal adjustments, new orders in April were more than 10 per cent higher than in January but still fell 10 per cent short of the 1953 spring peak. Most of the change has come in the durable goods lines, with orders for nondurables holding close to the year-ago volume for the past several months. Even after the pickup, however, new orders for durable goods were off more than 20 per cent from early 1953.

Despite the improvement in order volume, sales have continued to exceed new orders by an appreciable margin. As a result, order backlogs fell another 6.5 billion dollars in the first four months of the year and at the end of April were 30 per cent lower than a year earlier. The disappearance of backlogs has begun to take its

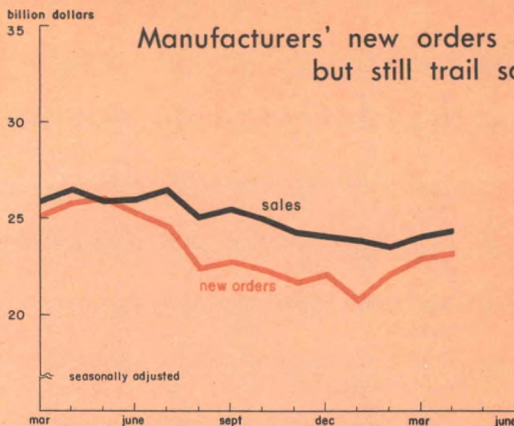
toll in some durable goods lines. Two manufacturers of railroad equipment, for example, recently announced complete shutdowns of Midwest plants.

**Consumer durable goods output** has increased moderately in recent months after having fallen sharply in the latter part of 1953. Total output, according to the new Federal Reserve index, advanced 8 per cent from December through May but still was 15 per cent below the May 1953 high. As compared with last year's peaks, output of major household goods (furniture, appliances, radio and television sets) is off 20 per cent, automobile production, 12 per cent, and other durables, 10 per cent.

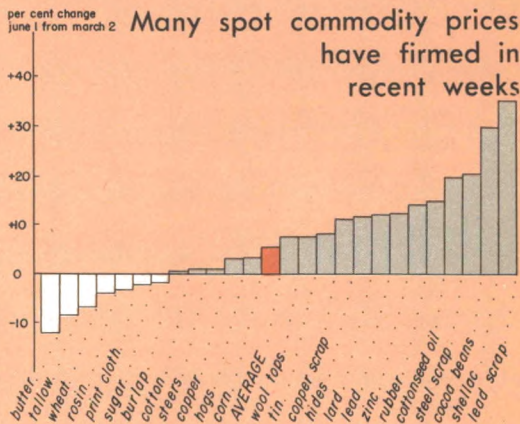
Although automobile production has been maintained at a fairly high and even pace so far this year, new car inventories held close to their all-time peaks through the big spring selling season. With new model introductions coming up in the fall, a sharp cutback in output is expected in the third quarter. Production of television sets has picked up since March, and inventories have been reduced from last fall's very high level, but stocks of most major appliances are still more than ample. New orders for furniture showed little strength through April, and backlogs are far below a year ago. Thus, some decline in the production of consumer durables seems likely in the period immediately ahead.

**Spot commodity prices** have firmed somewhat in the past few months, with average prices of 22 commodities up 6 per cent from the beginning of March to June 1. In general, gains have been most pronounced for the non-ferrous metals—lead, zinc, tin and copper scrap—and imported raw materials. For the most part, these reflect the Indo-China crisis, planned Government stockpile purchases and the high level of world industrial production and materials demand. There has been no tendency, however, for the increases to spread to finished products. The weekly wholesale price index, heavily weighted by processed industrial goods and farms products, showed no change over the same three-month period.

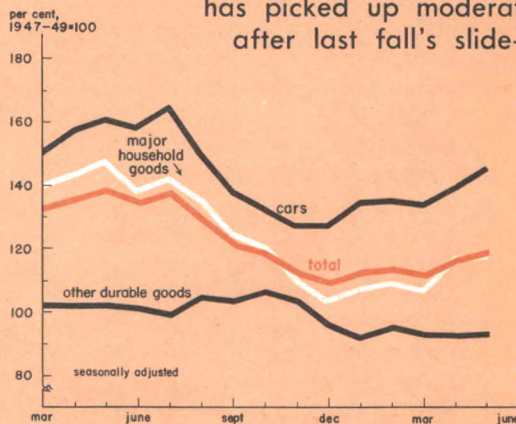
Manufacturers' new orders rise but still trail sales



Many spot commodity prices have firmed in recent weeks



Consumer durable goods output has picked up moderately after last fall's slide-off



## Inventory adjustment rolls on

Expectations as to the course of business in the second half of 1954 depend heavily upon an evaluation of current and future inventory trends. Last October after three months of falling sales American businessmen succeeded in reversing the upward movement of stocks on hand. Liquidation apparently continued at an accelerated pace into the second quarter of 1954.

An improved level of sales and orders since the start of the year suggests that the most depressing phase of the inventory adjustment has passed even though further net reductions may lie ahead. Nevertheless, it is apparent that aggregate inventories remain large both in absolute terms and in relation to sales. The seven-month cutback, seasonally adjusted, has amounted to only 2.4 billion dollars—less than 3 per cent—whereas the previous build-up had lasted 14 months and totaled 7.5 billion dollars or over 10 per cent. The 1949 reduction, by way of contrast, was almost 7 per cent.

### Inventory adjustment plus

Terming the shift to lower levels of business activity which began last year an “inventory recession” merely serves to pinpoint the most striking aspect of the movement. During this period Federal Government outlays have been cut significantly, business expenditures on plant and equipment have eased downward, and retail sales have slowed moderately. But after allowing for the fact that all of these developments are interrelated, it is clear that the inventory switch has been the most potent factor at work.

The impact of the shift from accumulation at a seasonally adjusted rate of almost 8 billion dollars per year in the second quarter of 1953 to liquidation at an estimated 5 billion pace in the second quarter of 1954 turns a spotlight

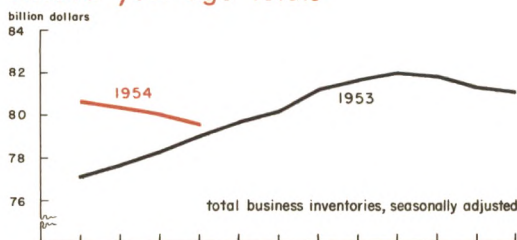
on the dramatic character of inventory movements. But there is another element in the picture a little more difficult to grasp than the mere fact that inventories are rising or falling. It is the effect of changes in the *rate* at which inventories are being accumulated or reduced.

### Liquidation accelerates

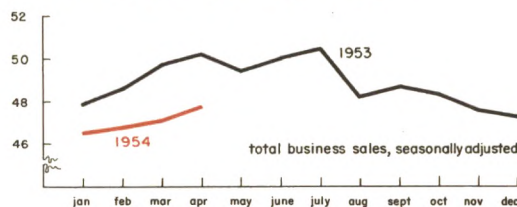
Businessmen were drawing down inventories at a 300 million dollar a month pace on the average from September through March. In April the monthly rate stepped up to one-half billion on the basis of available data. There is a question as to how long such a rate will be continued in the face of a rising level of new orders which has been reported from February on. In fact the greater rate of liquidation observed recently may have resulted from the improvement in sales.

If final demand holds at the level of recent months a pickup in production and employment could occur in the near future even though the inventory decline continued. A need for more output would develop merely because of a slowing in the rate of liquidation. In that case a growing *proportion* of current sales would be made from new output rather than

### Inventories decline but exceed year-ago totals



### Sales improve but lag 1953



from stocks of goods already in existence. This favorable outlook, of course, would depend upon the continued suppression of "secondary effects" resulting from the payroll slicing which has already occurred in manufacturing lines as the pressures of inventory reductions brought layoffs and shortened workweeks.

In the absence of a sustained betterment in final sales, it should be noted that the mere fact that "consumption has been outrunning production" is not necessarily a bullish sign. This is simply another way of saying that inventories have been falling. The process can go on for a considerable period of time, and the longer it continues the greater the possibility of a cumulative sequence—cuts in income and sales leading to further inventory reductions.

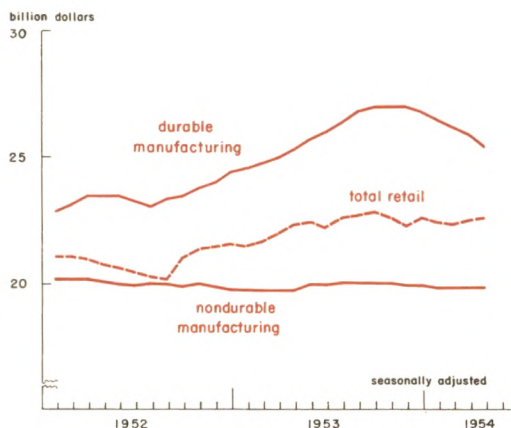
### Producers' stocks cut sharply

During the first four months of 1954, manufacturers accounted for all of the net business inventory liquidation. From December through April, producers cut their inventories by 1.5 billion dollars. Machinery makers, primary metal firms and most other classes of hard goods industry contributed to the cutback. Moreover, the great bulk of the reduction has occurred in the holdings of purchased materials in the hands of durable goods producers. Goods in process and finished goods have remained at or near their peaks in most instances.

Manufacturers, in contrast to retailers and wholesalers, have a "three stage" inventory. *Purchased materials* consisting of raw materials and semi-finished items become *goods in process* and then *finished goods*. Each of these segments must be considered separately if the situation is to be viewed clearly.

Close control of the purchased goods category is usually possible because the manufacturer is able to cut back his buying just as the consumer does at retail. Speculative motives aside, producers have only one reply to the question of "how large should holdings of purchased materials be?" Their answer is "large enough to permit efficient scheduling of production." In recent months smaller holdings

## Hard goods makers cut stocks, other holdings steady



of purchased materials have been deemed sufficient because of the easier supply situation.

The manufacturer combines labor and materials to produce finished or semi-finished goods. The length of time raw materials remain in the plant may vary from a matter of a day or so in the case of food processing industries to two or three years in the case of electrical generating equipment.

It is cheapest to "travel light" at all inventory levels to the extent this course is possible without losing business. However, goods in process usually move through the production process once it is begun, and the fact that buyers expect prompt delivery—thirty days or less from order to delivery once more has become the rule—requires sellers to keep ample stocks of finished goods on hand.

There is considerable evidence that many manufacturers still consider their over-all inventories too high. This conclusion, based partly on published opinion surveys, is buttressed by the old stand-by—the stock-sales ratio. In April, after some months of rising sales and falling inventories, producers' stocks were still 1.94 times sales, as compared with 1.71 times a year before, and remained high relative to virtually any other postwar period. These ratios are below prewar, but the value

of such comparisons is questionable because of changes in business management practices.

### Possible shortages still loom

There is little reason to believe that the purchased materials segment of manufacturers' inventories will soon be rebuilt to earlier levels in the absence of a new world crisis. In recent months some manufacturers have kept liquidations at a slow rate because of uncertainties regarding the Indo-China situation. Some steel users, moreover, have stepped up orders because of the possibility of a nationwide steel strike or price increases resulting from wage adjustments in that industry. A general reversal of the inventory trend, however, is not now in prospect.

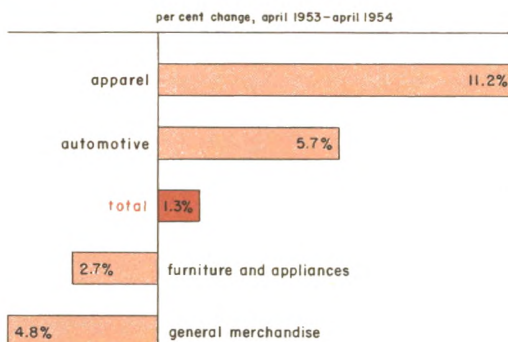
A significant rise in defense orders would have a marked effect on manufacturers' inventories. Most of these products have a long lead time during which materials are purchased and value built up in goods in process. This factor together with the steel strike was mainly responsible for the sharp rise in inventories of durable goods producers which began in 1952 and culminated in the peak of last fall.

### Retail counters well stocked

The retailer has only finished goods to contend with, but this does not mean he has less of an inventory problem than the manufacturer. In fact, inadequacies of inventory management—either too much or too little—are prominent causes of failure. The retailer's stock in trade is usually a much larger proportion of his assets than it is for the manufacturer. As a result, in the absence of current or potential shortages he too desires to keep holdings to the lowest level commensurate with meeting his customers' needs in order to maximize profits.

During the past year retailers have been playing a game of musical chairs with the manufacturer and the wholesaler or distributor, each attempting to shift the inventory burden along the line. Success in this effort has been particularly marked in the appliance field where retailers' holdings are generally well below last year, whereas manufacturers' stocks are substantially higher.

### Total retail holdings still top last year



Retailers participated in the reduction of inventories at all levels that occurred in the fourth quarter of 1953. This year, however, retail stocks have fluctuated very little and have shown some tendency to rise especially in the case of food and apparel. In part, the stability of retail stocks in the aggregate is a reflection of the fact that sales have declined only moderately since the peaks of last year. Even more important, however, is the fact that retail inventories were built up cautiously during the first part of 1953 despite rising sales. Many merchants had tasted the bitter fruits of uninhibited accumulation during 1951.

*Department stores* have been able to keep order backlogs low for the past year, partly because of the ease of delivery. At the end of April, stocks on hand at Midwest department stores were only slightly below year-ago totals, but order backlogs were off 12 per cent. Sears Roebuck recently announced that inventories were to be increased again despite the fact that sales were running 10 per cent below year-ago results.

*Television inventories* were large at the end of last year. Since that time the number of finished sets held at all levels has been brought down substantially by cutting back production although sales were slightly exceeding the pace of the previous year.

*Furniture store holdings* apparently have been reduced by drastic cuts in ordering de-

spite a relatively poor level of sales. An improved level of orders was expected at the June furniture market because of the depletion of dealers' stocks.

*Apparel stores* have not progressed in solving their inventory problems. Sales have not matched year-ago experience whereas inventories remain substantially higher.

*Automobile dealers* customarily assume the entire inventory burden of finished goods. Ordinarily all new cars are either in the hands of the dealers or on the way. On June 1, the number of new passenger cars on hand amounted to about 640,000—close to the postwar high and 100,000 greater than last year in the face of slower sales.

### **Avoidance of the spiral**

The lack of haste or apprehension evident in the orderly reduction of stocks since last fall reflects the continuance of business confidence in high-level sales for 1954. In most cases this sanguine attitude toward prospects has been warranted up to the present time. As a result, little downward pressure has been exerted upon prices—an unusual condition during an inventory slump. This means that inventory cuts in dollar volume terms reflect physical changes as well.

Inventory developments will continue to be analyzed carefully as a bellwether of over-all business activity. The trend will go far toward determining whether the unmistakable signs of leveling of business activity in the second quarter signaled a "bottom" and a new uptrend or merely a hesitation in a continuing slide.

The area of individual discretion with regard to inventory management is probably wider than ever before in the postwar period. Goods are in ample supply, business continues to be well financed internally, and credit is readily available. Under these conditions the businessman can maintain a close watch over his purchasing. He has, however, much less control over sales. The consumer's ability and willingness to buy will continue to exert a dominant short-run influence upon the level of inventories.

## **Consumer spending shifts from goods to services; retail sales fall off**

Consumer expenditures for services have risen 5 billion dollars in the past year. Because of this, *total* consumption expenditures have held very close to last year's third-quarter peak, even though retail sales have dropped moderately lower since early last fall. Such service outlays as are represented by utility and fuel bills, medical services, use of public transportation facilities and rents bulk large in the average family's budget but do not find their way into the retail sales totals. Service expenditures have been moving upward during most of the postwar period, partly because of steadily rising prices. Regardless of the future course of retail trade volume, they can be expected to continue a gradual advance in the months ahead.

### **Spending patterns in transition**

During the postwar period as a whole, consumer purchases have been much more heavily concentrated in goods—particularly durable goods—than was the case before the War. The share of the consumer's dollar spent for durables such as cars, appliances and furniture, has averaged one-fourth more than in the years 1936 through 1941, while purchases of soft goods have taken about 5 per cent more than before the War. Service expenditures, on the other hand, have averaged about one-sixth lower than prewar relative to total spending, although they still have accounted for nearly a third of all consumption outlays.

Nevertheless, in the past few years, there has been a decided tendency to move toward the prewar allocation of the consumer's dollar. Service outlays, which reached a low point of less than 30 per cent of total spending in 1947, have increased slowly but steadily since then and in the first quarter of this year accounted

for more than 35 per cent of total expenditures. Outlays for nondurable goods have been declining relative to total purchases during much of this period. Until recently, on the other hand, durables had maintained their earlier postwar ratio to total spending through the liberal use of credit and accumulated liquid asset balances.

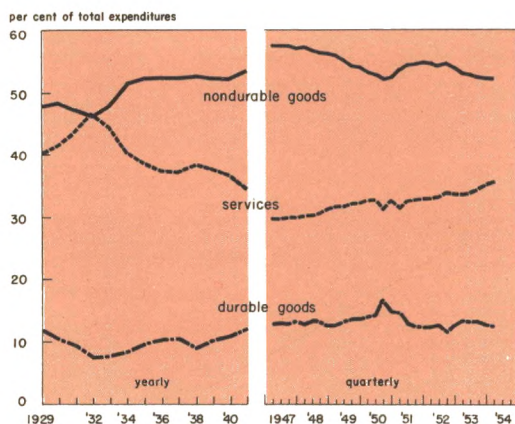
The gradual shift in spending from goods back to services has had a significant economic effect in recent months. The increasing number of dollars spent on services has not been a complete offset to the smaller volume of goods purchased from the standpoint of supporting over-all business activity. This reflects the fact that many service industries—utilities, transportation, rental housing—employ fewer workers per dollar of sales than are associated with the production and distribution of goods. Moreover, the current and prospective volume of consumer purchases of goods plays a major role in business decisions to build up or reduce inventories—now an 80 billion dollar stock. Increases in service outlays have little inventory effect, since such holdings are relatively small in most service industries.

In addition, the largest single service outlay is for housing accommodations—both rental and owner occupied. Two-fifths of the rise in

service expenditures during the past year has been in this category. The housing component consists of rent payments and, in order to maintain comparable treatment of renters and homeowners, the estimated rental value of owner-occupied dwellings. In the first case, the rise in payments from tenant to landlord reflects mostly higher rents rather than additional services or increases in the supply of rental housing. A large part of the “imputed” expenditure for owner-occupied housing does not represent money payments at all, but rather allowances for depreciation and noncash return on the investment. Since this is an estimate of rental value, the increase over the past year also reflects higher rental prices.

Finally, part of the increase in service outlays other than for housing also results from higher prices rather than increased volume. While prices of most goods have held steady during the past year, the cost of medical care has risen 4 per cent, household operation 3 per cent, utilities and fuel about 2 per cent and many other services by lesser amounts. Thus, it is clear that the maintenance of total consumer spending through expanded service outlays has been consistent with declining employment and production in the consumer industries.

### Consumer spending for services gradually rising—purchases of goods decline



### Retail sales drop moderate

The decline in retail sales volume for all types of goods combined and for the nation as a whole this year has been relatively small. Total sales in the first five months were only 2½ per cent below those in the same period last year. Since volume in the first half of 1953 was at a record high, this year's experience has been good by any earlier comparison. But sales of some types of outlets have fallen considerably more than the average, and sales in many of those communities which have experienced sizable declines in employment and labor income have been relatively hard hit.

Nationally, the decline in sales volume has been most pronounced for automobile dealers, apparel stores, department stores and other general merchandise outlets. During the first



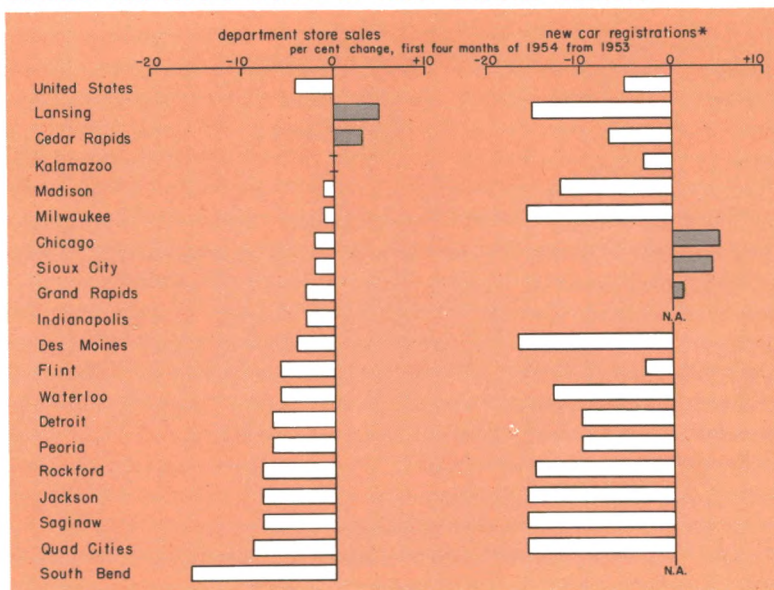
five months of this year sales of the automotive group (including accessory dealers) were 8 per cent below the same months of 1953. In part, this reflects lower prices for used cars, but the number of new cars sold has also been moderately below last year's volume. Sales of this group were sharply higher last year than in 1952, however, and in fact had accounted for *three-fourths* of the year-to-year gain in total retail volume.

Apparel store sales, which were relatively weak last year, fell 7 per cent short of 1953's volume during the same five-month period. Department store sales were off 5 per cent in the January-May comparison, while sales of the leading mail order houses have dropped 10 per cent or more below last year's totals. Furniture and appliance store volume has been maintained close to the year-ago level, reflecting aggressive price competition and a continued large volume of home building. Sales of the food group are unchanged from early 1953. Benefiting from a boost in prices last summer and an expanding number of cars on the road, however, gasoline station sales have increased 8 per cent this year—the best showing of any major merchandising group.

### In the Midwest

For individual District centers, the best available indicators of trade volume are department store sales—broadly representative of the general merchandise and apparel groups—and new car registrations. These show a wide variation in experience among individual cities (see chart), much of which can be explained

## Trade indicators down in most District centers



\*First three months N.A. Not available  
Based on data from R. L. Polk & Company

by differences in local economic conditions.

In centers where employment and labor income have fallen substantially, both department store sales and new car registrations generally show sizable year-to-year declines. This has been the case in the Quad Cities, Peoria and Waterloo, all adversely affected by declines in tractor and farm equipment output, and in South Bend and Detroit, where automobile production has been sharply lower this year. Sales declines in Jackson and Rockford may also be traced to reductions in defense-related and other durable goods manufacturing activity. On the other hand, in centers where employment has been fairly well maintained, sales generally have run only moderately behind year-ago levels.

### Sales-income gap widens

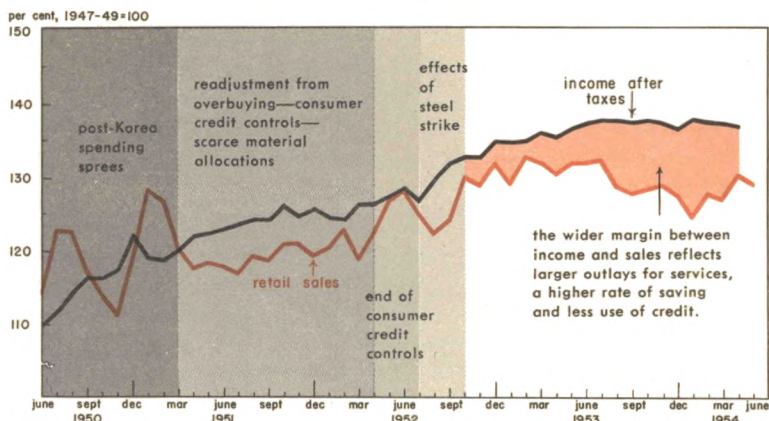
While retail sales have been running moderately below the 1953 volume, personal income after taxes has remained close to last year's peak, partly owing to the income tax reduction which became effective January 1.

Consequently, the gap between sales and spendable income has widened appreciably and since last fall has been larger than at any other time in the post-war period (see chart on this page). Because of the maintenance of aggregate income, many have viewed the decline in sales as a temporary phenomenon. If true, the resurgence of retail sales in April and May may mark a return to a more "normal" relationship with disposable income.

A number of forces have been at work in bringing about the wider gap between income and sales. First is the increasing rate of expenditures for services, most of which do not enter the retail sales picture. These are likely to continue edging upward; certainly no decline can be expected which would free funds for purchases of goods. Second, although total spendable income has been maintained, wage and salary receipts have fallen by more than 8 billion dollars from last summer's peak rate, reflecting reduced hours and lower employment in most manufacturing lines. This has been largely offset by increases in rental income, interest payments, transfer payments (primarily unemployment compensation) and the 10 per cent reduction in income taxes. The net effect, however, may have been to limit spending, at least temporarily.

Another major development affecting consumer purchasing power has been the turnaround in the trend of instalment credit. Such debt declined 900 million dollars in the first four months of this year, as compared with an increase of 1.1 billion in the same months of 1953. Although this change has resulted largely from consumer decisions not to borrow rather than from unavailability of credit, it has had the effect of cutting consumer purchasing

## Retail sales off relative to consumers' income



power by 6 billion dollars at an annual rate. Finally, the pace of savings accumulation at financial institutions has continued at or above last year's high level in recent months, perhaps reflecting greater uncertainties regarding the future.

### Prospects

By postwar standards, consumer outlays for durables and most soft goods have been relatively low since last fall in comparison with both disposable income and total spending. Moreover, aggregate income has held up well, liquid asset holdings are large, and consumers may become willing to incur additional debt for the purchase of durable goods as their present indebtedness is paid down. New credit extensions, after seasonal adjustment, advanced in April for the first appreciable month-to-month rise in more than a year. All these signs suggest that retail sales may hold at the higher spring levels and perhaps rise further in coming months, barring further significant declines in income.

On the other hand, consumer holdings of all types of durable goods and of long-lasting non-durables such as apparel are the highest ever. Moreover, some families may be attempting to build up their cash positions and reduce spending in anticipation of lower prices or because

of uncertainties as to future prospects. Preliminary findings of the 1954 Survey of Consumer Finances, for example, indicate that the proportion of spending units having definite intentions to buy this year has dropped by 13 per cent in the case of new cars and 16 per cent in the case of furniture and major appliances. Thus, the future strength of retail sales would seem more dependent than usual upon the values offered, the appeal of new merchandise and selling effort expanded.

## BANKING AND FINANCE

### Bank loans reflect changing pace of business activity

This spring's pattern of economic activity has had its effects on the money and credit structure and especially on bank loans to business. Like any other shift in bank portfolios, changes in business loans alter the nation's money supply and this in turn influences the economic climate, thus completing the complex round of interrelationships among money, credit and business.

#### Industrial credit demands

Business loans at leading banks across the nation slid off about 1½ billion dollars in the first 5 months of this year. Standing at 21.9 billion at the end of May, these loans were nearly 1 billion below year-ago levels. But this decline has been neither steady nor uniformly distributed, geographically or among industries. Furthermore, this drop has occurred in spite of the fact that business loan totals have been bolstered over the past year by large bank holdings of Commodity Credit Corporation and Reconstruction Finance Corporation certificates of interest. These certificates represent "shares" in pools of loans made by these agencies. Midwestern bankers were active participants in these loan pools, as indicated by the fact that Seventh District banks held over

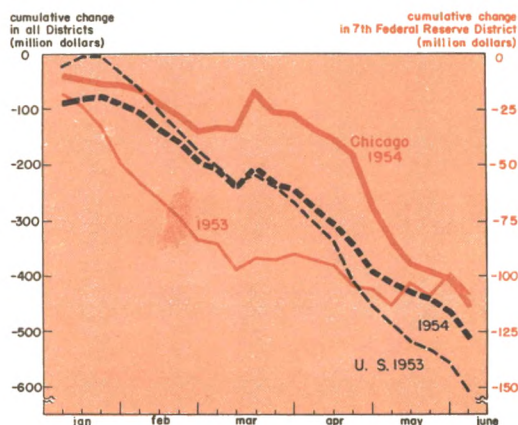
one-third of the half a billion dollars of certificates outstanding at the end of May.

Distinct industrial trends can be discerned within the fluctuations in business loan totals. The sharpest contrast between 1954 and prior years is found in the borrowings of producers of *metals and metal products*. These loans have declined at leading District banks at a 6 to 7 million a month average rate over the past year, while in preceding months they expanded at about a 21 million a month rate. One of the major causes of this net loan liquidation has been the sharp cutback in defense contract work in the past year. Loans made by Seventh District banks to these producers for financing defense contracts have declined over 25 million dollars since last June, nearly half of the cutback coming in the fourth quarter of 1953. Nondefense demands for credit have also been reduced under the impetus of slackened business activity.

Loans to *oil, coal, chemical and rubber producers* exhibit sharp divergence between the District and national patterns. In the early part of this year, such loans at District banks increased over 75 million but declined nearly 70 million in banks located outside the District.

Net paydowns of loans to *commodity dealers*

### Food, liquor and tobacco loans at Seventh District banks declined slowly early this spring



are running well behind a year ago. To some extent this is a reflection of smaller loan expansion in the fall of 1953 than a year earlier because of lower prices for agricultural products and large Government-financed crop inventories. More significantly, however, it also reflects slower inventory liquidation this year than last.

Loans to processors of *food, liquor and tobacco products* were being paid down less rapidly in the Seventh District than in the rest of the nation in the early part of this year. Accelerated inventory liquidation during the second quarter, however, brought District net repayments up to the year-ago volume by the first of June. There appears to have been some shifting away from bank credit by these borrowers. Funds are being currently obtained more cheaply by sales of open market paper and perhaps also by funding of short-term debt.

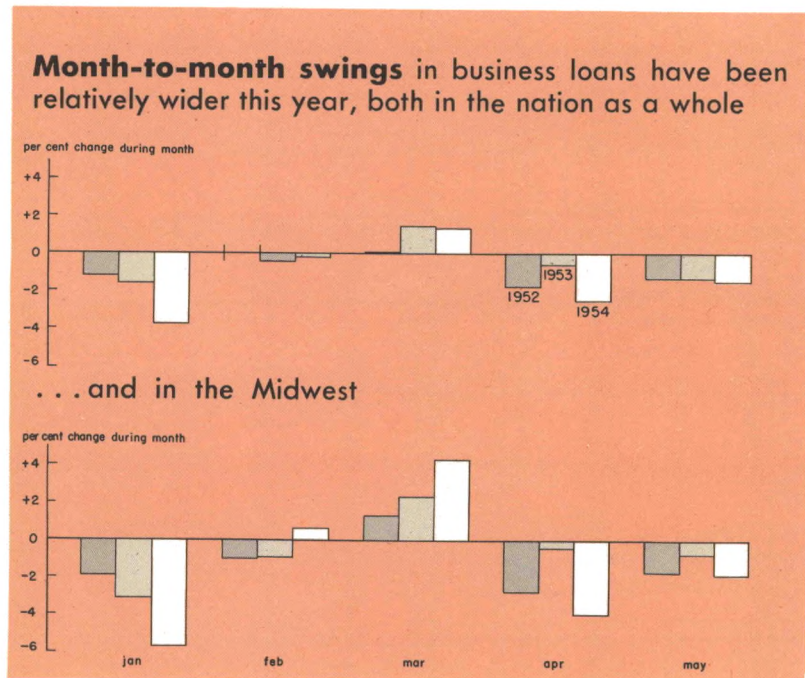
Just as there are differences between the District and the nation in some industrial lines, there are differences in total loan changes.

Month-to-month fluctuations in total business loan volume of banks in the New York and Chicago Federal Reserve Districts are generally sharper than those for the nation as a whole. This may be ascribed, at least in part, to the fact that the largest businesses tend to borrow from banks in these areas. Smaller firms, which borrow from other banks across the nation, may rely more continuously on set forms of financing to meet recurring short-term capital requirements, regardless of the potential interest cost savings available by shifting from one credit source to another. Furthermore, these smaller firms may reduce fluctuations in their short-term bank needs by receiving more credit from their suppliers and extending less credit to their customers than do the larger businesses.

In the Chicago area the pattern of greater fluctuation has been adhered to this year. The sharpest District-national divergence occurred under the impetus of March 15 tax borrowing. Business loans rose about 4.3 per cent during March at leading District banks but expanded only 1.4 per cent in the nation.

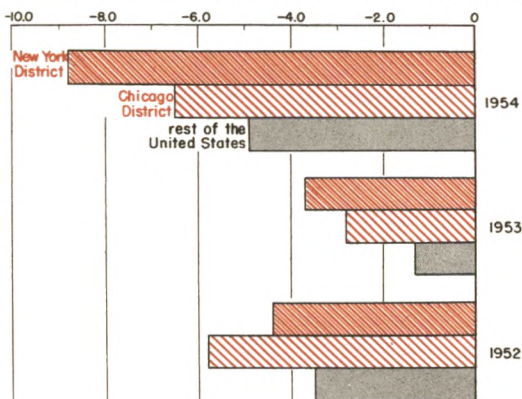
In recent years the March borrowing peak has tended to become more pronounced. This may be attributed to the influence of the Mills plan under which payment of corporate income taxes has been accelerated and increasingly concentrated in March and June. The incidence of the June 15 tax payment date has been widely heralded as the first of the "seasonal" influences which would tend to swell business loan totals during the ensuing six months.

In the months ahead we may reasonably ex-



## The spring decline in business loans has been sharper in New York and Chicago than in the rest of the nation

per cent decline in total commercial, industrial and agricultural loans, january through may



pect inventory accumulation by the seasonal borrowers to buoy business loan totals. However, their influence may well be less effective this year than last. Continued weakness in the outlook for agricultural prices suggests that a lower loan volume will be required to finance processors' inventory accumulations. Some loan expansion in nonseasonal lines may recur if the general tempo of business picks up, but present indications do not point to a return to 1953 levels of business loan totals.

### Other District loan trends

Loan expansion since late 1953 has not been fully offset by the selective declines this spring. Total District loans are about 6 per cent above year-ago levels, but this change in total conceals a variety of significant changes in several categories of loans other than business loans.

The chief contributor to the high loan volume has been *loans guaranteed by the Commodity Credit Corporation*, which account for somewhat over one-third of the total agricultural loans of District banks. These loans are guaranteed both as to principal and interest. Like the certificates of interest in CCC and RFC loan pools, they have proven to be attractive to Midwestern bankers. District banks now

hold about two and one-half times as much of this loan paper as they did a year ago.

At the same time, *farm real estate loans* have increased modestly, and *other farm loans* have dropped about 10 per cent in dollar volume. This decline from year-ago levels was not uniform throughout the District. Slight increases in these "other" farm loans were registered in most areas of Wisconsin and in small sections of Michigan and Indiana. Declines were heaviest in areas where cattle feeding is important.

*Loans to individuals* are still above 1953 levels in District banks. However, all types of instalment credit extended to consumers have been dropping steadily since the first of the year. The excess of repayments over new extensions of consumer instalment loans reflects particularly this year's somewhat reduced dollar volume of sales of new and used autos.

*Real estate loans* of all types, on the other hand, have risen in the past 12 months, a reflection of the continuing building boom. Falling interest rates and more liberal terms for borrowers have been instrumental in maintaining the unprecedented volume of residential construction.

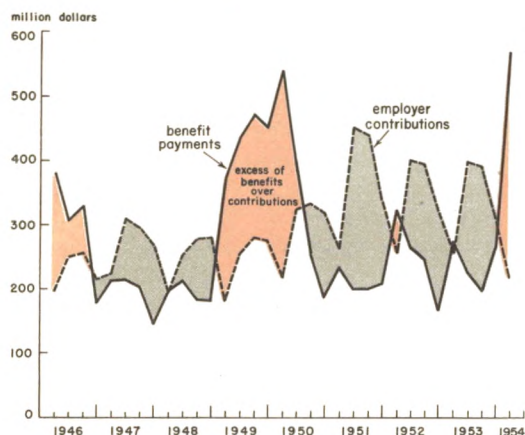
## LABOR

### Jobless benefits partial offset to income dip

The decline in employment which began last fall found state unemployment insurance funds at record highs—close to the 9 billion dollar mark in the aggregate. Measured against the shrinkage in wage earnings during recent months, this is a large total. It is not the presence of these reserves, however, but rather the prospective rate at which they will be spent which is significant in evaluating the compensation system's part in offsetting the reduction in current earnings.

From the inception of the unemployment insurance program it has been clear that such

## Insurance system adds to income during recessions and withdraws funds in boom periods



a device cannot be expected substantially to counteract deflation. Perhaps the best support for this conclusion is in the fact that benefits are most limited in amount and duration with respect to those who have the greatest exposure to job loss—the workers with least seniority and minimal training and skills. In the face of a strong downward movement, particularly if it is long sustained, the system can at best provide only partial short-term relief to the limited number it covers.

The full impact of unemployment compensation on the economy remains unclear; it has never been defined in the same precise way as the role of fire or casualty insurance, where exposure to certain specified and predictable losses determines premium costs and the adequacy of insurance reserves can be clearly ascertained. What does unemployment insurance cover, and, hence, what is the meaning of “adequacy” as the term is applied to fund reserves?

The system should and does cover certain employees thrown out of work briefly in the course of localized readjustment. Reserves, though, have become far larger than they need to be to take care of such frictional unemployment—to tide workers over short periods of

joblessness brought about by factors like temporary plant shutdowns and the initial impact of industrial relocations.

Those insured under the system always face the added threat of possible job loss on a wholesale scale during periods of general recession, a risk not predictable (and thus not “insurable”) in the same manner as frictional unemployment. A part of the cost of such cyclical joblessness could be carried by the insurance system if preservation of reserves did not take priority over their use. But, since recessionary unemployment would always constitute a potential threat to reserves, benefits are limited by a variety of rules designed to protect the system’s solvency.

### A case in point: 1949-50

At the end of 1948, balances in state insurance reserve accounts stood at 7.6 billion dollars. During 1949 and the first half of 1950, they fell by about one-eighth as an accompaniment and, in part, the aftermath of a recession that saw total unemployment rise from 1.6 to 4.7 million. Total wage and salary income during the 1948-49 downturn declined by about 4½ per cent from peak to trough.

The outflow of reserves from the unemployment insurance funds reached 95 million dollars a month, or an annual rate of 1.1 billion, during the first quarter of 1950. Since the drop in wages and salaries, however, was nearly 6½ billion dollars, on an annual basis, the insurance system made up only about one-sixth of the decline in wage and salary receipts.

### Protection of the reserves

Reasons for the slow payout of fund balances are several. Cash payments to those entitled to them, for one thing, are limited by law. Maximum weekly benefits range from \$20 to \$33. Average benefits paid come to only a third or so of the wages of workers in the kinds of employment covered by the program.

The President has suggested that the state legislatures liberalize weekly benefits by increasing ceilings to at least half of prevailing weekly wages, as was roughly the case when

the program was inaugurated in the late Thirties. Considerable support is found, too, for an increase to three-fifths or even two-thirds of wages.

The state plans also restrict the duration of benefits. These limits range from 16 to 26½ weeks, depending upon the state. Although a benefit claimant had been steadily employed for many years and payroll taxes had been paid in his behalf during all this time, part of the sum accumulated becomes sterilized as soon as he reaches the end of his period of benefit eligibility. As the period of unemployment lasts beyond the statutory limits and measures designed to protect reserves come into play, the insurance system loses its stimulus to the economy.

Another proposal made by the President is to make maximum benefit periods at least 26 weeks in all the states. Like the plan to raise benefit ceilings, such a measure would help somewhat in bringing the scope of benefits closer to current needs, but it would have little effect on the basic nature of the program.

In addition, the system does not apply to all the gainfully employed and thus all who lose their jobs when there are layoffs. Only those who work in "covered" establishments, which support the system by paying payroll taxes, are entitled to insurance benefits. These number about 36 million, around two-thirds of total nonfarm employment and 60 per cent of all the gainfully employed.

Finally, another factor serving to insulate reserves against the impact of joblessness is the continuing inflow of employer payroll tax con-

tributions. Under the experience-rating systems used by the states, an employer's payroll tax rate depends upon the balance in the state reserve and upon the stability of the employer's job rolls. After a period of unemployment has been under way for a time, therefore, the rates tend to go up, just as they decline when times are good. This "perverse" elasticity of payroll tax rates helps to cushion the reserves against the impact of an outflow of benefit payments, but its timing may be unfortunate, if unemployment persists, since higher payroll costs aggravate the basic trouble.

### Funds large relative to payouts

The adequacy of unemployment insurance reserves sometimes is measured by relating them to past rates of withdrawal. In such terms the total on hand January 1 in all state accounts, roughly 9 billion dollars, would support the first quarter 1954 rate of benefit payment for nearly 4 years. Such a method of measurement, however, ignores the effect of limits on the duration of benefits and thus understates the capacity of the funds to withstand prolonged unemployment. Furthermore, the situation varies so widely from state to state that it is impossible to read meaning into a measure of the "adequacy" of the over-all balance.

Just as this comparison understates the probable longevity of the reserves, it misleads as an indication of the role the balances can play in a prolonged period of depressed income. Limits upon benefit duration mean that, as unemployment drags on, beneficiaries "exhaust" their compensation rights and have to fall back upon other resources: their savings, help from their relatives and, if no other support is forthcoming, public assistance. The payout from the funds tends to aid the short-term unemployed. Thus, if joblessness stabilizes, unemployment compensation payments will dry up.

Similarly, at the inception of a period of unemployment, when a fuller restoration of lost spending power might help materially to stem further deterioration, many of the first claimants are found either totally ineligible or else

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## Unemployment compensation systems in the Seventh District states, 1953

	United States	Illinois	Indiana	Iowa	Michigan	Wisconsin
Maximum weekly benefit .....	—	\$27.00	\$27.00	\$26.00	\$27.00 <sup>1</sup>	\$33.00
Maximum benefit period (weeks) .....	—	26	20	20	26	26½
Minimum number of employees in covered establishments .....	—	6	8	8	8	6
Gainfully employed (thousands) <sup>2</sup> .....	63,453	4,100	1,800	1,000	2,800	1,500
Nonfarm employment (thousands) <sup>2</sup> .....	55,245	3,800	1,500	700	2,600	1,200
Employees covered by unemployment compensation (thousands) <sup>3</sup> .....	36,397	2,537	1,059	370	1,885	803
Per cent of gainfully employed .....	57	62	59	36	68	54
Per cent of nonfarm employment .....	66	67	68	53	74	68
Average weekly wages (covered workers) <sup>3</sup> .....	\$71.19	\$78.57	\$76.27	\$65.58	\$87.86	\$73.46
Average weekly benefits during 1953 .....	\$23.58	\$25.31	\$23.95	\$21.75	\$27.15	\$27.05
Per cent of wage covered by benefit .....	33	32	31	33	31	37

<sup>1</sup> Increase effective in 1954: \$30.00 to single person earning at least \$75.51 weekly, \$42.00 for recipient with four dependents.

<sup>2</sup> State data partially estimated.

<sup>3</sup> First six months.

entitled to benefits that are small in amount and of short duration. The reason for this is that typically those who first feel the impact of job curtailment are the marginal workers—new entrants to the labor force, sporadically employed elderly workers and members of minority groups, and comparatively low-paid manual laborers—whose limited wage credits and short terms of employment entitle them to only nominal benefits. Later on, as layoffs extend more deeply into the groups of workers holding higher-paid jobs and having substantial seniority, the weekly benefit amounts and durations of benefit payment tend to rise toward their respective ceilings.

Another proposal recently under study by Congress would set up a new fund from which interest-free loans could be made to individual state reserves threatened with depletion, owing to exceptionally heavy drains upon them. The difference between the annual proceeds of the 0.3 per cent Federal payroll tax and the cost of administering the state programs (covered, as now, by Federal grants to the states) would be earmarked specifically for this purpose.

Such a plan would afford protection to states particularly hard hit by unemployment, while

allowing some deferment of the increase in payroll tax rates needed to pay back the loans.

### The short-run problem

At the present time and perhaps in the months lying immediately ahead, interest is centered on measures that can sustain or enlarge the stream of consumer incomes and spending.

If employment fails to pick up, reserve balances will continue to decline, although not in direct relation to the decline in income, and the stream of benefit payments will tend to lessen the load that other, more potent anti-recessionary measures will have to carry. Unlike defense spending and some of the other important segments of public expenditure, unemployment insurance on balance is likely to exercise a net expansionary effect. Moreover, it will tend to do so automatically.

This element of the nation's social security program has been designed to meet the modest objective of providing protection against short-term joblessness; it is not and by its nature it cannot be any more than a first-line defense against a pervasive downswing in general business conditions.