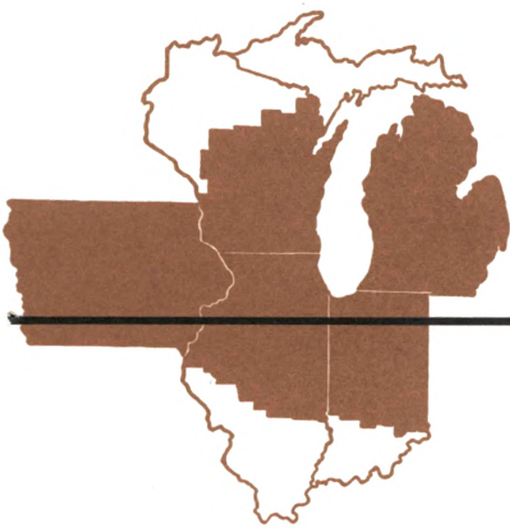
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1960 November

Contents

THE Trend OF BUSINESS

In August and September, economic activity edged downward from the record levels maintained in earlier months. Industrial production, which had held at 109 to 110 per cent of the 1957 average from February through July, declined to 107 in September. Nonfarm employment, seasonally adjusted, fell about 150,000 in August and September from July's record 53.1 million. Retail trade dropped to a 216 billion dollar annual rate in September, down from 218 billion in August and 227 billion at the record high last April.

Although employment in most lines has been slipping somewhat, after allowing for seasonal trends, the total number of jobholders in September, including agricultural workers and the self-employed, was the highest on record for the month and was more than 1 million above the same month a year ago. Personal income has been relatively stable since July and was at an annual rate of about 408 billion dollars in September, some 6 per cent above September last year. Retail sales at department stores and automobile dealers in late September and early October showed improvement, manufacturers' orders rose in some lines (particularly defense) and contract awards for heavy construction were strong throughout the third quarter.

Total business inventories, after rising rapidly in the first quarter and at a slower pace in the second quarter, began to decline slowly in July and August. However, inventories of purchased materials in the hands of manufacturers started to decline earlier. From the end of May to the end of August, purchased materials declined by 400 million dollars or over 2 per cent. During the same period, inventories of finished goods rose by a like amount. Production of materials had reached a peak as early as January. Since that time, the production rate for materials has declined 6 per cent, while total output of final products until quite recently was maintained at a record high.

It is unusual for output of materials to decline substantially over a period of several months while output of final products is maintained. The cutbacks began early in the year in steel and spread later to copper, aluminum, cement and other items. All this suggests that an inventory adjustment of the type which typically accompanies a downturn in general activity has been under way since early this year, long before there was any appreciable slippage in total output.

The mixed signs outlined above, together with the knowledge that credit availability has been increasing and that government spending has been rising, have caused some observers to conclude that the current adjustment will not be long lived or deep.

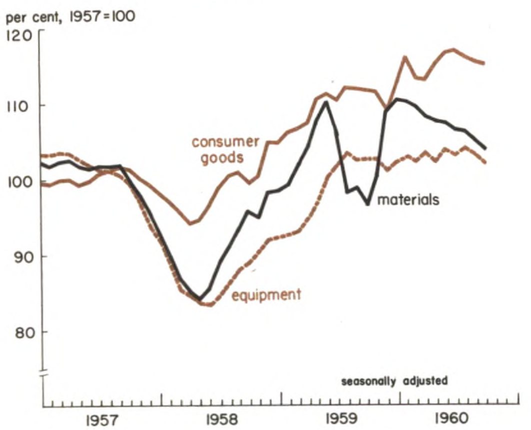
Employment declines in manufacturing

Between July and September, manufacturing employment, seasonally adjusted, declined 180,000—a little over 1 per cent—about equally divided between hard goods and soft goods. In addition, the average factory work week was reduced to 39.3 hours, about 1½ per cent. The number of workers in transportation and retail trade also declined moderately during these months. These declines were offset, in part, by increases in employment in finance and government. The late harvest in many areas deferred the usual seasonal reduction in agricultural workers.

Unemployment was 5.7 per cent of the labor force in September. This was approximately the same as September a year ago when the secondary effects of the steel strike were becoming apparent. The strikers themselves were not counted as unemployed unless they sought other work, but those who were unemployed and seeking work because of the strike were considered to be unemployed.

In September, 7 of 150 major labor market areas were reclassified by the Department of Labor as having a significantly larger rate of employment than in July. Three of these centers—Milwaukee, Kenosha and Muskegon—are in the Seventh Federal Reserve District. These areas have been affected by reductions in output of appliances, furniture and machinery. The accompanying table gives the classification of Midwest centers in September compared with earlier periods.

Production of materials has declined since early this year



Production lower on a broad front

Virtually all types of manufacturing output declined between July and September. Total manufacturing output dropped about 3 per cent. Some individual lines were off much more—5 per cent in the case of petroleum refining and furniture and 7 per cent in the case of iron and steel, nonelectrical machinery and building materials. Reflecting the earlier-than-usual shift to new models, automobiles were the only major industry to increase production over this period.

Although the high for the year was reached in most industries in June or July, a number of lines including steel, automobiles, electrical machinery, lumber, leather and paper, oil and gas well drilling and coal mining have not regained the levels reached as long ago as January. In general, it was the durable goods producers which had witnessed a slump in the first half of the year. But some nondurable goods were also undergoing adjustments.

In contrast to manufacturing and mining, public utilities continued to increase output through September to a record high. However, utilities account for only about 5 per cent of total industrial production.

Auto sales and retail trade

Personal income was 1 per cent higher in the third quarter than in the second and 6 per cent above the same period of last year. But consumers were tending to save more and spend less. This is indicated by a rise in some types of liquid savings and by the trend

A — Critical labor shortage, unemployment less than 1.5 per cent, sizable labor gains expected, current labor shortage not due to seasonal factors.

B — Job opportunities slightly in excess of job seekers, unemployment between 1.5 and 2.9 per cent, some increases in employment expected, labor shortage may be seasonal.

C — Job seekers slightly more than job openings, unemployment between 3.0 and 5.9 per cent, no significant increases in employment expected, unemployment may be partly seasonal.

D — Job seekers in excess of job openings, unemployment between 6.0 and 8.9 per cent, expect no significant increase or declining employment, labor surplus not due to seasonal factors.

E — Job seekers considerably more than job openings, unemployment between 9.0 and 11.9 per cent, declining employment or no significant increase in labor requirements expected, labor surplus not due to seasonal factors.

F — Job seekers substantially in excess of job openings, unemployment 12.0 per cent or more, declining employment or no significant increase in labor requirements expected, current labor surplus not due to seasonal or temporary factors.

	Sept. 1957	Sept. 1958	Sept. 1959	Sept. 1960
Illinois				
Chicago	B	D	C	C
Quad Cities	C	C	B	C
Peoria	B	D	C	C
Rockford	B	C	B	C
Indiana				
Fort Wayne	C	E	C	C
Gary-Hammond*				C
Indianapolis	B	D	C	C
South Bend	C	F	C	C
Terre Haute	D	D	D	D
Iowa				
Cedar Rapids	B	C	B	B
Des Moines	B	C	B	B
Michigan				
Detroit	D	F	D	D
Flint	E	F	E	C
Grand Rapids	D	F	C	C
Kalamazoo	C	C	B	C
Lansing	C	E	C	C
Muskegon	D	F	C	D
Wisconsin				
Kenosha	D	C	B	C
Madison	B	C	B	B
Milwaukee	B	D	B	C
Racine	C	D	B	C

*Included in the Chicago metropolitan area until 1960.

of retail sales. Total retail sales were 3 per cent *less* in the third quarter than in the second and were about the same as in the comparable period of last year.

Consumers have also been less willing to incur debt. Instalment debt, which had climbed rapidly during the first half of 1960, has shown only small monthly increases since midyear. The advance in August was 168 million dollars, down appreciably from the 249 million increase in July, and the smallest rise for any month since November 1958. During the first and second quarters, in contrast, the increase in consumer instalment debt averaged more than 400 million dollars monthly.

The slower growth of instalment debt has been especially pronounced in automobiles and household durables. Automobile credit outstanding grew in July and August by an average of only 31 million dollars, which compares with a monthly increase of 180 million during the first half of the year. New loans secured by other consumer goods actually fell below repayments during August, by 12 million dollars. During the first seven months of the year, new credit extended exceeded repayments by an average of 87 million dollars a month.

Two-thirds of the decline in retail spending between the second and third quarters was attributable to lower sales at automotive outlets. The dollar volume of sales by these retailers was 10 per cent less in the third quarter than in the second and was 6 per cent below the same period of the previous year.

In the first six months of 1960, dollar volume of automobile dealers was less than 2 per cent above last year while the number of new passenger cars delivered was 11 per cent higher. This reflected the lower average price of both new and used cars. In the 1959 model year, only 3 per cent of all passenger cars carried basic retail prices of less than $2,000. In the 1960 model year, nearly one-fifth were in this class. In the third quarter, deliveries of new cars were 4 per cent above last year while dollar sales of all automobile retailers were 6 per cent *less*.

When 1961 models were introduced in late September and early October, prices, with a few exceptions, were unchanged or were reduced. Moreover, there is a further increase in emphasis upon lower-priced lines. The potential car buyer now is offered a greater variety of automobiles than in past years. In the early weeks of the new season, it appeared that the new cars were finding favor.

Initial schedules called for production of 1.9 million passenger cars in the fourth quarter. This would be 50 per cent above the same period last year, which was affected by the steel strike, and well above any other fourth quarter except 1955. The new car market will have to be very strong to justify production at this rate. New car inventories, domestic production only, totaled 865,000 units at the end of September, about half of them 1960 models. This is far more than ever before at this time of year. In addition, inventories of autos produced abroad amount to about 125,000 units.

The growth of consumer services

During the past decade, personal consumption expenditures for services have increased faster than for goods. Thus, service expenditures account for a rising proportion of consumer outlays, 39 per cent in 1959 compared with 33 per cent in 1949. A further increase may occur in the current and succeeding years as the amenities of living spread and larger proportions of income are spent on travel, recreation and education.

What is a "service"? One tends to think of shoeshines and haircuts—services which one individual renders to another as he employs his individual effort and skill. However, these "personal" services are only a portion of the total. The over-all services category is extremely heterogeneous. It includes such diverse items as rent, electricity, interest, legal advice and tonsillectomies. The individuals and firms which produce these services do not comprise an "industry," or even a group of closely related industries.

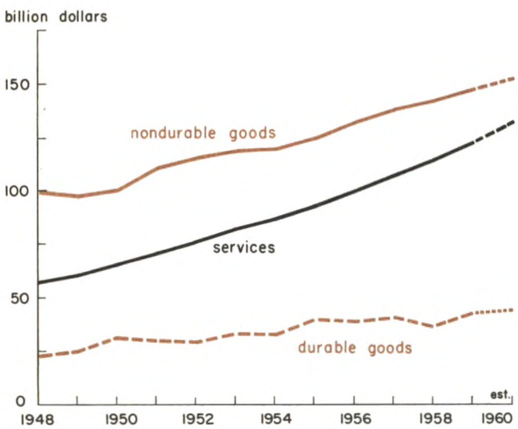
Services are distinguished from goods in that they are "produced" and "consumed" simultaneously. In general, they cannot be inventoried by business firms or stored by consumers. As in any classification, of course, some items must be grouped arbitrarily. Sales of natural gas, for example, are included with other utilities as a service, although gas is essentially a commodity like oil or coal. Meals purchased in eating establishments, on the other hand, are classified as nondurable commodities, although when one "eats out" he is paying mainly for the preparation and serving of the food.

Services and the good life

Between 1949 and 1959, total consumption expenditures increased 73 per cent. Over the same period, total service outlays rose 105 per cent. In part, this reflects the faster rise in prices of services than in the average of prices for all consumer purchases—34 per cent as compared with 22 per cent. But even after adjustment for price changes, purchases of services have risen more than goods. In considerable degree, this shift reflects a more affluent society.

In the early postwar years, consumer markets were starved for many kinds of goods as a result of the sharp rise in income and restrictions on production during World War II. Furthermore, demand was augmented by high marriage and birth rates, large holdings of liquid financial assets and a low level of consumer debt. By 1949, the pipelines were filled, goods were generally available in adequate supply and most prices were free to respond to forces of supply and demand. Nevertheless, the swing toward services has continued.

Consumer expenditures for services have risen steadily



Some rapidly rising services

Housing is the most important by far of the services. It is also the most intangible since it consists largely of the "service" provided by the occupied dwelling unit. The rental value of owner-occupied dwelling units—imputed rent—is included in the estimates of expenditures for consumer services as well as the rent paid in cash by tenants. The former has grown rapidly in the past decade as a result of the trend toward home ownership. In 1959, imputed rent was 68 per cent of the total as compared with 64 per cent in 1949.

Housing was in short supply in the early postwar period, and this situation continued for a considerable time. Between 1949 and 1959, "outlays" for rent more than doubled, accounting in the latter year for 13 per cent of total consumption spending and one-third of all spending on services. In part, the rise in rent can be attributed to the large increase in the number of residences and in floor space. But a major factor was the rapid rise in rental rates on new properties—both tenant and owner-occupied—as building costs rose, and upon older properties as rent control was gradually abandoned.

Between 1949 and 1959, rental rates rose 33 per cent, compared with 22 per cent for the prices of all consumer purchases. However, rents were relatively low in 1949, as indicated by the fact that the rent index was only 21 per cent above prewar 1939 compared with 72 per cent for all services.

Other rapidly growing services are electric, gas and telephone utilities. In 1959, these expenditures totaled 11.5 billion dollars, more than two and one-half times as much as in 1949. The quantity of these utility services rose rapidly; prices increased somewhat *less* than the average of all consumer prices.

The increase in expenditures for utility services reflects various facets of the rise in the level of living. Consumer use of electric stoves, dryers, TV sets, air conditioners and various other electrical appliances has resulted in a large increase in the consumption of kilowatt-hours of energy. The rise in purchases of gas results primarily from the extensive use of gas heating in new homes and the conversion of coal and oil units in existing homes. Greater spending for telephone service largely represents more widespread installation of phones and the greater use of long-distance lines.

Some of the other services for which expenditures have risen rapidly include interest on personal nonmortgage debt, up from 1.5 billion dollars in 1949 to 5.5 billion in 1959; private education, up from 1.7 billion to 3.9 billion; and foreign travel from 850 million to 1.9 billion.

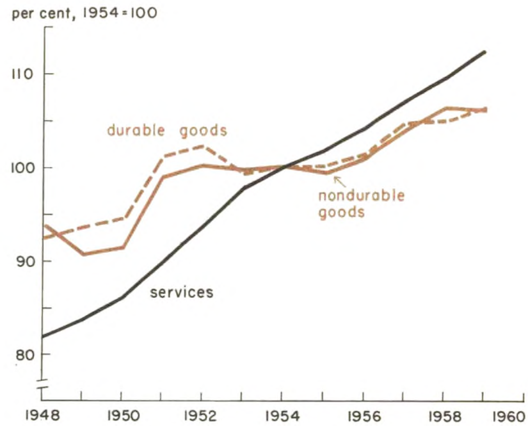
Some services have declined

Not all types of service outlays have risen during the postwar years. Motion picture box office receipts dropped from 1.5 billion dollars in 1949 to 1.3 billion in 1959. This decline reflects, in large part, the growth of television. Radio and TV repair, which accounted for only 200 million dollars of personal consumer expenditures in 1949, had risen to 780 million in 1959.

Another important consumer service which now absorbs fewer dollars than in 1949 is passenger fares for streetcars, buses and intercity railroads. Outlays on these forms of transportation dropped from 2.3 billion dollars to 1.9 billion. However, expenditures for travel by airlines and autos rose sharply. The airlines' receipts from individuals increased from 150 million to 740 million dollars, while the cost of auto repairs, including the net cost of auto insurance (after payment of claims), rose from 2.9 billion dollars to 6.2 billion.

Payments to domestic servants has been a relatively slow-growing category of service outlays. These expenditures increased less than half as much in the decade as services generally — 48 per cent — although wage rates of such workers advanced substantially. Attractive jobs elsewhere have reduced the

Prices of services have risen much more than goods in the past decade



number of domestic servants. Moreover, the development of labor-saving devices and the availability of purchased foods which feature "built-in maid service" have replaced the need for "domestics."

Government services

In addition to those purchased by consumers, important services are furnished by governmental bodies. Broadly speaking, the great bulk of all government spending is for the purpose of providing services to the public. Even the military establishment can be considered as providing the "service" of protecting the nation against potential foreign aggressors. A substantial portion of government outlays (especially of state and local governments) is for services which overlap or are similar to those consumers purchase for themselves.

In 1949, total government spending for purposes other than national defense, pensions, unemployment compensation and other transfer payments amounted to 26.8 billion dollars. By 1959, these outlays had nearly doubled, rising to 51.7 billion dollars.

Services and "value of the dollar"

Aside from housing and public utilities, the prices of most services are determined largely by wages paid to individuals. In the case of domestic servants, doctors, lawyers and the like, the outlay consists almost entirely of payments for personal services rendered. Other lines in which wages are more important than the cost of materials and capital include hospital care, auto repairs and insurance.

The prices of services which require relatively large amounts of labor have risen much more than the prices of most other goods and services. This is true whether comparisons are made over the past ten years or the entire period since prewar 1939.

A decade of change in personal expenditures for services

	1949	1959	Per cent change
	(million dollars)		
Total personal consumption expenditures	181,160	313,840	+ 73
Durable goods	24,580	43,360	+ 76
Nondurable goods	96,610	147,650	+ 53
Services	59,970	122,830	+105
Housing			
Rental value of owner-occupied homes	10,920	25,680	+135
Rents paid by tenants	6,370	11,590	+ 82
Household operation			
Electricity	1,750	4,540	+159
Gas	1,030	2,880	+180
Telephone	1,740	4,040	+132
Domestic servants	2,360	3,520	+ 49
Recreation			
Radio and TV repairs	200	780	+290
Motion pictures	1,450	1,280	− 12
Legitimate theaters	180	340	+ 89
Spectator sports	240	270	+ 13
Clubs and lodges	460	740	+ 61
Net loss on racetrack betting	250	470	+ 88
Foreign travel	850	2,110	+148
Education			
Higher education	780	1,720	+121
Elementary and secondary	480	1,360	+183

	1949	1959	Per cent change
	(million dollars)		
Transportation			
Auto repairs	2,360	4,540	+ 92
Auto insurance—less claims paid	560	1,670	+198
Tolls	90	280	+211
Streetcars and buses	1,400	1,240	− 11
Taxicabs	580	630	+ 9
Commutation	80	120	+ 50
Intercity R. R.	520	350	− 33
Airlines	150	740	+393
Personal services			
Shoe repairs	200	240	+ 20
Cleaning and laundering	2,280	2,770	+ 22
Beauty and barber shops	1,040	1,980	+ 90
Physicians	2,340	4,600	+ 97
Dentists	920	1,960	+113
Undertakers	950	1,510	+ 59
Financial			
Brokerage charges	250	960	+284
Bank service charges	310	750	+142
Lawyers' fees	830	1,660	+100
Interest on nonmortgage debt	1,500	5,540	+269
Other			
Religious and welfare	2,240	4,280	+ 91
Cash sent abroad	190	260	+ 37

Industries in which output per man-hour is rising often grant wage increases without raising prices by corresponding amounts. This is possible because the cost of capital and improvement in technology, used to increase output, is relatively low compared with wages. In the case of many services with a high labor input, however, it is difficult to increase output per hour of labor because of limited opportunities to apply mechanization.

As a result, prices of such services tend to rise as wage rates in other lines rise. This permits service workers to participate in the general rise in personal income. Also, prices of many services are determined largely by organized groups which exercise some control over the number of persons who may engage in supplying the service.

Obviously, not all services are priced largely on the basis of direct labor input. In the case of housing and utilities, which account for 40 per cent of all service expenditures, the capital investment is extremely large. The importance of labor currently incorporated in the cost of the products of an industry tends to vary inversely with the amount of capital used.

In the case of housing, capital is about ten times annual gross rents. For utilities, the ratio ranges from two to five times gross sales in most instances. By way of comparison, in most manufacturing industries, annual sales about equal invested capital.

High productivity of services

Electrical utilities have made enormous strides through larger generating units and mechanical handling of fuels. The telephone systems have been revolutionized by the introduction of the dial phone.

Output per man-hour also is being increased in certain service industries with a large labor input through the substitution of capital for labor. Banking, insurance and other financial businesses, for example, are introducing data-processing equipment which can reduce labor requirements substantially.

In the case of some types of services—medical and dental care provide the best examples—quantitative measurements lack meaning because of immense improvements in the quality or effectiveness of the service available. The price of medical care, as recorded in the Consumer Price Index, has risen almost 45 per cent since 1949, about twice as fast as the total of all consumer prices. However, no account is taken of the advances which have been achieved in preventive medicine and in the speed of cures. In many instances, a doctor can now handle a case in his office which, only a few years ago, would have required hospitalization.

Many recent discussions of trends in productivity and economic growth have viewed the relative rise in service prices and expenditures with concern — as a factor which has tended to slow the rate of economic progress and accentuate inflationary pressures. However, as in other broad groupings, great diversity exists among the various types of consumption expenditures which are termed "services." Lack of progress in output per man-hour is not characteristic of all important service categories and quality improvements also are of great significance. On balance, of course, it is true that price trends for individual goods or services will tend to reflect changes in costs of supplying them and those in which the benefits of technology and mechanization are less applicable will rise more, or decline less, than the average of the group.

America's capacity to produce

A recent survey of expenditures for new plant and equipment planned by business firms indicates that the upswing in these outlays which began two years ago has leveled off. It is now anticipated that capital spending will total 36.4 billion dollars in 1960—about 12 per cent more than in 1959—whereas, in the spring, outlays were expected to exceed 37 billion dollars. This largely reflects a reduction in expenditure plans by industries such as steel, motor vehicles and petroleum refining which have found new business lagging expectations.

The rise in capital expenditures appears to have ended without having exceeded the previous high established in 1957. Moreover, the rise from the low point was only about half as large as the preceding expansion which began in 1954.

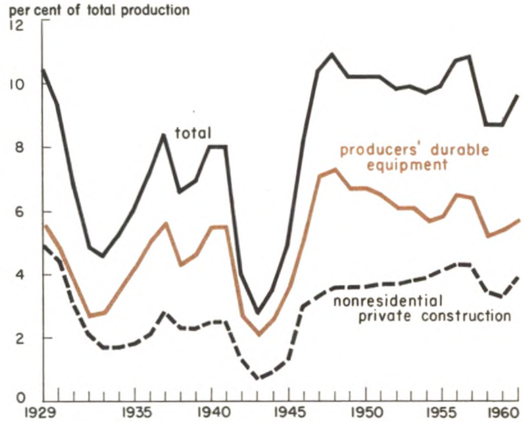
Statistical confirmation of the leveling in capital expenditures comes as no great surprise. Early in the first quarter of 1960, it became evident that, although the economy was operating at record levels, virtually all types of goods and services were in ample supply. The shortages of basic materials which hampered output in the early postwar period were no longer apparent. Business capital expenditures were geared more to replacing aged and obsolete facilities with modern equipment and re-aligning production processes to achieve greater operating efficiency. In sum, America's capacity to produce had at least temporarily overtaken demand.

The determinants of capacity

A nation's capacity to produce goods and services is determined by the size and training of its civilian labor force (including management), the availability of raw materials and the quantity and productivity of its capital goods. Any one of these can set limits to total output.

During periods of strong inflationary pressures—whether war or peacetime—total demand presses hard upon resources, and numerous barriers to the further expansion of output are encountered. Nevertheless, some firms—even entire industries—may be operating below capacity because of shortages of materials and man power while others may be operating at low rates because of

Private capital outlays equal
10 per cent of total output since 1945



insufficient call for the particular items they produce despite the high level of demand over-all.

In 1944, shortages of man power and raw materials tended to brake further general increases in production. Unemployment averaged less than 700,000 or 1.2 per cent of the labor force. (During 1960, unemployment has averaged about 4 million workers or over 5 per cent of the labor force.) The job market during the war years was artificially strong. An unusually high proportion of the population age 14 and over was in the labor force and unemployment was at a wartime low. Many materials were in short supply and were rationed.

When the fighting ended in 1945, war production was abruptly curtailed, and millions of men and women were released from defense industries and the armed services. Almost overnight, the critical man power situation was alleviated, and some unemployment over and above the irreducible "float" appeared. However, some basic materials continued to be in short supply.

During the postwar period, industrial capacity expanded faster than output, although the pace was somewhat uneven. But it was not until 1957, aside from recession years, that the bottlenecks imposed by shortages of basic materials and plant capacity were broken. Since then, the economy has been in a significantly different situation from that which prevailed from 1941 through the war and most of the first twelve postwar years.

Why did it take so long to develop ample productive capacity? The answer is complex. First, investment during the 15-year period ending in 1945 was subnormal because of the impact of the so-called "Great Depression," and because of the war which placed emphasis upon the utilization of existing capacity for military purposes. New investment during the war was restricted largely to defense-oriented projects. Gross private investment in producers' durable goods and nonresidential construction during the years 1931-45 totaled about 230 billion dollars in terms of 1959 prices.[1] Although a huge sum, it was hardly enough — according to some estimates — to offset wear and tear and obsolescence.

In the 15-year period 1946 to 1960, private investments in producers' durables and nonresidential construction totaled about 640 billion dollars in 1959 prices. Over the entire postwar period, capital investment equaled about 11 per cent of total output, compared with 7 per cent in the preceding fifteen years.

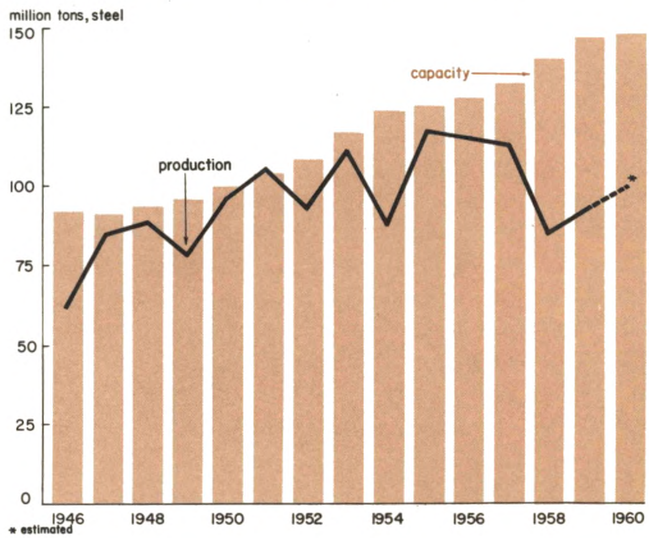
This is an impressive figure considering that between the end of World War II and the beginning of the Korean War in 1950, new investment was retarded somewhat by the general concern that the postwar prosperity might be short lived.

The continuous-process industries

Unfortunately, there is no set of statistical tools which can be used to measure the extent of unused capacity for the economy as a whole with any degree of precision. This is because there is no meaningful measure of capacity for most industries. Many facilities which could be operated continuously are, in fact, manned only a portion of the day and five or six days a week. If an industry does not produce continuously (and could do so), it is not operating at capacity in a strict sense.

Attempts to assign capacity figures to an industry on the basis of what it has done in the past or on the basis of what executives

Steel capacity continued to rise rapidly after 1955 even though output declined

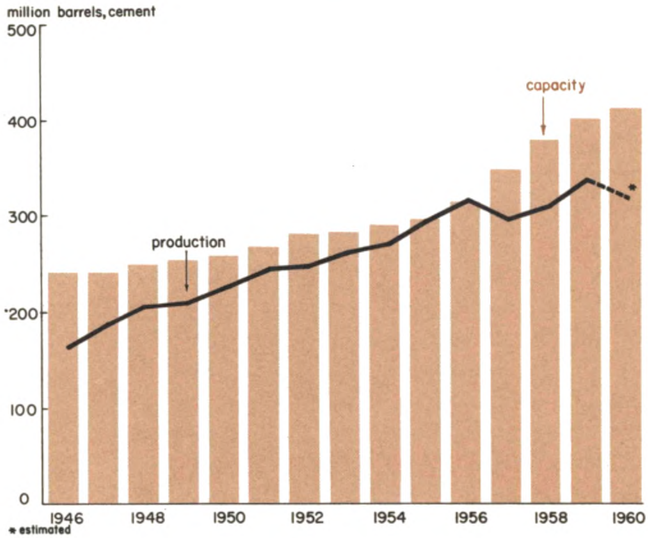


[1]The figure would be somewhat larger if Government wartime investment in industrial facilities, later sold to private firms, were included.

consider a "comfortable" operating rate are only rough guides at best. Another complicating factor is that a large share of facilities are "marginal," either because they are inefficient (high cost) or not adapted to current needs and can be retired when more modern facilities become adequate to handle prospective demand.

On the other hand, certain industries, some of them very important, operate "around the clock." Because of the high cost of starting and stopping production in these "continuous-process" industries, units are shut down only for cleaning and repair or because a lag in demand indicates that output cannot be sold at acceptable prices. For these industries, the "practical" capacity of output can be rated.

Cement capacity rose sharply in 1957-59— margin over output now close to a decade ago



Steel, aluminum, copper refining, cement, glass, petroleum refining, chemicals and paper are examples of continuous-process industries. Many of the products of these industries were in short supply a few years ago. In general, there are no close substitutes for most of these materials, except as they can be substituted for each other; for example, cement for steel and aluminum for copper.

The continuous-process industries constituted real "bottlenecks" in the achievement of higher production throughout most of the postwar period. The steel, aluminum and cement industries, for example, often operated *above* "rated capacity," which makes some allowance for normal downtime, in order to fulfill demand. In this environment, prices were bid up without stimulating much additional output.

During the Korean War, the Government provided a special incentive to business firms to increase capacity, particularly in the basic material industries. This took the form of rapid tax write-offs on certified facilities. However, after a relatively short decline in economic activity in 1953-54, many firms raised their sights substantially on capital spending for 1955, 1956 and 1957 without any special incentives from Government.

This surge in capital outlays largely reflected programs to expand capacity in the continuous-process industries where demand was expected to grow in the future.

Some case histories

At the beginning of 1947, annual capacity of the *steel* industry was rated at 91 million tons. At the beginning of 1950, this figure had increased to 100 million tons. In 1955, it was 126 million and at the start of 1960, 149 million tons. Although this rate of expansion roughly paralleled the over-all growth of the economy, the demand for steel did not grow as rapidly. Reflecting this, the industry should be able to supply the expected demand for steel this year at an average operating rate of no more than 70 per cent of capacity. In 1947 and 1948, the industry operated at 94 per cent of beginning-of-year capacity. In 1950 and 1951, this rate was close to 100 per cent. In 1955, it was 93 per cent.

At the beginning of 1947, *cement* capacity was rated at 242 million barrels. In 1950, the figure had increased moderately to 259 million. A more rapid increase in succeeding years brought capacity to 298 million barrels at the beginning of 1955 and to 414 million in 1960. The cement industry had some unused capacity in the early postwar period, but in 1955 and 1956, output equaled 100 per cent of beginning-of-year capacity. In the current year, it is unlikely that output will exceed 75 per cent of rated capacity owing to curtailments in private construction and a stretch-out in the Federal Interstate Highway Program.

The increase in domestic *aluminum* capacity has been spectacular. From less than 700 thousand tons at the end of World War II, capacity rose to 1.4 million tons in 1955. Development of important new uses for aluminum in the construction, packaging and transportation industries, plus the Korean War rearmament, sparked the industry's growth. During this period, production averaged close to 100 per cent of capacity. By the beginning of 1960, industry capacity had reached more than 2.3 million tons, but output is not expected to exceed 80 per cent of capacity for the current year.

The picture outlined above for steel, cement and aluminum also could be applied to chemicals, copper and other nonferrous metals and petroleum. In all cases, the rise in capacity has outstripped the increase in demand.

The United States is not the only nation which has expanded its industrial base. All other industrialized nations have done the same, and some of the underdeveloped countries have acquired capacity to produce basic industrial materials. As a result, there is at present world-wide competition in the case of some basic materials to a greater extent than ever before. Petroleum is perhaps the prime example.

Now the question is whether the output capacity of these industries is *too* large in relation to current and prospective demand. Indeed, the steel, chemical and aluminum industries have all operated substantially below rated capacity in the first nine months of 1960. Does this hold any significance for our future rate of economic growth? The presence of unused capacity in an industry is a boon to the buyers of its products because it means upward price pressures may be moderated or reversed. Buyers may also be tempted to carry lower inventories knowing they can replenish their stocks as needed, on rather short notice, without risk of price increases. For the producers, however, ample capacity means increased competition and

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lower profit margins. In the continuous-process industries, where capital investment is large relative to sales, the profit squeeze becomes particularly intense because of heavy fixed costs. The impact of this profit squeeze on investment decisions is mixed. It may either stimulate increased spending to achieve greater efficiencies or greatly discourage new investments.

For the economy as a whole, however, the emergence of some "elbow room" between output and capacity in the continuous-process industries should permit growth in general economic activity without such price pressures as were operative during most of the postwar period. It may also help to lessen the impact of future inventory adjustments on business activity. Finally, the existence of idle capacity should serve as a strong stimulus to expand United States exports.

Midyear Budget review

By their sheer size, the flows of funds into and out of the Federal Treasury exert a profound influence upon the economy. And the condition of the economy, in turn, has a good deal to do with the behavior of tax receipts and Government expenditures. The difference between income and outgo—the surplus or deficit—for some purposes may be taken as a measure of the net impact of Federal transactions. A surplus thus indicates that the Government is taking more from the stream of income than it is returning, while a deficit implies that it is injecting more by expenditure than it is withdrawing by taxation. A surplus in general means, too, that the Government is lessening its use of borrowed funds and a deficit that it is increasing its indebtedness to the rest of the community.

The Budget of last January projected a surplus of 5.9 billion dollars for the current 1961 fiscal year. This is on a cash basis, taking into account all the funds maintained by the Federal Government and netting out internal and certain other transactions. The Midyear Review of the Budget, released in October, forecasts a surplus of 2.5 billion dollars—3.4 billion dollars under the figure expected earlier.

In part, the downward revision is the result of a change in the outlook for tax receipts, especially corporation income tax payments. Prospective revenue also has been scaled down because the original estimates had included about 100 million dollars in receipts from proposed legislation that was not enacted. Expenditure estimates have been raised, moreover, to take into account new spending that had not been anticipated in the earlier budget proposals.

According to statements made by Bureau of Budget officials, the revenue estimates assume that Gross National Product will total about 505 billion dollars for the current calendar year. During the third quarter, GNP was 503 billion, at an annual rate, and this also was its average for the year through the third quarter. Third-quarter results, of course, were not available at the time the midyear review was drawn up. The estimate of receipts from individual income taxes remains the same as in January, at 43.7 billion dollars. Indications of lower corporate profits, however, caused estimates of revenues from corporation income taxes to be reduced from 23.5 to 21.5 billion dollars. Estimates of corporate profits appear to have been reduced further since the midyear review.

Increases on the expenditure side since the January estimates were drawn up are ascribable, in part, to a pay increase for Federal civilian employees, totaling about 746 million dollars, which affects nearly all departments. In addition, defense spending for procurement of aircraft, missiles and ships, research and development of weapon systems, and Army National Guard and Army Reserve units have been revised upward while estimated expenditures for operation and maintenance and military construction have been cut back.

Of the 1.1 billion dollar increase in commerce and housing, 808 million is an addition to the expected deficit of the Post Office Department. This is traceable both to the salary hike and to the decision by Congress not to raise postal rates.

	Fiscal 1960, actual	Fiscal 1961 January estimate	Fiscal 1961 Midyear estimate
Receipts		(billion dollars)	
Individual income taxes	40.7	43.7	43.7
Corporation income taxes	21.5	23.5	21.5
Excise taxes	9.1	9.5	9.4
Trust fund receipts	21.4	22.5	23.8
All other receipts	7.0	7.3	6.8
Deduct: Intragovernmental transactions and seigniorage on silver	4.8	4.4	4.7
Total receipts from the public	95.0	102.2	100.6
Expenditures			
Major national security	45.6	45.6	46.0
Commerce and housing	2.8	2.7	3.8
Agriculture & agricultural resources	4.8	5.6	5.4
Interest	9.3	9.6	9.1
Trust fund expenditures	21.7	21.3	22.9
All other expenditures	14.7	16.3	16.1
Government-sponsored enterprise expenditure (net)	.5	-.3	-.3
Deduct: Intragovernmental transactions and excess of interest accruals over payments	5.2	4.5	4.9
Total payments to public	94.2	96.3	98.1
Excess of receipts over payments	.8	5.9	2.5

Lower rates of interest are reflected in the decline in predicted interest charges for the public debt. The new estimate of interest payments in the current fiscal year is 490 million dollars lower than the January estimate. This revision makes interest the only major budget item for which the midyear spending estimate is below the actual expenditure in fiscal year 1960.