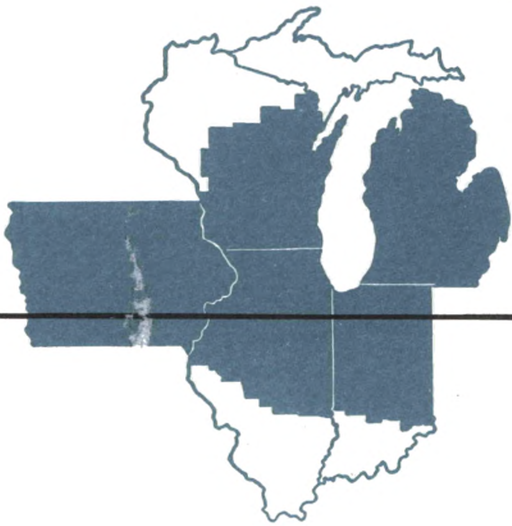
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1954 October

Contents

THE Trend OF BUSINESS

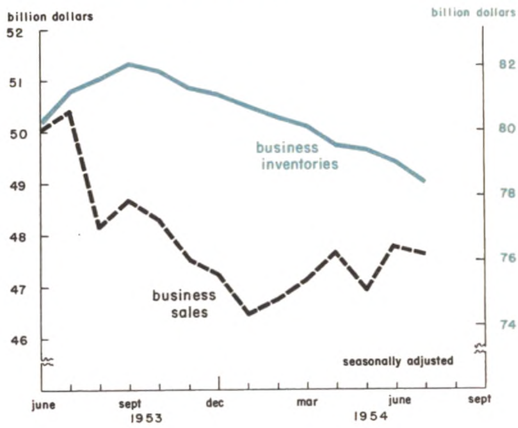
There is very little evidence in the business picture at present to suggest that any significant change in over-all activity is immediately in the offing. Expectations that the fall months will bring a more than seasonal upswing are as yet unrealized. On the other hand, there have been no important developments during the summer which point to a worsening in business generally. In fact, most aggregate measures of activity have moved within a very narrow range since last spring—two principal exceptions being construction, which has increased substantially further, and employment, which has continued to decline gradually on a seasonally adjusted basis.

The probable course of Federal spending in the months ahead was clarified recently by publication of the President's midyear budget review (see page 16). Estimates of national security outlays in fiscal 1955 have been reduced substantially from those contained in the January budget message. At 43 billion dollars, such outlays would be nearly 5 billion less than actual expenditures made in the fiscal year ended last June. The decline in prospect, however, is substantially smaller than the 10 billion dollar drop from the mid-1953 peak which has already taken place. Moreover, estimates of cash receipts have also been pared, owing to tax reductions and lower levels of business, with the result that the cash deficit is expected to be larger than in the past fiscal year.

The most recent SEC-Commerce survey of business intentions to invest in new plant and equipment, just released, also offers little hope for an improvement in demand in this sector (see article, p. 4). Total outlays are now expected to be 6 per cent less than in 1953, with most of the decline coming in the second half—off over 8 per cent from the same period last year. Perhaps equally important, this is the first postwar year in which capital spending estimates have not been revised *upward* from those indicated by the initial survey taken early in the year. The *downward* revision this time may indicate some deterioration in business confidence as the year has progressed.

The impact of lower Federal expenditures and business capital outlays could be more than offset by a turnabout in the course of business inventories. Even a halt in the decline of holdings which began late last year would result in about a 4 billion dollar improvement, at annual rates, in aggregate demand. Latest figures indicate that the inventory decline continued unabated through July, however. Seasonally adjusted, the reduction

Business inventories have dropped substantially in the past year, but sales are off, too

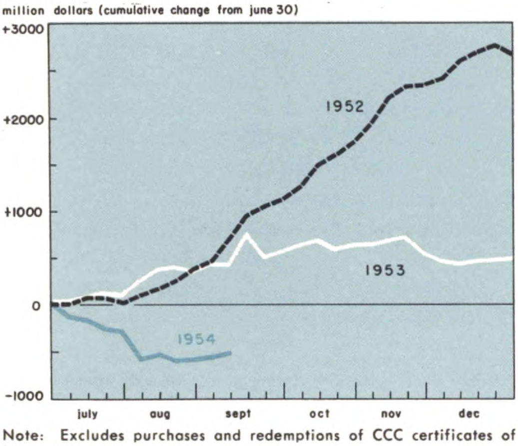


amounted to 630 million dollars—the largest monthly drop since the current wave of liquidation commenced just a year ago.

Moreover, the relationship between inventories and sales has changed little in the aggregate over the past year, owing to a concurrent drop in sales. At the end of July, stock-sales ratios were still higher than a year earlier for the important durable goods manufacturers' group and for wholesalers of soft goods as well. Retail stocks of both durable and nondurable goods were in about the same relationship to sales at the end of the month as in July of 1953.

Industrial production, after allowance for seasonal movements, has held steady since April at a point about 10 per cent below the 1953 high. Some individual components, of course, continued to show changes. Output of steel, oil, lumber, apparel and cars and trucks eased off at least moderately during the summer, while the production of most household durables increased substantially in response to good levels of demand and alleviation of earlier excesses in finished goods inventories. Steel output increased only slightly in September from the summer lows, but trade reports suggest that a sizable pickup is still in prospect some time before year-end. At the same time, automobile production in September and October is expected to be sharply below August and at the lowest level since 1946, reflecting model change-overs and a desire to allow dealers time to move out stocks of 1954 models.

Business loans at big city banks fail to show seasonal loan rise



Note: Excludes purchases and redemptions of CCC certificates of interest.

Wage and salary employment, as estimated by the Bureau of Labor Statistics, has continued to weaken during the summer. In August, such employment was nearly two million—4 per cent—less than a year earlier. This compares with year-to-year differences of 1.6 million in May, 1 million in February and no decline at all as recently as last December. Wage and salary employment also dropped below comparable 1952 levels for the first time in August. Groups most affected by the contraction have been production workers in manufacturing—particularly durable goods firms—and employees in the mining and transportation industries.

Retail sales, after seasonal adjustment, eased off by about 1 per cent in both July and August from the June high for this year. Much of the reduction, however, was accounted for by a drop in automobile sales from the exceptionally high June rate. Retail sales totals should compare favorably with those of a year ago through the fall season. Volume dropped abruptly in the late summer of 1953, mostly due to a reduction in apparel and automobile sales, and showed little recovery until the spring of this year. Therefore, a real pickup in retail trade this fall will require more than moderate plus figures as compared with last year.

The usual fall rise in business loans at big city banks has been notable mostly for its absence so far this year. From the end of June through September 8, such loans declined 550 million dollars, after adjustment for repayment of the special CCC certificates of interest issued last winter. This compares with increases of 370 million dollars in the same period last year and 680 million in 1952. Most of the difference in loan movement between this year and last has resulted from reduced borrowings by metals and metal products manufacturers and public utility and transportation firms. Expectations are that the loan rise during the remainder of this year will continue to be much less than seasonal, unless the inventory liquidation of recent months is reversed and business activity picks up substantially.

The income position of agriculture has weakened further in recent months, continuing the gradual downtrend which began in 1951. In the first half of this year, farmers' cash receipts from marketings, including CCC loans, ran at a seasonally adjusted annual rate of 31 billion dollars, 2 per cent less than in the corresponding period in 1953 and 4 per cent below 1952. Preliminary data for July and August indicate further slippage in the third quarter (see article, p. 11). Farm operators' net income has dropped considerably more during this period, owing to the stickiness of production costs. The resultant contraction in farm demand for consumer goods and for producers' equipment such as farm machinery promises to continue as one of the most persistent weaknesses in the over-all business situation.

Boom subsides for capital goods

New plant and equipment outlays of business are expected to total 26.7 billion dollars in 1954. Achievement of the projected level of expenditures would mean a decline of 6 per cent from last year's record, but 1954 would still place as the second best year.

The absolute level of capital spending, therefore, is still high, but the slowing pace has been persistent.

> The decline has continued uninterrupted since the third quarter of 1953. Fourth-quarter spending apparently will be off over 10 per cent from the top rate.
>
> Plans have been cut back since surveys made earlier in the year. The September projection for the year as a whole shows a reduction of over one-half billion dollars from the estimates of last February.
>
> There is no convincing evidence that the downswing will be reversed in the foreseeable future. Order backlogs of capital goods producers continue to slide.

Capital expenditures of the railroads and some manufacturing industries are being cut drastically this year. This development is in line with the ample capacity now available in such lines as steel, homefurnishings, farm machinery, textiles and chemicals. Public utilities will be off as much as the total—the first time in the postwar period that the upward trend for these firms has been reversed. Isolated segments of industry are expanding capital spending, however. Commercial building has been at a new high, and the automotive industry reports larger outlays.

Equipment buying takes the brunt

New tools and equipment account for perhaps 70 per cent of all business capital expenditures. Declines in these items have outweighed stability in total business construction. Spending on all producers' equipment, including farm machinery, is running about 12 per cent below the peak.

Some types of machinery and equipment have been hit much harder than the totals. In some cases the slide began three years ago. Truck output this year is estimated at 970,000, about 20 per cent below 1953 and about one-third less than the peak year of 1951. Farm machinery production in the first three quarters has lagged 1953 by over 20 per cent. As in the case of trucks, 1953 output of tractors and farm implements was well below 1951. The reduced level of operation in machine tools and railroad equipment has been especially important in some areas.

Tool building in the Midwest

Business equipment sales are of vital importance to Midwest centers. The five states of Michigan, Illinois, Wisconsin, Indiana and Iowa account for only 16 per cent of the nation's population, but they include 28 per cent of all electrical machinery employment and 38 per cent of all nonelectrical machinery workers. These states also have a major share of railroad equipment building facilities, and over two-thirds of all employment in the farm machinery industry and in the motor vehicle industry which provides business with trucks, trailers and passenger cars.

Production of particular goods is often concentrated in certain areas. This is because "like begets like." A firm often locates close to competitors because suppliers and skilled workers are readily available.

Detroit, widely known as the automobile capital of the world, also accounts for about 14 per cent of the nation's employment in the metal-working machinery lines. A multitude of industrial machinery firms and tool and die shops have grown with the automotive industry. However, their skills and facilities are put to work for other customers as well.

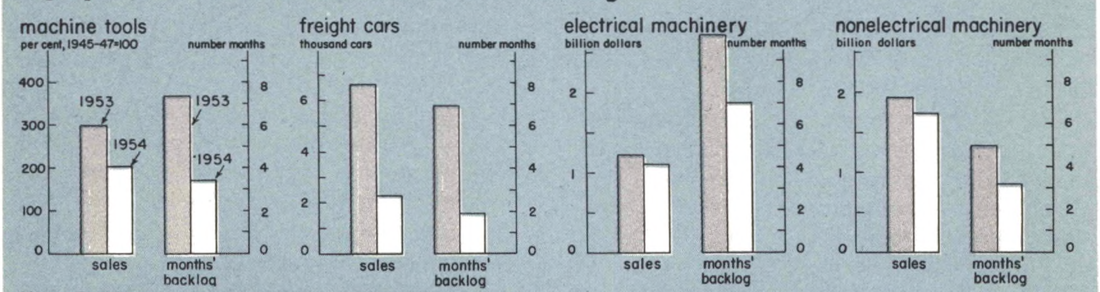
Chicago contains a wide variety of machinery including such lines as presses and materials-handling equipment, but they do not loom so large in relative importance as in most other large centers in this area. Farm machinery and railroad equipment are also noteworthy. Perhaps, the city's standout contributor to industrial equipment output is the Western Electric Company which employs over 20,000 persons and supplies the Bell System with a large share of its equipment.

Milwaukee's machinery firms account for 40 per cent of its entire manufacturing employment. Included in this group are a dozen or so establishments which are among the nation's largest producers of heavy industrial goods such as mining equipment, construction machinery, pumps, diesel power, cranes and electrical apparatus. The largest employer in the metropolitan area is the Allis-Chalmers Manufacturing Co., which ranks among the "big three" in the production of electrical generation and transmission equipment. This firm also is an important producer of farm machinery and industrial equipment. More than any other large city, Milwaukee is a "capital goods" town.

Indianapolis too produces a large volume of machinery. About 25 per cent of all of the city's manufacturing employment is concentrated in these lines. Electrical equipment firms are especially important, including plants owned by RCA and Western Electric.

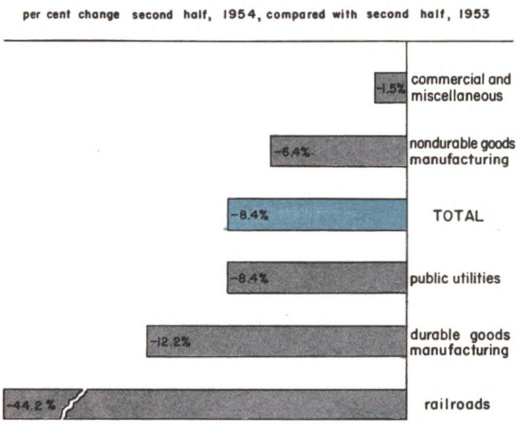
Smaller cities, such as Muskegon, Fort Wayne and South Bend, also are factors in the equipment industries. Peoria, home of

Equipment deliveries melt order backlogs



Note: Freight car and machine tool data are for August, others for July.
SOURCE: *Railway Age*, NMTBA, Department of Commerce.

Slump in capital outlays greatest in railroads



Caterpillar and Le Tourneau, is extremely important in the earth moving equipment field. Farm machinery and related items are vital to the economies of the Quad Cities area, Racine and Waterloo as well as a number of other centers.

Machines that make machines

One of the key industries in the machinery category is the machine tool group, the products of which contribute prominently to continued technological progress. This term usually has been restricted to devices such as lathes, milling and boring machines and the like which shape parts by removing chips and shavings of metal. Recently, the term has been applied more broadly to include hydraulic presses and forges as well.

Machine tools account for only 5 per cent of total dollar volume of producers' durables, and the industry contains no giant firms. Nevertheless, these products are vital to modern industry. The production bottleneck caused by the supply of machine tools early in World War II and in the Korean crisis is well remembered. Within a few months after the start of hostilities, orders for most types of machine tools skyrocketed.

More than any other line, with the possible exception of freight cars, this industry is at the "end of the lever" of industrial fluctuations. Three years ago machine tool builders' order backlogs were equal to 23 months production. In July, shipments were 24 per cent below last year and the backlog had receded to less than four months of the "demonstrated production rate."

The great bulk of the nation's machine tool-building capacity is located in a few cities in New England and Ohio and, in this District, Rockford, Detroit, Milwaukee, Fond du Lac, South Bend and Madison. The industry is dominated by highly specialized, relatively small concerns. Well-known firms seldom employ upwards of 1,000 workers.

Rolling stock output plummets

Lagging freight volume and a sharp drop in railroad earnings have contributed to a 50 per cent decline in freight car deliveries since last year and a virtual disappearance of order backlogs. During the 12 months ending July 1, moreover, unfilled orders for diesel-electric power units fell from 564 to 124. Passenger car business, by way of contrast, has been maintained partly on the strength of Canadian buying.

Railroad equipment has long provided a prime example of a "boom and bust" industry. The most recent buying spree, as the accompanying chart reveals, is drawing to a close. Past experience has caused producers of freight cars to use the profits of good years to acquire subsidiaries in other lines of activity in preparation for this inevitable letdown.

During May, the Pressed Steel Car Company, until five years ago a producer of freight cars exclusively, closed its last car-building plant at Mount Vernon, Illinois. More recently, the company has announced its final retirement from the car business and put the plant up for sale. Pullman-Standard also chose May to shut down its Michigan City, Indiana freight car plant, making no announcement concerning the resumption of operations.

The Chicago area contains, in addition to important freight and passenger car-building facilities, the Electro-Motive Division of General Motors. This firm produces a large majority of the nation's diesel locomotives.

For some time, it has been evident that the day was not far off when locomotive builders would have to concentrate on replacement, rebuilding and exports or turn to other products. Deliveries of new units together with reduced traffic has brought the nation's railroads close to full dieselization. According to the ICC, 18 of the 38 largest Class I railroads were carrying on 95 per cent or more of all freight, passenger and switching operations by diesel power during the first four months of the year. Steam locomotives accounted for as much as half of the freight haulage on only three roads; in passenger service, on only two; and in switching, only one.

Expanding the market

New orders for producers' equipment continue to lag despite generally stable business activity. This situation is a natural consequence of the heavy outlays of recent years which were spurred by intense demand, Government urgings and the ability to write off defense-connected purchases against excess profits tax earnings. A lower level of output of these goods cannot continue indefinitely, however, if the American economy is to realize its potential for growth.

Some capital goods producers hope to reverse the downtrend in output through more vigorous sales campaigns and improved equipment which will pay for itself rapidly through lower costs. They also look to increased foreign buying which, in the recent past, has depended primarily upon the supply of dollars available abroad. The Government has extended a helping hand in the domestic market. Stimulation of producers' goods output was the motivation behind the provision in the new tax bill which allows a business firm to write off, for tax purposes, as much as two-thirds of the cost of a new fixed asset in the first half of its life. But there is no indication that the downtrend in spending for capital goods will be halted in the months immediately ahead.

Time deposits continue growth

The business dip since mid-1953 has touched almost all sectors of the domestic money and credit structure. One eye-catching exception, however, is the unabated growth in money placed in time deposits in the nation's banks. By the end of August 1954 such deposits in commercial and mutual savings banks aggregated nearly 72 billion dollars, up 5 billion from year-ago levels.

Time deposit growth typically has withstood all except the most severe business declines. In the past two decades, such deposits have had a virtually uninterrupted expansion. The rate of growth was dampened during the earlier postwar years, partly because of consumer desires to carry out war-deferred spending and partly because of the competitive "bite" of alternative savings outlets. Since 1951, however, time deposit gains have ranged between 7 and 8 per cent a year, with the growth since mid-1953 setting a postwar record in dollar volume.

Movements in time deposit balances reflect individual motivations regarding the proportions of current income to be saved much more strongly than do checking account totals. With aggregate personal income after taxes high and well maintained over the past year and with increased uncertainties in some peoples' minds regarding future income prospects and the course of prices, the "public" has been in a saving mood. Indeed, the prime competitors of banks for savings accounts—the savings and loan associations—have also enjoyed a record inflow of funds over the past year, while the savings bond program has experienced its best sales year in some time. Although savings accumulation may not persist at the current high rate, continued growth in time deposit balances seems assured so long as income is maintained at close to the present level.

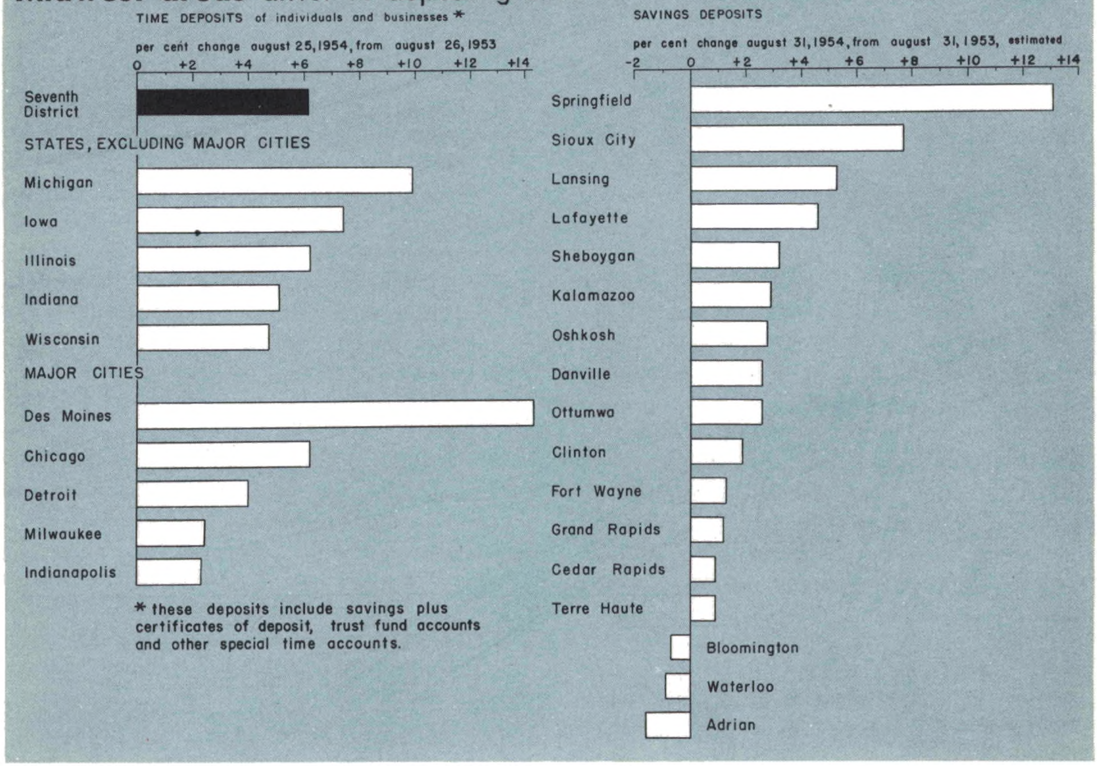
Time growth lags in Midwest

Seventh District member banks experienced a 6½ per cent gain in time deposits over the year ended last August. This rate of increase, however, was less than two-thirds of that for all member banks in the nation. The rate of growth has been roughly similar in most areas of the country, but much greater relative gains in the New York and Dallas Districts boosted the national average increase to more than 11 per cent (see chart).

The sharp rise in time deposits of New York District member banks has resulted in part from piling up of such balances by foreign banks. Drastic reductions in yields on short-term Governments and other money market securities over the past year have made time deposits a relatively more attractive investment for such temporary lenders. Continued prosperity, reflecting the strong growth trend in the Southwest, has been a major factor in the more rapid time deposit expansion for banks in the Dallas District. In addition, member banks in both of these areas have enjoyed unusually large gains in escrow deposits of state and local governments over the past 12 months.

Probably the major reason behind the poorer showing of Midwest banks recently with regard to time deposit growth has been the relatively sharper decline in business activity in this area than in the nation generally. Durable goods industries, especially important in many Seventh District centers, have taken the brunt of the business decline, just as they had shown a larger than average expansion in earlier years. In addition, cash receipts and net income have fallen off substantially in the farm sector, im-

Midwest areas differ in deposit growth



* these deposits include savings plus certificates of deposit, trust fund accounts and other special time accounts.

portant in the economies of most nonmetropolitan District communities. A longer look at time deposit growth shows that Seventh District member banks have not fared badly, however. From December 1945 through last August, time deposits in this area have risen 61 per cent as compared with a 60 per cent gain for the nation as a whole.

Who owns the time deposits?

The most important group of holders of time deposits in Seventh District member banks are individuals and businesses. Their deposits accounted for 97 per cent of the 7.2 billion dollars in member bank time deposits as of June 30, 1954. The dollar volume of these accounts has grown by 6 per cent over the past year.

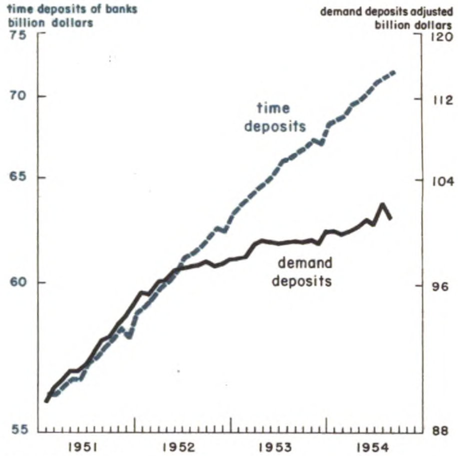
In most District banks, by far the largest share of time deposits is in conventional savings accounts. A growing variety of special types of time accounts, however, has appeared in recent years. Some banks hold significant amounts of trust fund accounts, and Christmas and other savings club accounts have been promoted by many institutions. In addition, some District banks have attempted to meet the competition of other savings repositories in their local communities by issuing time certificates of deposit, which carry a fixed maturity and yield somewhat higher rates of interest than those on straight savings.

The bulk of the time deposits not held by individuals and business groups consists of funds of states and municipalities. As of June 30, these accounts had grown by roughly 26 per cent over the preceding year and were quite important in a few Illinois and Michigan banks. In addition, District banks held about 25 million dollars in time accounts of the United States Government. Foreign time deposits have more than tripled since mid-1953 but still amounted to only 15 million dollars, all in Illinois banks.

Rate of growth varies widely

Within the over-all upward trend of the savings account total, rates of growth have varied widely among individual District banks. Within

Contrasting trends in time and demand deposits



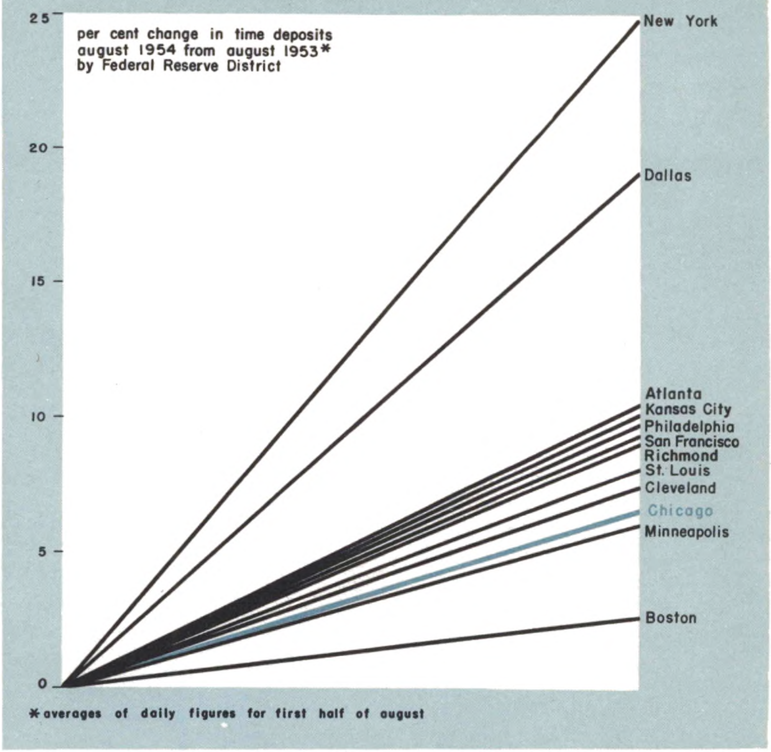
Demand and time deposits are adjusted to exclude U.S. Government and interbank deposits. Demand deposits are also adjusted to exclude items in process of collection and are seasonally adjusted.

The steady growth in time deposits is in distinct contrast to recent movements in checking deposits. So-called "adjusted demand deposits"—checking accounts owned by individuals, businesses and state and local governments—have shown only modest increases since last year.

While overshadowed by time deposit gains, the behavior of demand deposit totals has not lacked significance. Though small, the *increase* in privately held demand deposits contrasts sharply with the *contractions* accompanying most past recessions. Tied closely to total bank loans and investments, demand balances usually declined in times of stress as businesses and individuals repaid bank debts by drawing upon their checking accounts.

With the demand deposit structure much more dependent upon changes in Government security holdings than before the War, however, the total of such deposits is now less subject to spontaneous contraction during such business downturns. The same recessionary forces which lead private borrowers to repay debts also tend to reduce tax receipts and increase Federal borrowing needs. During the past year, bank acquisitions of Government securities have more than offset the moderate declines in business and consumer loans.

Seventh District member banks trail nation in time deposit rise



a group of 160 member banks for which data are available,[1] about one-fourth experienced net declines in savings balances in the year ended August 31. On the other hand, 9 per cent reported gains of 10 per cent or more, while one-fourth indicated a 5 to 10 per cent increase in savings account balances.

The reasons for these disparate changes are both numerous and complex. A major factor in a few areas has been bank stimulation of deposit growth by increasing interest rates paid. Thus a rate increase for savings deposits in Springfield banks appears to have contributed importantly to the 13 per cent rise in that area's reported savings deposits over the past year. A good share of the recent sharp rise in time deposits of member banks in Des Moines apparently stems from the relatively high interest rates paid on savings—as well as the institution two years ago of time certificates of deposits at the maximum 2½ per cent rate. Modernization of quarters or promotional advertising may have affected movements in savings totals. The experience of individual banks also has varied with the degree and intensity of competition from other institutions for the savings dollars.

Perhaps most important, individual bank experience has varied with the state of business in the communities in which they are located.

The attitude of potential savers in the community is also an important but intangible factor influencing the course of savings account totals. If people are cautious or apprehensive regarding the future, their rate of saving may increase regardless of changes in interest rates or the amount of promotional expenditure. Member banks in some areas have enjoyed large relative increases in savings balances over the past year with interest rates remaining unchanged, local business activity well maintained and competition for savings continuing as before. It may be that some people have temporarily grown more cautious and have plowed a larger proportion of income into savings for use when times seem more propitious.

[1] Statistics presented in this section were derived from a current survey of savings debits and deposit balances of 160 banks in the Seventh District. These banks accounted for about 35 per cent of total time deposits—except interbank—in the District on June 30, 1953. For 17 centers, reporting is sufficiently complete to permit regular monthly releases on trends in savings deposit balances and debits thereto.

Midwest farmers sell more hogs — for less money

Wondrous are the ways of the "Law" of supply and demand. Practically everybody has at least a passing acquaintance with it; yet, nobody, economists included, can be sure of its many ramifications in a particular situation —like, for example, the increase in hog marketings this fall.

Briefly, the Law says that prices tend to vary in the same direction as changes in demand and in the opposite direction from changes in supply. Unquestionably this is true, and it applies to the hog situation this fall when marketings will be more than 10 per cent larger than a year ago while demand is expected to hold steady. But for farmers, meat packers, consumers and others who have a direct interest in hog prices, as well as the industries which sell their products to hog farmers, the crucial question is this: *how much* will the increased supply cause hog prices to drop this fall?

"Elasticity of demand" for hogs

To shed some light on that question, studies have been made of "elasticities." Price elasticity of demand for a commodity is the per cent change in volume of marketings which accompanies a 1 per cent change in price. For example, a recent USDA study indicates that, if hog marketings increase 10 per cent from one year to the next, hog prices received by farmers decrease about 20 per cent, if other things remain the same—an elasticity of 0.5.

Of course it is not certain that the "true" elasticity actually is 0.5 or that it remains stable at that figure. And it is certain that "other things" *never* remain the same from one year to the next. Nevertheless, the figure provides a rough idea of what may be expected in price behavior, especially if discerning judgment is exercised regarding changes in "other things."

To illustrate, the following table presents the hog picture for the last half of 1952 and 1953 compared with hypothetical data for the like period in 1954.

From the last half of 1952 to the like period in 1953 hog slaughter dropped 12 per cent, and this was accompanied by a price rise of 22 per cent. "Other things" tended to offset each other. A 33 per cent increase in cattle slaughter, which had some depressing effect on hog prices, was at least partly counterbalanced by a 3 per cent increase in consumer disposable income.

In the last half of this year it is expected that hog slaughter will exceed the year-earlier quantity by some 11 per cent. This will be accompanied by a price reduction roughly

Supply-demand factors in the hog situation—last half of the year

	Hog slaughter (million head)	Year to year change	Price received by farmers for hogs (dollars per cwt.)	Year to year change	Cash receipts from hog marketings (billion dollars)	Year to year change	Slaughter of cattle and calves (million head)	Year to year change	Consumer disposable income (billion dollars)	Year to year change
1952	41.5		18.50		1.78		15.2		124.7	
		−12%		+22%		+ 7%		+33%		+3%
1953	36.5		22.50		1.90		20.2		128.9	
		+11%		−20%		−11%		+ 5%		+1%
1954[1]	40.5		18.00		1.70		21.2		130.0	

[1] Hypothetical data for 1954 used to illustrate possible changes.

double that magnitude if the 0.5 elasticity holds true for this period. Cattle slaughter probably will again exceed the year-earlier volume, but by a small percentage. In recent months consumer disposable income has been running about 1 per cent above year-ago levels.

Larger output, smaller income

Since gross receipts from sales are the product of price times quantity, and since prices fluctuate about twice as widely as the volume of product sold, gross receipts will be larger when the volume drops, and vice versa. That is, farmers' cash receipts from a small crop are greater than for a large crop. For example, from the last half of 1952 to the corresponding period in 1953 hog slaughter dropped but farmers' cash receipts from hog marketings rose 7 per cent. On the other hand, between the last six months of 1953 and the like period this year increased hog slaughter will be accompanied by a drop in farmers' cash receipts.

If the hypothetical 1954 data in the table were to be realized, this decrease would amount to 200 million dollars. And since about half the hogs in the U. S. are marketed from farms in the Seventh District, farmers' income from hogs in that area would be approximately 100 million dollars less than it was in the last six months of 1953.

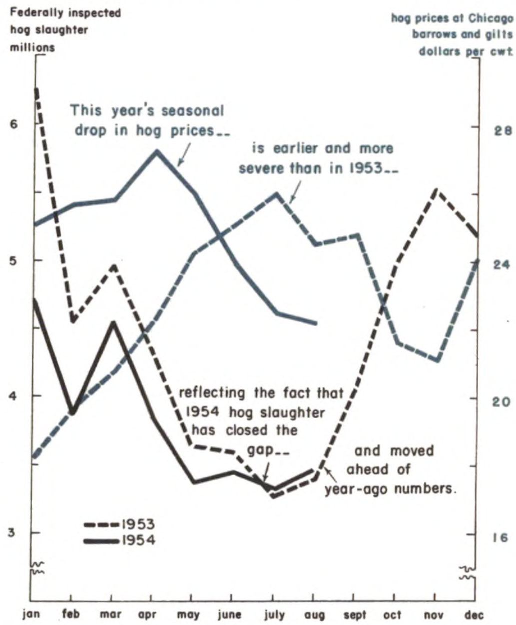
Elasticity for food groups

The phenomenon of low elasticity characterizes the demand for most farm products. In addition, the degree of elasticity is lower for *groups* of foods than for individual commodities, and the elasticity declines as the groups are made more inclusive. For example, certain cuts of beef and pork are rather close substitutes for each other in the tastes of consumers. Consequently, housewives will shift purchases from one of these types of meat to another in response to changing price relationships. Most of the elasticity develops out of this substitution. But if all meat taken together is compared with other types of food, then the substitutability is not so close, and the elasticity is lower. The figure is about 0.4 for all meat in the aggregate. This means that a 1 per cent change in the total meat supply would produce a 2.5 per cent change in price.

There are some types of foods—like potatoes—which have a very low elasticity. Consumers buy about the same quantities of these despite relatively large price changes. Commodities like potatoes tend to lower the average elasticity for all foods taken together. But a more important influence affecting the elasticity for all food in the aggregate is the fact that food is very dissimilar to nonfood goods and services as far as consumer preferences are concerned. In other words, more food is a poor substitute for fewer TV sets, autos and such.

For *all* farm products taken together, the elasticity is about 0.25, according to one study. This means that a 1 per cent increase in marketings of farm products may be accompanied by a 4 per cent drop in price. Thus, large price changes are needed to move small

Hog price pattern this year reflects expected larger slaughter this fall



increases in supply into consumption within a given market.

Pork and beef too

The meat situation this fall is more complex than the problem posed by increased cattle marketings last year. In 1953 when beef supplies were very large and pork supplies small, price adjustments ensued which encouraged consumers to substitute beef for pork. Now beef supplies remain large; in fact, larger than in 1953, and beef prices have held fairly steady near the reduced levels of last year. Getting consumers to increase consumption of pork while maintaining consumption of beef is a more difficult problem than was faced last year. We now have an increased supply of both pork and beef, and this food group has a lower elasticity than pork considered separately.

In the early months of this year hog slaughter was well under year-earlier numbers. As the months passed that gap was narrowed, and packers worked down their pork inventories. Wholesale pork prices declined very sharply and hog prices responded with a seasonal drop that came earlier and was sharper than in 1953. In the last half of August hog prices dropped about $4.00 per hundredweight in Chicago as slaughter rose above the level of August 1953.

Surveys of hog farmers' marketing intentions indicate that slaughter will run above year-ago levels for the remainder of this year and on into 1955. The margin between this year's marketings and those of a year ago will be greatest in the September-October period. During these months the pressure on hog prices is expected to be greatest. In the November-December period the hog supply will be only moderately above a year ago. However, the price recovery from the seasonal low is expected to be moderate because supplies will remain large throughout the winter. A recent U. S. Department of Agriculture survey indicates that sow farrowings this fall in six Corn Belt states will exceed year-earlier numbers by about 14 per cent. If this prospect materializes, hog supplies will continue large at least until the middle of 1955.

Fitting the property tax for the bigger job ahead

Mounting demands on the services and facilities provided by local governments have touched off an anxious search for additional funds. More often than not surveys of revenue possibilities are prefaced with assertions to the effect that "property already is paying all it can" or that "ways must be found to lighten, not to increase further, the burden on real estate."

Producing about 10 billion dollars a year, only a small fraction of it for state purposes, the property tax remains the cornerstone of local revenue systems. Such developments as stepped-up state grants, greater reliance on user charges and the wider adoption of non-property taxes are a big help in the struggle to balance local budgets, but they have not led to any lessening of property taxes. In fact, the pressure on budgets generally has been so intense that yearly increases in property levies have been more or less the rule for a good many years, as the property owner is painfully aware. Ways to improve the operating efficiency of the tax on property, to gear it effectively to today's, and tomorrow's, needs thus are again receiving close attention.

Examined and re-examined

Reforming the property tax has been a popular diversion for many years. Dozens of "model plans" have been formulated, and a good deal of concrete work has been done in recasting legislative and administrative arrangements affecting this tax. But that more remains to be achieved would be agreed to by virtually everyone conversant with the matter.

The insensitivity of property taxes to changes in business activity has been the cause of much of the difficulty in which local governments have found themselves in the last few years.

Property taxes, yield doubles but importance lessens in a generation's time

Today

10 billion dollars is their yearly yield. This is 10 per cent of all public revenues, making the property tax the most productive state-local revenue source and next in importance to Federal taxes on incomes.

The annual property tax bill amounts to something less than 3 per cent of the value of the nation's production of goods and services.

All of the 10 billion except about 400 million dollars, which goes to the states, is used to support local governments. The Federal Government does not levy property taxes.

35 per cent of the 10 billion total makes up one-half the income of city governments.

30 per cent of property taxes collected produces roughly one-half of school district income.

The remaining 35 per cent finds its way to the other local governments — townships, counties and special-purpose units—and to state treasuries.

In 1929

5 billion dollars was collected from property, but this was more than 40 per cent of the total, and the property tax was the largest of all producers of public revenues.

Property taxes came to slightly more than 5 per cent of gross national product.

4.7 billion dollars of the 5 billion total was collected by the local governments, leaving the remaining 300 million for the states.

45 per cent of the total accounted for nearly four-fifths of city government revenues.

25 per cent of the total made up all but 15 per cent of the total revenues of school districts.

30 per cent helped meet the costs of local units other than cities and school districts and of state governments.

For one thing, the assessed valuations which are used in figuring tax bills usually lag far behind the inflationary forces that call for greater local spending. Equally significant is the fact that the process of administering the property tax is so long and drawn out that, even when a tax increase has been set in motion, it may be a matter of many months before the additional income is realized by the governmental bodies.

Timely taxation

Practically every proposal for comprehensive reform of the property tax has put a good deal of emphasis on the interval between the time property is assessed and the time taxes are collected. Abbreviating that interval, often a year and a half or even longer, would reduce the chance that important changes in taxpaying capacity could occur between the time liability for the tax is established and the time bills have to be paid. Furthermore, such a step would help the taxpayer to see more clearly the connection between the services he enjoys and the price he pays for them, insofar as he can gauge it from an inspection of his tax bill.

This proposal takes on added appeal when the timing of the property tax is compared with the timing of most of the other levies familiar to taxpayers. Current collection of the Federal individual income tax has become so thoroughly entrenched that we may well wonder how we ever got along without it.

The states, too, in turning to withholding as a means of collecting their taxes upon individual incomes, have been moving closer to the goal of current collection. Their sales, motor fuel, tobacco and liquor taxes are on a current basis so far as taxpayers are concerned, although the businesses which do the collecting usually remit after a lag of a month or so.

The instalment process

The really significant contribution made by present schemes for withholding at source lies as much in the division of annual tax bills into a number of instalments, each of them small enough to be manageable, as it does in its shortening of the time lag in the collection process. While the withholding principle hardly could be applied to the property tax, more widespread adoption of instalment payment holds much promise. Not only does it offer a way to secure more nearly current collection, but it provides a way to split tax bills into small, more easily payable amounts.

Although we have gone to "pay as you go" for the Federal individual income tax, we seldom have questioned the practice of requiring the homeowner to pay in one or two instalments (occasionally more than two are provided for) a yearly property tax bill amounting to several hundred dollars. To many a taxpayer, the yearly real estate bill may well be the largest single item of disbursement during the year. Small wonder that proposed increases in property taxes so often provoke vigorous taxpayer opposition.

Nearly everything the consumer buys he pays for as he goes along, or very nearly so. This usually is true of his food, his rent or the expense of operating his home and often his clothing. If he buys a home, it is practically inevitable that he will pay for it in monthly instalments. Over half the purchases of furniture, appliances and new cars involve instalment credit, and two-thirds of used car buyers use credit to finance their purchases. Why, it seems reasonable to ask, should local governments present bills for their services—for this is what the property tax amounts to—in a lump sum?

Since the depression, the practice of requiring homeowners paying on mortgages to make monthly deposits to tax accounts kept by mortgagees has gained in acceptance. Perhaps as many as 40 per cent of all homeowners nowadays settle their real estate taxes in monthly instalments. Direct provision for multi-instalment tax payment, therefore, no more than generalizes an already familiar practice. Incorporation into an instalment-payment plan of a "prepayment" feature appears as a further development of real promise.

Spreading the year's tax bill evenly over a 12-month period (a quarterly or bimonthly plan would do for the smaller bills) should considerably simplify the taxpayer's budgetary problem. Furthermore, the fact that the cost of local government then is expressed in terms of a comparatively small amount due periodically places this item on a parity with the other expenses the taxpayer has to provide for at regular intervals. This gives the property owner a better conception of the relation between local spending—as it affects him—and the local public services he gets in return.

Making an old tax better

The property tax is one of our oldest sources of public revenues. To eliminate property taxes, or, for that matter, even to reduce them substantially, would disturb formal and informal contractual arrangements of years' standing. Real estate investors have grown accustomed to the property tax and have been buying and selling properties subject to a tax obligation. The fact, then, that the property tax has registered an effect that it would be difficult if not impossible to undo argues strongly for its retention. And even apart from this consideration, the impressive productivity of levies on property practically guarantees them a long life. It thus is appropriate that lessons learned from experience in the fields of Federal and state taxation be applied in the property tax field, also, to the extent that they are applicable.

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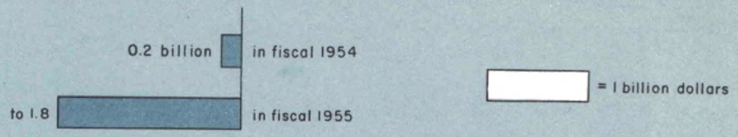
The Federal budget reviewed

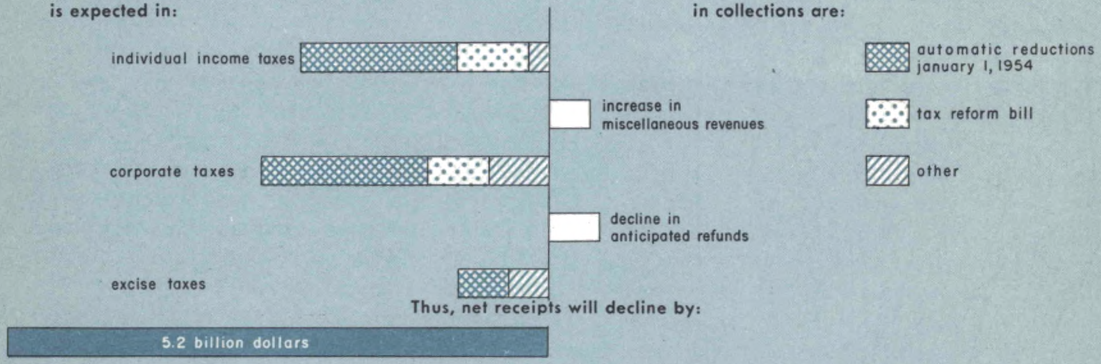
A larger deficit is in the cards for fiscal 1955, according to the President's midyear budget review. After taking a new look at the prospects for Treasury receipts and expenditures in the year ending next June, it is estimated that the scheduled 3.6 billion drop in outlays will be more than offset by a 5.2 billion fall in net receipts from 1954 levels. As a result the **Federal cash deficit** will rise from . . .



The big drop in receipts reflects the automatic tax reductions that went into effect last January 1, the recent tax reform bill and the slower tempo of business activity.

Decreased revenue, totaling 6.1 billion, is expected in:

Partially balancing the decline in collections are:



The drop in spending planned for the present fiscal year is concentrated in a few areas.

Whereas some outlays will be **increased,** thus accentuating the deficit . . .

they will be far outweighed by **decreases** in expenditures for: