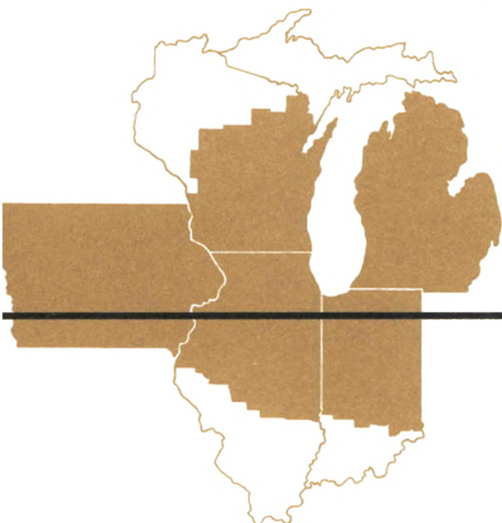
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1962 January

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THE Trend OF BUSINESS

Autos give lift to activity

During the fourth quarter of 1961 a sharp increase in output and sales of automobiles helped raise business activity above the plateau of the summer and early fall. While the improvement in autos has been a major factor in the national picture, it has been all-important in strengthening the economies of many Midwest centers in which the assembly of cars or the production of components is the dominant industry.

New models were introduced in September, earlier than in most previous years. However, availability of these new cars was delayed by strikes at General Motors and Ford in September and October, which clipped about 250,000 units from production schedules. Nevertheless, from October through December over 1.8 million cars were assembled—5 per cent more than in the same period of last year and second only to 1955.

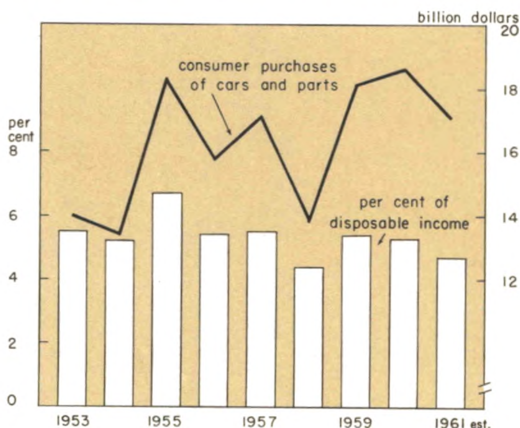
As production rose and dealer stocks became more adequate, sales spurted. In November, 585,000 domestically produced cars were delivered to customers. On a daily rate basis this was 23,400, a level which has been exceeded only in the spectacular period from March through September in 1955. The step-up of sales was stronger than had been indicated by various polls of consumers in recent months.

It appears that consumers are prepared to use more credit in order to carry their plans into practice. In the first nine months of 1961 outstanding instalment credit extended for the purchase of automobiles declined 700 million dollars in contrast with a rise of 1.5 billion in the same period of 1960. In October 1961, however, new auto loans exceeded repayments on a seasonally adjusted basis for the first time since November 1960. Sales in November and December indicate that the uptrend in outstanding credit has continued.

Imports and compacts

In 1961 sales of imported cars declined as a proportion of the total for the second successive year. Imports had averaged only about 30,000 in the years preceding 1955, but grew rapidly thereafter, reaching a peak of 600,000

Consumer expenditures
for autos declined in 1961
despite fourth quarter upsurge



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units in 1959. In that year imports accounted for 10 per cent of the United States market. With the introduction of a variety of domestically produced compacts, imports were reduced to 500,000, or 7.5 per cent of total sales, in 1960 and 375,000, or 6 per cent, in 1961. Among the small imports only Volkswagen has been able to increase its penetration of the market, while others have lost ground. Industry experts believe that foreign cars can retain about 5 or 6 per cent of the American market.

The number of different models of compacts has increased sharply. In recent months about 35 per cent of all sales were compacts, up from 30 per cent last year. Actually the line between "compacts" and "standard-size" cars has become blurred as a variety of "in between" wheelbases have been introduced.

A compilation made by Ward's Automotive Reports indicates that the proportion of cars with "suggested" retail prices under $2,000 rose from 3 per cent for the 1959 model year to 20 per cent in the 1961 model year. At the other extreme the proportion of cars selling for over $3,000 declined from 13 per cent in 1959 to 10 per cent in 1961.

Increasing numbers of car buyers seeking lower-cost vehicles have turned to the used car market. Used car prices rose 20 per cent between January and September but declined in the fourth quarter.

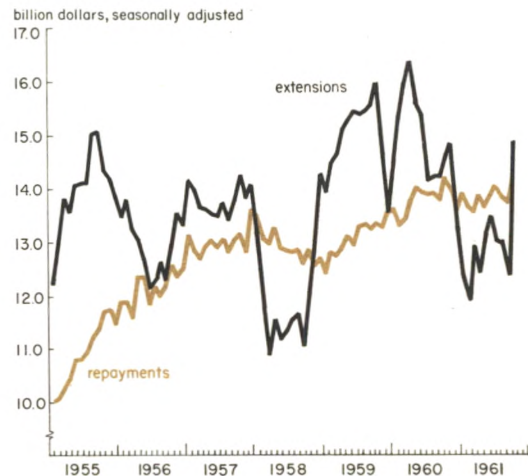
Inventory control

During 1960 inventories of domestically produced new cars rose 400,000 to a record of 1 million units at year-end. At the end of 1961, on the other hand, inventories were about 250,000 *less* than at the beginning of the year. Inventories—in terms of day's sales—at the end of 1960 amounted to 53 days, but by the end of 1961 had dropped to about 35 days.

The relatively slow inventory build-up after the introduction of 1962 models was not simply the result of strikes or larger-than-anticipated sales. Some of the producers deliberately restricted production until consumer preferences clarified and the potential rate of sales became more evident. On more than one occasion in the postwar period, most recently in late 1960, dealers have become so heavily stocked that sharp cutbacks in production were necessary. In 1962 auto manufacturers have a powerful additional incentive to stabilize production because, under the new wage contracts, any layoffs associated with subsequent changes in output will necessitate substantially increased payments of supplemental unemployment benefits.

In most years in the past both production and sales have risen somewhat between the October-December and January-March periods. If the usual seasonal pattern prevails in the months ahead, the car inventory on hand

Instalment credit extended to car buyers moved above repayments in October



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at the beginning of 1962 need not presage a painful readjustment for auto centers.

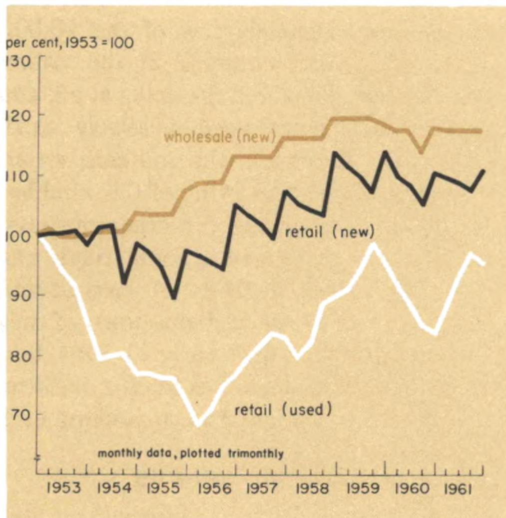
Autos and steel

The auto industry is steel's largest customer, purchasing about 20 per cent of all steel products. The impact of steel buying by auto producers, however, is even greater than this proportion suggests. First, steel orders by the auto industry tend to be volatile, often moving up or down quite sharply. Second, auto producers purchase a very large proportion of certain steel products, accounting for about 40 per cent of the combined tonnage of sheets, bars and strip. (These items account for 90 per cent of motor vehicle requirements, but less than half of all steel shipments.)

A substantial increase in steel buying had been expected after that industry's vacation shutdowns in July. Actually, production rose only to the June level in September and changed little through early December. During this period many firms were increasing their consumption of steel, but with ample production capacity for all kinds of steel delivery schedules did not stretch out appreciably. The missing factor was the expected surge in buying by the auto manufacturers.

In December the auto industry began to increase orders substantially. Sales of new cars and trucks had been larger than expected, and auto firms began to show greater interest in building inventories in anticipation of a steel strike in mid-1962. This development also has influenced other steel buyers to increase their orders so as to assure adequate supplies. As a result, production of steel ingots is expected by industry experts to reach a near record annual rate of about 140 million tons during the first half of next year, but to decline in the second half.

New car prices leveled after 1958, while used car prices continued to show large changes



SOURCE: Bureau of Labor Statistics.

Auto sales in 1962

Forecasts of car sales in 1962 by industry analysts have ranged between 6.5 and 7 million domestic sales of passenger cars, including imports of about 400,000. The Department of Commerce expects production of cars this year to be between 6.4 and 6.8 million. These figures, which include exports and changes in inventory, are generally consistent with industry sales projections.

The banner year is still 1955 when 7.2 million new passenger cars were sold. In four of the six years since then sales have been close to 6 million units. The exceptions were 1958 which saw a drop to 4.7 million and 1960 in which sales reached 6.6 million.

Total expenditures on autos depend upon prices as well as volume and the distribution of sales among price classes. The average

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price of all cars sold reached a peak in 1958 and 1959 before declining more than 3 per cent in 1960. This reduction reflected a larger proportion of sales of the less expensive cars. List prices for identical models have changed very little in recent years.

From 1953 through 1961 consumer purchases of autos and parts ranged between 5.2 and 5.5 per cent of personal income after taxes, except for three years. The exceptions were 1955 which saw the proportion leap to 6.7 per cent, 1958 which saw a decline to 4.4 per cent and 1961 when outlays were about 4.7 per cent of income. The "surge" in auto sales in the fourth quarter of 1961 merely brought dollar volume of expenditures back to the average relationship to "disposable" income of recent years.

It appears that 7 million cars would be sold in 1962 if the average 1953-61 relationship between disposable income and automobile sales prevailed, even though income for the year as a whole averaged no higher than in the fourth quarter of 1961. But some additional rise in income is indicated by official forecasts and, as noted above, the relationship of auto sales to consumer income in individual years has varied greatly.

Municipal borrowing for industrial development

Since 1936, nearly 300 cities, counties and other local governments in nine states (mostly in the South) have borrowed almost 200 million dollars to provide plant facilities for use by private firms. More than half of this financing has occurred in the last four years, a period in which many communities have been plagued by persistent and substantial unemployment.

Climbing but still small

Although municipal borrowing for industrial purposes has increased sharply, it is still small in relation to the total amount of state and local bonds issued. In 1960, for example, the 41 million dollars in financing for industrial purposes was less than 1 per cent of the 7.2 billion total borrowed by state and local governments for all purposes.

Until now, relatively few of the 20,000 municipalities and counties in the nation have done any industrial financing at all, and most of these have been relatively small communities located in the southern states. In some instances borrowing of this kind has overshadowed financing for other purposes such as the provision of schools, roads and sewerage and water plants. A conspicuous example is that of an Alabama town of only 1,500 population which early in 1961 borrowed 25 million dollars to build a fertilizer plant for lease to a major meat packing firm.

Objective of the financing

As the interest paid on municipal securities is exempt from Federal income taxes, local

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governments often can borrow funds in the capital market at lower interest rates than private borrowers, particularly small and newly established business firms. To an investor in the 50 per cent income tax bracket, for example, an industrial bond would need to return 7 per cent before taxes to have as much appeal as a tax-exempt security yielding 3½ per cent. The tax advantage connected with municipal bond financing is reflected in the spread between market yields on municipals and industrials. Yields on newly issued corporate debt securities recently have averaged more than a full percentage point higher than on municipal bonds of comparable rating and maturity. Communities interested in encouraging industrial development, therefore, may be able to offer tempting inducements to business firms seeking locations for new plants.

Areas troubled by labor surpluses understandably have been motivated to use municipal credit for industrial development. Among these have been communities adjusting to declines in farm income and employment and towns historically dependent upon coal mining, railroad operations and certain types of manufacturing. The main purpose in attracting industry is simply to secure more jobs and income. The side effects that increased payrolls may be expected to have upon retail sales, service activities and property values often lead to broadly based support for municipal sponsorship of business development. These incidental benefits in some cases have been the sole or primary incentive. Utilization of public borrowing to foster industrial development has not been confined to towns in the labor-surplus category.

The question of purpose

Municipal governments are of course limited to the exercise of powers and duties serving a clearly defined public purpose. Although it may appear that promoting economic development by helping to finance private firms meets the test, so might almost any other kind of commercial activity carried on by a public agency. In some cases the states have acted expressly to affirm the propriety and constitutionality of municipal financing to aid industrial development. Legislation permitting the use of local credit for this kind of activity has been adopted in 17 states including Illinois and Wisconsin; authority apparently is available in several others as well.

In many cases, the authority to borrow to support industrial development has been limited to the issuance of bonds repayable solely out of revenues from the projects financed. Only 4 of the 17 states authorizing local industrial financing, 3 in the South and Wisconsin in the North, permit municipalities to use general obligation bonds—that is, debt supported by a claim on general tax revenues, for this purpose. Revenue bond financing is permitted by 16 of the states, including Illinois.

A common arrangement is one under which a municipality sells bonds to purchase a site and build a plant meeting the specifications of a business firm. The plant is then leased for a term coinciding with the period of debt amortization, with rental payments sufficient to cover principal and interest on the bonds. In the event the tenant fails to meet its obligations under the lease, it is subject to eviction and another occupant is sought for the premises. If none can be found, the creditors must stand any resulting loss if revenue bonds were involved in the financing.

Until the past few years, the part played by the state governments in connection with industrial development had been limited chiefly to the provision of legislation enabling

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Seventeen states have authorized local governments to borrow for industrial purposes

	Type of borrowing authorized	Bonds issued* (millions)
Alabama	revenue, general obligation	$41
Arkansas	revenue, general obligation	9
Georgia	revenue	—
Illinois	**revenue**	—
Kansas	revenue	—
Kentucky	revenue	24
Louisiana	revenue, general obligation	3
Maine	revenue	—
Maryland	revenue	—
Mississippi	revenue, general obligation	79
Missouri	revenue	—
Nebraska	revenue	—
New Mexico	revenue	4
North Dakota	revenue	3
Tennessee	revenue, general obligation	29
Vermont	revenue	—
Wisconsin	**general obligation**	—
Total		$192

*Through October 1961.

local units to borrow for that purpose. This, of course, was in addition to the fact gathering, advertising and other promotional activities that the states had long carried on to attract new industries and tourists. But now several states have established programs of credit aid to industrial development that resemble the local industrial financing plans.

Leading the way, New Hampshire in 1955 established an Industrial Development Authority having the power to issue up to 1 million dollars in revenue obligations. Oklahoma was next to move into the field, when in 1960 legislation was adopted permitting the state to borrow up to 10 million dollars in general obligation bonds for industrial purposes. In 1961 Connecticut, Illinois and New York joined the group. Connecticut and New York adopted the general obligation borrowing approach with ceilings of 25 and 50 million dollars, respectively. The Illinois program authorizes revenue bond financing—at present up to 5 million dollars—for direct investment in industrial facilities. Under the other state plans, funds are to be channeled through local nonprofit industrial development agencies.

Besides these programs that provide for direct state borrowing for development purposes, several other aid plans are financed by appropriations out of tax funds or involve the guarantee of industrial mortgages, i.e., the assumption of contingent liabilities.

The public credit aspect

Any debt incurred by a local or state government is, of course, a use of public credit. But indebtedness backed solely by the rental earnings generated by a specific industrial facility is scarcely different from the direct borrowing done routinely by business firms, except for the tax-exemption feature (and perhaps an implied "moral" obligation of the public body). In effect, local or state revenue bond financing of business plant means that the sponsoring governmental body stamps its tax immunity upon debt that is essentially equivalent to private borrowing.

If the financing represents general obligation borrowing, backed by the full faith and

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credit of the issuing unit, the public credit aspect takes on a somewhat different meaning. A transaction of this kind makes the tax base of the community at least contingently liable for the indebtedness. That is, if earnings of the enterprise prove insufficient to cover debt requirements, tax revenues must be drawn upon to cover the deficiency.

In either case—but conspicuously with financing of the revenue bond type—the use of public credit often holds considerable appeal to communities as an avenue for sponsorship of industrial development. The subsidy inherent in the financing—the income tax exemption of the interest—is borne by the U. S. Treasury, rather than by the local community. Yet, if the local community stands to benefit by the development, then presumably it possesses some capacity to supply the financial inducement itself, should any special incentive be needed at all.

In many areas, wholly private, nonprofit corporations have sprung up in recent years to provide funds for industrial investment. An estimated 250 such agencies have been chartered in the five states of the Seventh District; about half of them have become active. Capital is furnished by local merchants and others immediately concerned with the economic well-being of the locality. Tax funds or property tax concessions and other incentives have been provided, in other instances, to firms locating within or close to the community. Both the wholly private plans and arrangements for local tax aids call for financial support essentially by the area within which resulting benefits may be expected to accrue.

Industrial financing questioned

The use of public credit to aid industrial development has drawn serious criticism. One objection is that it involves public participation in an activity that is the proper responsibility of private enterprise and initiative. Another, somewhat more specific criticism is that it amounts to a means of tax avoidance which, applied in a selective manner, tends to create unfair competition among business firms and areas. Popular resentment, it is contended, in time could build up to jeopardize the tax immunity provided by law for municipal obligations in general. Considerations such as these appear to have been among the factors prompting the Investment Bankers Association, the Municipal Law Section of the American Bar Association and the Municipal Finance Officers Association to take stands in opposition to the use of municipal borrowing for industrial purposes. Until recently, this opposition had been a deterrent to participation by the larger investment houses in the underwriting of municipal industrial bonds.

Continued use of public credit for promoting industrial development, nevertheless, appears likely. Local areas experiencing prolonged and severe unemployment understandably will seek to attract new enterprises or expansions of existing operations that hold promise of additional jobs.

The question remains, however, whether the provision of facilities for the use of private business firms is an appropriate use of public credit, given the tax exemption of interest on municipal securities. A further question is whether the use of credit aids to industrial development is consistent with attainment of the best possible geographical distribution of productive activity—which is so vital to maximum economic growth. Are the communities offering inducements of this kind, the places where industrial expansion "ought" to occur, particularly if such aid is available in some areas of labor surplus but not others and the inducements call for little, if any, direct financial effort on the part of the communities that stand to benefit?

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Government has big role in agricultural exports

Perhaps no activity has more diverse effects, is less understood by the American public and arouses more controversy among other nations than the agricultural export programs of the U. S. Government. In the fiscal year ended June 30, 1961, our agricultural exports reached a record high of 4.9 billion dollars. About 1.5 billion was under "special" Government programs. An additional 1.3 billion, while being recorded as "commercial" exports, was subsidized by the Government through export payments, loans and sales of Government-owned stocks to private exporters below domestic market prices. All told, about 60 per cent of our agricultural exports last year were subsidized in one way or another.

Most of the increase in overseas shipments of United States farm products in recent years has been in the subsidized sectors. While total farm exports in fiscal year 1961 were 1.8 billion dollars above the level of fiscal 1955, exports subsidized by the Government had risen about 1.6 billion. The Government's increasing role in the agricultural export picture is largely an outgrowth of domestic price support programs which have held United States prices on many agricultural commodities above the world level while at the same time channeling massive stocks of agricultural commodities into the warehouses of the Commodity Credit Corporation (CCC). Although the "special" export programs were originally conceived as temporary measures for achieving rapid disposal of the farm commodities owned by the Government, they have gradually taken on the marks of an integral link between a permanent surplus disposal program and our foreign aid effort under the banner of "Food for Peace."

Background

The United States has long evidenced a deep concern for poverty and hunger in many parts of the world. During World War I and the early 1920's, American foodstuffs were shipped overseas to help alleviate hunger and threats of famine in the war-devastated countries of Europe. During World War II, food shipments were resumed under Lend-Lease. Following the war, the United States and Canada donated large amounts of food to the United Nations Relief and Rehabilitation Administration for distribution among the nations of Europe and the Far East. Grants under the Marshall Plan (1948-51) and, subsequently, under the Mutual Security Act enabled many countries to obtain food and fibers from the United States as well as machinery and other capital equipment needed to rebuild their economies.

Throughout the postwar period, the Government has had the authority to subsidize exports of farm commodities through use of barter arrangements, credit, sales at less than domestic prices and other devices. Subsidized export programs originated in the 1930's as a means of maintaining or expanding exports, which had tended to decline as domestic agricultural support measures raised market

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prices above the world level.

Until 1954, however, exports under subsidized programs were quite small in relation to the total. In July of that year, in response to a rapid build-up of agricultural commodities in Government warehouses, in part, attributable to a tapering off in foreign demand associated with the recovery of European agriculture, Congress passed the Agricultural Trade Development and Assistance Act of 1954—commonly known as Public Law 480—consolidating many of the various "special" Federal export arrangements into one act with a greatly expanded budget. In addition, existing provisions in the Mutual Security Act authorizing shipments of agricultural commodities to foreign countries were extended and broadened. However, MSA shipments have accounted for only a relatively small part of the substantial increase in "special" exports in recent years.

The P. L. 480 programs

Public Law 480 provided for sales of surplus farm products to "friendly" foreign governments in exchange for their currencies which were not convertible into dollars and hence could not be used to purchase needed foodstuffs through normal commercial channels. Major emphasis was placed on this technique because it was widely believed that the "dollar shortage" was severely limiting exports of American agricultural products and economic development in many countries.

Another section provided for donations of surplus agricultural commodities to "friendly" countries or to "friendly" people to avert threats of famine, associated with such disasters as droughts, earthquakes and floods, and for other humanitarian purposes such as the feeding of undernourished children and war refugees. Donations of surplus foods to private American charity groups and international relief agencies for distribution to needy persons overseas were authorized. Also included was the authority for barter transactions, under which surplus commodities could be exchanged for strategic raw materials and other goods and equipment.

At the outset, the program was limited to three years and had a total budget of 2.3 billion dollars—2 billion for reimbursing the CCC for the cost of commodities sold for foreign currencies and 300 million for donations to avert famine. No special budgets were

Planned uses of foreign currency proceeds under sales agreements signed through June 30, 1961

	Amount (Million dollars)	Per cent
Loans to foreign governments	2,940	44
Grants for economic development	1,127	17
Loans to private enterprise	399	6
Common defense	399	6
United States uses*	1,753	27
Total	6,618	100

*Includes expenses of U. S. Government agencies overseas; sponsorship of educational and cultural activities such as student exchanges; promotion of trade fairs; etc.

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required for the barter program or donations to relief organizations, since the CCC was already authorized to engage in these activities.

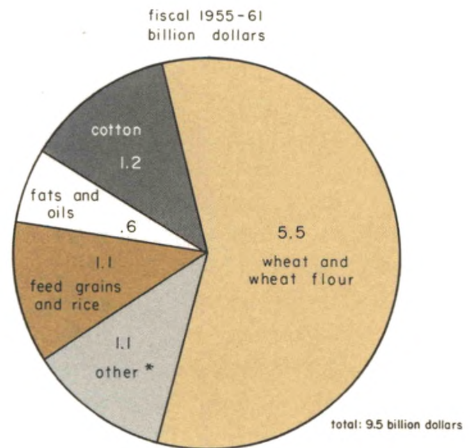
Since mid-1954, Public Law 480 has been repeatedly extended and expanded in scope. In 1959, the act was amended to provide for long-term supply contracts (up to ten years) with foreign countries and dollar loans (up to 20 years) at low interest rates to finance purchases of United States surplus farm commodities under these contracts. In 1961 Congress extended the life of the program through December 1964 and authorized an additional 4.5 billion dollars for foreign currency sales to "friendly" countries and 900 million for famine and relief donations. This brought the program's total authorization for these two activities to 18 billion dollars since its inception in July 1954.

Moreover, the Administration has announced it would place more emphasis on expanding exports of high-protein foods. These typically are among the higher price foods and, therefore, are often lacking in the diets of great numbers of people in the low-income nations. In keeping with this objective, the Secretary of Agriculture has increased price supports on dry milk, soybeans, peanuts and cottonseed, relative to those for wheat and corn, to encourage greater production of these commodities. Consideration also is being given to promoting greater utilization of wheat and feed grains exports for production of livestock abroad.

Foreign currency sales dominate

By June 30, 1961, marking the end of seven years of P. L. 480 operations, soft currency sales agreements had been signed with 39 countries. Commodities included in these agreements represented a total estimated CCC cost of 9.5 billion dollars (6.5 billion in export market value), or roughly 70 per cent of the cost of all programs drawn up under the act.[1] The accompanying chart highlights the prime importance of wheat and wheat flour in this phase of the program.

Wheat and wheat flour dominate P. L. 480 foreign currency sales agreements



* Includes 700 million dollars of ocean transportation financed by CCC.

Note: Amounts represent estimated CCC cost.

From the outset, the P. L. 480 foreign currency agreements were planned to "safeguard usual marketings of the United States" and not to "unduly disrupt world prices."

In September 1958, following vigorous protests from other agricultural exporting nations about the "dumping" aspects of these exports, Congress amended the act to provide that future sales should not "unduly disrupt normal patterns of trade with friendly coun-

[1]CCC cost for the commodities made available for export includes the corporation's original price support payment (which is usually substantially higher than the estimated export market value) plus storage, interest, processing and shipping charges.

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tries." The result was a temporary slowdown in this part of the program, but in fiscal years 1960 and 1961 exports rose 14 and 13 per cent, respectively, reflecting primarily heavy deliveries of wheat to India. In fiscal 1961 exports under soft currency sales agreements amounted to a record 935 million dollars, bringing the total for the seven-year period to 4.6 billion measured in terms of estimated export market value.

About 56 per cent of the shipments have gone to five countries — India, Spain, Yugoslavia, Pakistan and Poland.

India, which has received 23 per cent of the exports, will doubtless continue to be a major beneficiary of this phase of the program. A 1.3 billion dollar agreement with India was signed in May 1960, providing for the delivery of 16 million tons of wheat and 1 million tons of rice over a period of four years. One-fourth of the wheat and all of the rice is to be used to build a national food reserve which, presumably, can be drawn upon to cover estimated food deficits in years of poor crops.

An elaborate array of programs has been developed in cooperation with foreign governments to utilize the local currencies received under P. L. 480 sales agreements. The contracts specify the proportion of total proceeds to be used for grants and loans to the purchasing government and for loans to private business firms. The remainder may be used for payment of expenses of U. S. Government agencies incurred abroad, educational activities, trade fairs and exhibits to promote American exports, and common defense.

As of March 1961, the equivalent of about 4.6 billion dollars in local currencies had been acquired under the program and about 2.1 billion had been disbursed. Roughly half the disbursements represented development loans to foreign governments, primarily for irrigation and water power development programs, rural electrification and industrial projects. Interest and amortization payments on these loans are expected to provide a sizable inflow of local currencies which may be loaned again.[2]

Other phases of P. L. 480

Through June 30, 1961, the equivalent of about 3 billion dollars of surplus farm products had been shipped abroad under the donation and barter phases of the program.

During fiscal 1955-60, exports representing donations for famine relief and other emergency purposes averaged less than 100 million dollars per year. This may reflect the small amount of food which can be easily used to alleviate emergency food shortages. In fiscal 1961 these exports rose to 146 million dollars, primarily reflecting shipments under programs to combat famine in parts of Africa and the Near East as a result of severe drought in those areas. The food shortages in Africa

[2]Loan agreements were originally denominated in dollars, which meant that the exchange risk was assumed by the borrowing country; but in April 1959 this provision was removed. For loans made after that date, the United States "will receive repayment of the same amount of foreign currency as it lent without regard to changes, if any, which may occur in the exchange value of the currencies."

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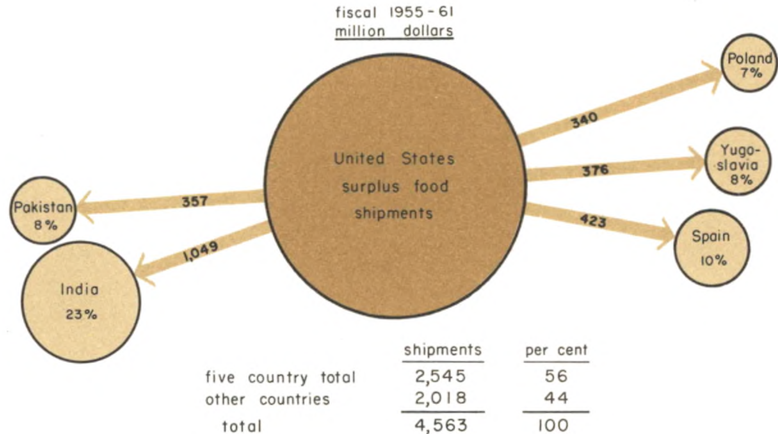
were further intensified by fighting in the Congo and Angola.

Grants of surplus agricultural commodities were authorized for the first time in fiscal 1961 to promote economic development in low-income countries. Under this program, the United States has agreed to ship wheat to Morocco and Tunisia, most of which will be used either directly or indirectly through exchange for locally produced foods, to distribute as wages to people employed on road construction, sewer, water, irrigation and other development projects in those countries. Another portion of the grain is to be sold locally and the proceeds used to buy domestically produced tools such as wheelbarrows, picks and shovels and other materials needed to complete the projects.

Over half the shipments under P. L. 480 foreign currency agreements have gone to 5 countries



	shipments	per cent
five country total	2,545	56
other countries	2,018	44
total	4,563	100

Note: Shipments represent estimated export market values.

Donations of surplus foods to charity groups and international relief agencies for distribution to needy persons have been rather steady, averaging just under 150 million dollars per year.

Exports under barter agreements, involving the exchange of surplus foods and fibers for "strategic" raw materials and other goods and equipment, rose from about 200 million per year during fiscal 1955 and 1956 to a peak of 400 million in fiscal 1957. Then, in response to criticism from private exporters and foreign governments, restrictions were placed on barter transactions to assure that they would not replace "normal" commercial exports. As a result, the volume of barter exports has dropped off to an annual rate of less than 150 million dollars.

The original barter program contained some unique features. It did not involve the direct exchange of products between two countries; instead, a private contractor—usually a metals importer—obtained Government approval of a barter contract, e.g., copper for corn. The contractor then turned the surplus agricultural commodity over to a private exporter and proceeded to buy the raw materials for delivery to the Commodity Credit Corporation. The farm products could be sold for dollars as regular commercial exports in whatever markets the best prices could be obtained. The bulk of the materials delivered under barter agreements were transferred to a "supplemental" stockpile established by P. L. 480, with the CCC receiving reimbursement under various appropriation acts.

These initial barter agreements, moreover, contained no restrictions as to countries of origin or destination, other than that they had

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to be "friendly." This facilitated the shipment of larger quantities of wheat and corn under these agreements to Western European countries during fiscal 1955 and 1956 in direct competition with ordinary commercial exports from this country, Canada and other exporting nations. Under revisions introduced in May 1957 subsequent barter agreements were approved only after it had been determined that the transaction would "result in a net addition to United States exports" and would not "disrupt world market prices unduly." A task force appointed last May is currently studying all aspects of the barter program with a view toward making recommendations for improving and expanding it.

On August 21, 1961, the first contract providing for long-term credit sales of surplus agricultural commodities to "friendly" countries was signed. It called for the delivery of about 2 million dollars of wheat and flour to El Salvador, financed by a five-year dollar loan, bearing an annual interest charge of 3⅝ per cent.

"Shotgun wedding?"

The United States has a large inventory of farm commodities, accumulated under various agricultural support programs, and wants to foster world peace in every honorable way. "Food for Peace," therefore, is an apt characterization of a desirable goal. But, getting one with the other is no simple matter as seven years of P. L. 480 operations have clearly demonstrated.

As noted above, leading agricultural export nations—Canada, Australia, Argentina—have on occasion protested against the "dumping" aspects of the P. L. 480 programs, claiming that their traditional export markets were being usurped. The programs may also have disrupted trade in other ways which are not readily apparent. For example, have the large shipments of wheat and wheat flour to India and Pakistan enabled these countries to increase production and exports of rice, thereby intensifying competition for other rice exporting nations? Spain has received rather substantial deliveries of fats and oils under foreign currency sales agreements. To what extent has this enabled Spain to expand her own exports of olive oil at the expense of exporters in Italy and Greece?

Successful use of P. L. 480 and similar programs in the recipient countries, at times, has been hampered by the inadequacy of local port, storage, processing and transportation facilities. Department of Agriculture nutrition experts estimate there are enormous protein deficiencies in the daily diets of many people in Central and West Africa, but acknowledge that in many countries a complete system of internal distribution "would have to be devised" in order to move the food to interior villages.

In addition, most foods purchased by foreign governments in exchange for their soft currencies are distributed locally through ordinary commercial channels. This does not always assure that the food will reach those in greatest "need."

Exports under P. L. 480 donation and barter programs

	Total exports fiscal 1955-61 (million dollars)
Donations	
Emergency	621
Through relief agencies	1,037
Barter	1,341
Total	2,999
Per cent of total P. L. 480 exports	40

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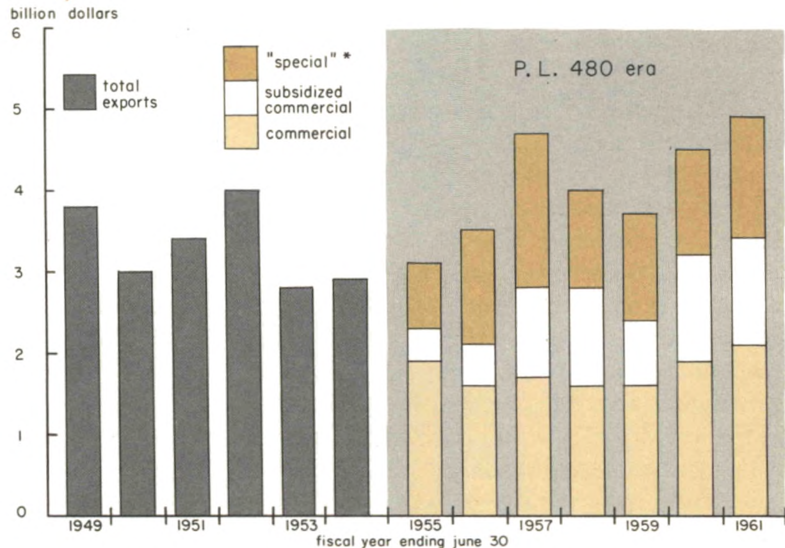
Our surplus disposal programs must be weighed carefully from the standpoint of their possible impact on the agricultural economies of the recipient nations. If local food prices decline as a result of large, sustained shipments of American foodstuffs, there is a risk that local agricultural initiative may be stifled. This would not only enhance rural poverty and reduce local production of food; it would also make the recipient country extremely vulnerable if the shipments stopped, owing to, say, an exhaustion of American surpluses, disruption of shipping or a change in foreign aid policies.

"Special" Government programs have boosted U. S. agricultural exports in recent years



* Includes exports under P. L. 480 programs and Mutual Security Act.

Additional problems are posed by the accumulation of large amounts of foreign currencies under P. L. 480, in some cases, about equal to the annual government budgets of the participating countries. If these funds are not used judiciously, they could generate severe inflationary pressures in the recipient countries. Furthermore, the value of these counterpart funds to the foreign country is reduced if they are used for purposes which would normally generate dollar earnings, e.g., U. S. Government overseas military expenditures.

A further question is whether the types of food that currently dominate the Government stockpile can be used effectively in helping to combat hunger and improve diets among the people of low-income countries. In many of these nations, local tastes and preferences do not readily permit acceptance of wheat and corn in daily diets. Yet, these two commodities have comprised the lion's share of Public Law 480 shipments. Some studies have shown that unbalanced diets and deficiencies in important nutrients do not necessarily represent shortages of foodstuffs but are often symptoms of lack of knowledge concerning proper dietary practices or deep-rooted customs (worship of cattle in India, for example) and prejudices concerning certain kinds of foods.

Efforts are now being made to channel American agriculture into the production of foods believed to be more acceptable for foreign consumption as well as helpful in correcting dietary deficiencies. While this will facilitate the Government's surplus disposal ef-

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forts, it can be a costly process. Price support relationships will have to be adjusted so as to provide an incentive to farmers to shift their production patterns in the desired direction. Indeed, higher supports on oil and protein crops in 1961 have materially boosted the cost of the domestic agricultural program. If further processing of commodities is required, additional expenses will be incurred since the greater the conversion, e.g., grain into livestock, the greater the expense.

While it is generally agreed that the agricultural surplus disposal programs of the United States have helped foreign countries to ride out such short-run problems as threats of famine associated with drought, floods, earthquakes and other disasters, the amounts of commodities which can be moved abroad for this purpose appear to be limited. The effectiveness of these programs in combating chronic malnutrition and in improving diets in low-income countries is less clear even though it provides a much broader opening for disposal of American surpluses. As noted above, malnutrition often results from lack of knowledge concerning the requirements for good diets. In such circumstances, raising educational levels, instituting health and sanitation programs and improving technology in agriculture and other industries may often be a more practical approach to the problem of improving human nutrition.

These programs, however, require financial and technical assistance in addition to shipments of surplus foodstuffs. In this connection, several experts have expressed the opinion that too much emphasis may have been placed on the surplus disposal aspects of P. L. 480 operations and not enough on drafting constructive long-range development plans for utilizing the soft currencies received under the sales agreements.

If development programs undertaken with these loan funds facilitate rapid economic growth in the recipient countries and bring substantial increases in their national incomes, then the aid has been of great benefit. With rapid progress, the countries involved could at some future date make the transition from continuing to receive further aid to repaying the loans without great shock. On the other hand, if the agricultural commodities exported to these countries have merely resulted in an upgrading of their diets instead of helping to further capital investment and increase productivity, then there is real question whether these programs can facilitate vigorous economic development.

A great risk is that the "Food for Peace" program's present emphasis on improving diets in low-income countries may be viewed as a convenient substitute for, instead of a complement to, needed economic development aid and planning in these countries and agricultural adjustment in the United States.

Annual Report

The Annual Report of the Federal Reserve Bank of Chicago will be mailed to the member banks early in January. It includes a brief review of the major developments in business, agriculture and banking as they affected the Seventh Federal Reserve District during the past year, statement of condition as of December 31, 1961, and of earnings and expenses for the year. Copies may be obtained on request to the Bank.

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