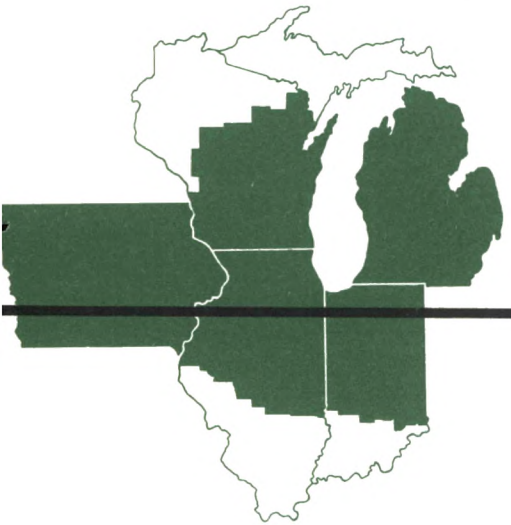
Business Conditions



1962 February

Contents

THE Trend OF BUSINESS

Business activity rose further in January following a marked acceleration in the fourth quarter of 1961. Steel continued to spearhead the advance in both the nation and the Midwest, while auto production remained at a high level. Output of industrial equipment continued to improve moderately, and production of farm equipment was increasing again after cutbacks caused by excessive inventories in the spring of last year. In addition, a number of Midwest centers reported increases in defense work, particularly in military vehicles and electronic equipment.

The business atmosphere in early 1962 contrasts sharply with the situation which prevailed a year ago when aggregate activity had been declining for several months. Most businessmen are now confidently forecasting increases in their sales and orders, and many of them anticipate that favorable conditions will prevail throughout the year. This optimism is buttressed by evidence that retail sales rose substantially in the final months of 1961 and that manufacturers' order backlogs continued to increase. In line with the faster tempo of activity, business demand for bank credit strengthened in December.

During the second half of 1961 inventories of durable goods manufacturers, seasonally adjusted, rose by about 300 million dollars per month—over 3 billion on an annual rate basis. Inventories probably are being increased at a faster rate currently, largely because of attempts to build steel inventories as a hedge against a possible strike. In January steel output was at an annual rate of about 120 million tons compared with total production of 100 million tons in all of 1961. Steel output is expected to rise substantially further in February and March. Industry forecasts, however, point to a maximum total output of 115 million tons in 1962.

While the build-up of steel inventories is adding impetus to the general business upswing at present, it is almost certain to be followed by a cutback in production after midyear whether or not a strike is called. Any early indications that labor-management difficulties will be resolved without a long work stoppage would tend to slow inventory buying and lessen prospects for substantial decline in steel production later in the year.

Two factors which had clouded the economic scene during much of 1961 became more favorable in recent months. First, the seasonally adjusted rate of unemployment which had been "stuck" at just under 7 per cent for almost a year dropped to 6.1 per cent in November and remained at this reduced level in December. Second, retail sales which had not responded fully to higher personal incomes from February through September, rose very sharply in the fourth quarter.

The consumer comes through

For the first quarter of 1961—the low point for the 1960-61 recession—retail sales were at an annual rate of 215 billion dollars. By the third quarter the rate had increased to

217 billion dollars, about 1 per cent. But in the fourth quarter sales rose 4.5 per cent to 227 billion.

The increase in retail sales in the fourth quarter of 1961 marked the largest quarter-to-quarter gain since the periods of "scare buying" in the Korean war more than 10 years earlier. Consumers reduced the proportion of current income saved and made greater use of instalment credit as they boosted spending. Personal saving probably declined to about 6 per cent of disposable income, compared with an average of 7.4 per cent for the past decade.

The upsurge in consumer outlays reflected in part the failure of these expenditures to increase more rapidly in earlier months despite higher income. Consumer spending usually rises rather slowly in the early stages of a business recovery while employment is increasing less rapidly than output. In addition, some individuals wish to rebuild savings which were reduced during the period of unemployment and shorter work weeks. Moreover, it takes time to create confidence that the current rise in activity will continue for some time.

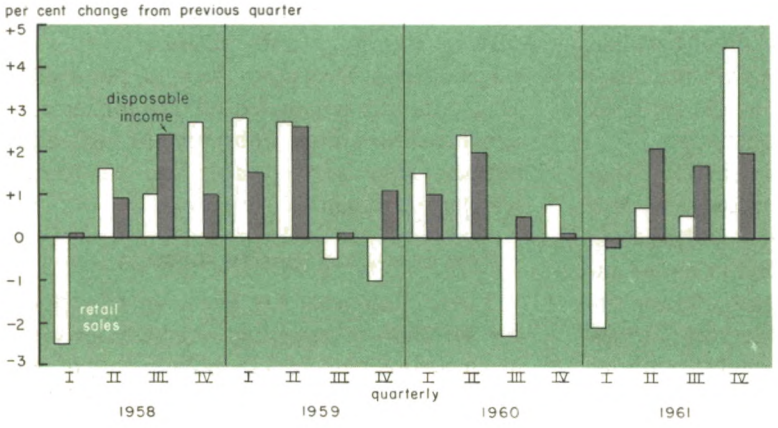
In 1958-59 retail sales increased only 2.5 per cent in the first six months of the upswing and 5.5 per cent in the second six months. It now appears that sluggishness of retail sales in the face of rapid general economic improvement was much more significant throughout most of 1961 than in the 1958-59 recovery period.

Why did retail buying revive so slowly in 1961? There are a number of possible explanations. One factor was that unemployment, although never so high as the peak rate in 1958, was a problem in more areas and was at a relatively high level for a longer time.

Limited availability of 1962 model cars, as a result of strikes in September and October, coupled with small holdover inventories of 1961 models, also held down sales in the late summer and early fall. As output rose the annual rate of sales, including imports, averaged close to 7 million units in November and December, compared with a total of less than 6 million for the year as a whole. This development was primarily responsible for the 9 per cent gain in sales at durable goods stores, including automobile dealers, in the October-December period. Sales at other kinds of stores rose 2.4 per cent during this period.

Another influence on consumer buying during 1961—incapable of measurement

Rise in retail sales in fourth quarter of 1961 was largest in recent years



but probably significant nonetheless—was the Berlin crisis. Studies of consumer behavior indicate that tension and uncertainty cause a deferral of major purchases while further developments are awaited. Moreover, during the summer and fall some reservists and national guardsmen were called to active service and draft calls were stepped up. Commonly, the shift from civilian to military life means reduced family income. As apprehension over the outbreak of war tended to abate in the final months of 1961, draft calls were reduced and it was suggested that national guard units might soon be deactivated. With these developments, came a marked strengthening in retail trade.

Christmas sales finished strong

December is always the largest month for retail sales because of Christmas gift buying. This is particularly true of department stores which sell about 15 per cent of their year's total volume in December—more than twice as much as the average for the other 11 months of the year.

Until the final two weeks of the Christmas season, department store sales had been disappointing. Late shoppers, however, more than made up for the earlier hesitancy. In the four weeks ending December 30, department store sales for the nation were 8 per cent above the record level of 1960, while in the Seventh District they were up 5 per cent.

Department store sales within the District were strongest in the smaller cities which serve rural areas. (Farm income had risen substantially in 1961.) The sales gain for a group of smaller centers in the Midwest was 9 per cent in the last four weeks of the year compared with increases of 2 to 5 per cent in the major metropolitan areas. For 1961 as a whole, department store sales in the District were 1 per cent above 1960 as compared with a 3 per cent rise for the nation.

Favorable sales results in the Christmas season also were reported by apparel stores, mail order houses and other establishments which do a large holiday business. Because the surge in sales came late in the year, inventories were reduced more than usual at many stores. As a result, markdown sales in January were less prevalent than in recent years.

The outlook for hogs

Hog farmers had a good year in 1961. As a result of high pork prices, farmers' receipts from hogs increased 6 per cent to 2.9 billion dollars and accounted for about 8 per cent of total income from farm marketings last year. In the Midwest, where hogs are the major source of income for many farmers, the results were even more favorable, and the prospects for 1962 are good. This spring farmers are planning to increase farrowings of pigs by about 3 per cent. Since this follows a 4 per cent increase in pigs farrowed last fall, the per capita pork supply in 1962 will be only slightly above last year.

This is a relatively slow rise in production in view of the favorable prices. Last fall the market value of 100 pounds of live hog was equal to the value of about 16 bushels of corn. In the past, hog-corn ratios as high as this have generally been followed by an 8 to 10 per cent increase in the number of pigs farrowed the following spring.

To a large extent, the small increase in hog production reflects the effects of the Government's 1961 feed grain program. Corn Belt farmers planted 18 per cent fewer acres of corn last year and the Government raised its price support on corn from $1.06 to $1.20 a bushel. Many hog producers scaled their hog production plans in accordance with the reduction in acreage and the expected higher prices for corn. By the end of 1961, when it

was apparent that even with less acreage the corn crop would be the second largest in history and only 7 per cent below 1960's record crop, hog producers had already made their plans for the 1962 spring pig crop. This assures favorable hog prices during most of the current year. But with the large 1961 corn crop providing ample "raw materials" and the unexpected low corn prices in recent weeks (reflecting large Government sales of "certificate" corn under the 1961 feed grain program), Corn Belt farmers should have ample incentive for expanding hog production substantially next fall.

The money in your pocket

By the end of January the Christmas bulge in currency in circulation had largely disappeared. Each year as the Christmas shopping season unfurls the amount of "pocket money" withdrawn from the nation's commercial banks rises sharply. Between the end of October and the second half of December 1961, the public's holdings of currency (including coins) rose 900 million dollars. To accommodate this increased flow, commercial banks boosted their holdings of vault cash by about 300 million dollars, bringing the total amount of currency outside the Federal Reserve Banks and the Treasury to a record 34 billion at year-end.

But the Christmas bulge is short-lived. Once the spurt in spending has passed, individuals, banks and other businesses quickly reduce their holdings of currency. By the latter part of January, with its mission accomplished, the bulk of the Christmas money had been returned to the Federal Reserve Banks. On the basis of past experience, the amount in circulation is expected to continue to decline into February to a seasonal low, roughly 1.4 billion dollars below the seasonal high in December.

Similar, though smaller, short-run changes in the volume of currency in circulation occur around other national holidays and even over weekends. These have an important impact on the nation's banks. Most apparent, of course, is the physical task of keeping the public supplied with the kinds and amounts of currency needed in each area and at all times. In 1960, for example, the 12 Federal Reserve Banks received and counted nearly 10 billion coins and close to 5 billion pieces of paper currency sent in by the commercial banks. The total value of this money handled during the year was about equal to the average amount outstanding. An even greater volume is handled by the commercial banks. Rough estimates based upon short-run changes in vault cash holdings of individual banks indicate that, on the average, banks pay out currency and coin to their customers about three times for each time it is shipped to a Federal Reserve Bank.

Shifts in the amount of currency in circulation also affect bank *reserves*. While the impact is less apparent to the users of money than the job of filling the current demand, it is important to the individual banks and the monetary system over-all. A withdrawal of deposits in the form of currency or coin re-

duces bank reserves and, in the absence of offsetting new reserves, would produce a contraction of deposits and earning assets of commercial banks several times the amount of currency withdrawn. A deposit of currency and coin, on the other hand, increases reserves and, again barring offsets, would permit an expansion of deposits and earning assets several times greater than the amount of the currency deposited. Currency flows, therefore, are important considerations to banks in the management of their reserves and to the Federal Reserve System in administering monetary policy.

Patterns in cash circulation

Of shortest duration is the "cash" drain that banks generally experience at the end of each week and the return inflow at the beginning of the following week. Vault cash holdings of all member banks, in an average week, drop by roughly 15 per cent on Friday. By the close of business on Monday, however, a net inflow typically restores vault cash to its previous level.

There is also a fairly regular *intramonthly* pattern in currency in circulation. Currency in the hands of the public is higher in the first half of most months than in the second half, no doubt reflecting the payment of bills due around the first of the month. The reverse is true for banks' holding of vault cash.

Superimposed on the weekly and monthly patterns are the large increases in cash in the hands of the public that occur at the time of major holidays, such as Easter, Memorial Day, the Fourth of July, Labor Day and Christmas. Individuals obviously need extra cash over the holidays when the banks are closed and expenditures for travel, lodging away from home and entertainment rise. As noted above, the most pronounced seasonal swing in currency occurs during the Christmas shopping season. During this period, banks as well as individuals and businesses add substantially to their cash positions.

The increase in aggregate holdings of currency during holiday periods does not affect all bills and coins to the same degree. During the Christmas season, for example, the demand for all coins and bills up to and including $100 rises, but demand for the smaller bills increases more than for the larger ones. This reflects the fact that consumer spending, especially for lower-priced durable and nondurable goods and the use of currency for gifts, reaches a seasonal peak during the weeks just before Christmas. These uses chiefly involve currency in denominations of $20 and less.

Individuals and businesses hold whatever volume of currency they desire, limited only by their ability to pay for it. Commercial banks serve merely as agents through which the choice of the public for a greater or lesser amount of currency is expressed. Flows of currency between the public and *individual* banks depend primarily upon the kinds of customers the banks have. Banks which serve mainly customers who make the bulk of their payments by check and hold little money in the form of currency keep a different proportion of their assets in the form of vault cash than banks which serve customers who make a large proportion of payments in currency. The holdings of vault cash by member banks in the Seventh Federal Reserve District range from a low of less than 1 per cent of total assets to a high of about 5 per cent.

Trends in currency circulation

Of greater interest perhaps than the short-run shifts are the changes in the public's holdings of currency over a period of years, particularly changes in relation to the total money supply and total spending. While cur-

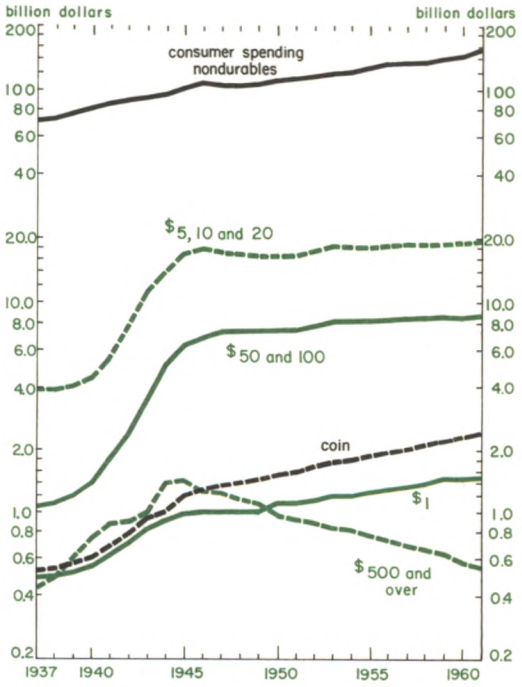
rency and coin are the only kinds of money held by many people—those not having checking accounts—this kind of money accounts for only one-fifth of the total. About four-fifths is held in the form of commercial bank demand deposits. In 1961, for example, demand deposits, other than those of the U. S. Government and of individual banks held in other banks, averaged 113 billion dollars. The currency and coin in the hands of the public was on the order of 29 billion dollars. Moreover, over many years the *proportion* of the money supply held as demand deposits has tended to rise—from less than 75 per cent in the early postwar period to 80 per cent today.

While *short-run* changes in the volume of currency in circulation appear to be linked to changes in consumer spending, it would be unrealistic to expect a close parallel between the two over long periods of time. Factors unrelated in any direct way to consumer spending have been associated with changes in currency holdings at various times. World War II for example, brought a substantial growth in the demand for currency, particularly $10, $20, $50 and $100 bills.

During the postwar period, particularly in the past decade, the volume of currency in circulation has increased less rapidly than consumer expenditures. This probably reflects a number of factors: the large wartime rise in demand for currency, the postwar growth of checkbook spending and the growth of various types of credit instruments, including charge accounts, revolving credit plans and credit cards.

In the past decade or so, the use of credit for small but regular purchases such as gasoline and lodging and meals away from home has increased. Periodic settlement with the creditor typically involves payment by check, not currency. Then, too, more and more people have acquired checking accounts and are using them more intensively.

During the postwar period, coins in circulation have risen more rapidly than large bills or consumer spending



The increasing use of substitutes for currency and coin has affected the various denominations of currency quite differently. In recent years, largely as a result of the widespread use of coin-operated vending machines, the amount of coins in circulation has risen at a faster pace than consumer spending for nondurable goods (see chart). Trade sources estimate that vending machines dispense a sixth of the cigarettes sold, a fifth of the candy bars and a quarter of the soft drinks. In addition, coin-operated machines are used for an increasing variety of services,

such as payments on toll roads, sales of packaged meals and for laundry, dry cleaning and other personal services.

Since 1951, the volume of $1 bills, on the other hand, has risen at the same rate as consumer spending for nondurables, while $5, $10 and $20 bills have grown at noticeably slower rates. The number of bills of $500 and higher denominations in circulation has declined even though personal income and spending have risen. This may indicate a continuing decline in large currency hoards accumulated by some individuals during World War II.

Of greater economic significance than just the *amount* of currency and coin is the use made of it. Unfortunately, very little is known about this. The number of times demand deposits are spent in a given month or year can be determined quite readily. In 1961, for example, aggregate demand deposits at all commercial banks were spent or "turned over" about 30 times. On the other hand, the number of times currency and coin "changes hands" cannot be readily determined as there is little information available on transactions of this type. It appears, however, that the turnover of currency is considerably less than that of demand deposits. Also, the turnover of currency and coin probably is less sensitive to changes in business activity than is that of demand deposits, but there is little specific evidence available to support these general impressions.

International commodity price problems

Many commodities traded in large volume in international markets have long been subject to rather abrupt and wide price fluctuations. For industrial raw materials this instability has largely reflected changes in demand over the course of the business cycle in major industrial countries, while for agricultural foodstuffs, it has more closely reflected changes in supply owing to the vagaries of weather, crop diseases or other natural events.

If these price fluctuations occurred within a generally rising trend, the consequences for economic and political stability in raw material producing countries might not be great, but most leading international commodity price indexes have reflected a downward price trend from the abnormal highs reached during the Korean emergency over a decade ago.

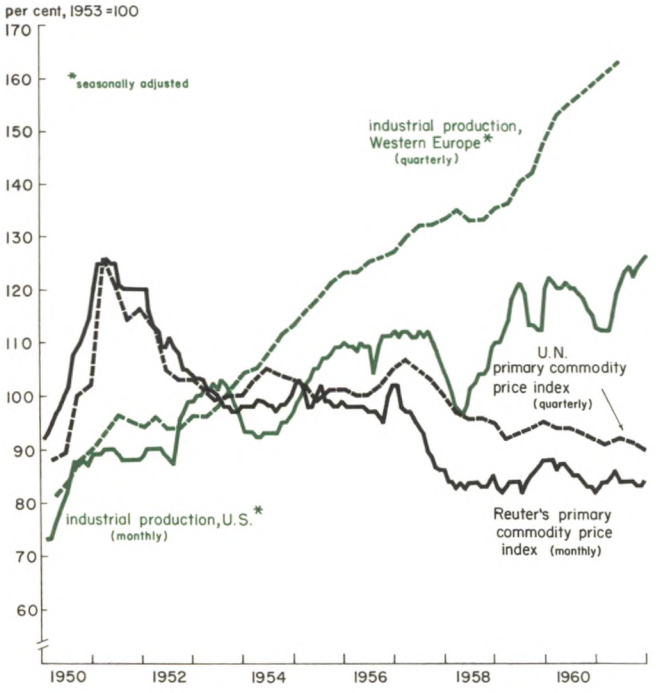
Currently, many important international commodities are described as being in "distress." In January of this year the spot (cash) price of sugar in the world "free market" dropped below 2.1 cents a pound—the lowest since 1941—following collapse of the Geneva International Sugar Conference over failure to agree on export quotas for 1962 and 1963. New York spot prices for key grades of cocoa and coffee are down 48 and 31 per cent,

respectively, from average prices in 1958.

Softness also has dominated international markets for industrial materials. The spot price of crude rubber in New York is currently about 25 per cent below the average in 1960. Lead prices have been under pressure owing to overproduction and high inventories. In November 1961 the spot price of lead in the London market dipped below 8 cents a pound—the lowest in 15 years. Tin, the major exception, is up about 20 per cent in price since the end of 1960.

To many observers, the absence of any appreciable price strength in international commodity markets has been puzzling, especially in view of the continued high level of business activity in Europe and Japan, the vigorous recovery of the United States economy since the early part of 1961 and the increased international tension associated with Berlin and fighting in the Congo.

Since 1953 primary commodity price indexes have drifted downward despite continued growth in Western industrial countries



The Korean experience

Following the outbreak of the Korean War in June 1950, basic commodity prices advanced sharply. This tended to confirm the belief, on the part of some observers, that the world was headed for a prolonged shortage of many primary commodities. In January 1951 the President appointed a special committee (known as the Paley Commission) "to study the materials problem of the United States and its relation to the free and friendly nations of the world." The commission report, submitted in June 1952, warned: "There is no blinking the fact that the United States and the free nations face a more difficult supply situation in the future than in the past."

The United States and British governments accelerated their stockpiling programs to assure adequate domestic supplies of "strategic and critical" raw materials. Purchase obligations issued by the United States stockpile agency rose from 253 million dollars in fiscal 1948 to a peak of 2.1 billion in fiscal 1951. These purchase contracts and the sharp price advances to which they contributed encouraged the expansion of existing raw materials supply sources as well as the development of new ones throughout the Western world.

But primary commodity prices quickly retreated from their Korean peaks. Reuter's index of primary commodity prices quoted on British markets and weighted according to their relative importance in international trade (1953=100) declined from a high of 126 in April 1951 to 104 by the end of 1952. By mid-1953 Reuter's index had receded to 100 —the level prevailing at the start of the Korean War. In the United States, by this time the Bureau of Labor Statistics index of spot commodity prices also had returned to its pre-Korean level.

Since mid-1953 most major international primary commodity indexes, while fluctuating considerably, have continued to drift downward. This has occurred against a background of recurring international crises involving Suez, Lebanon, Cuba, Laos and, more recently, Berlin and the Congo and continued vigorous economic growth in Western industrial countries.

From shortage to surplus

The above has essentially reflected a gradual shift in the world's supply picture from one of shortage to abundance.

On the demand side, stockpiling of strategic raw materials by the United States and Great Britain has dropped off dramatically. Purchase obligations issued by the United States stockpiling agency averaged less than 30 million dollars annually during fiscal years 1959-61, compared with an average of about 1.1 billion a year during the Korean emergency. This country in recent years has begun to make large net sales of crude rubber, copper and nickel from its strategic stockpile. The impact on prices, of course, is the reverse of that when the stockpile was being built up.

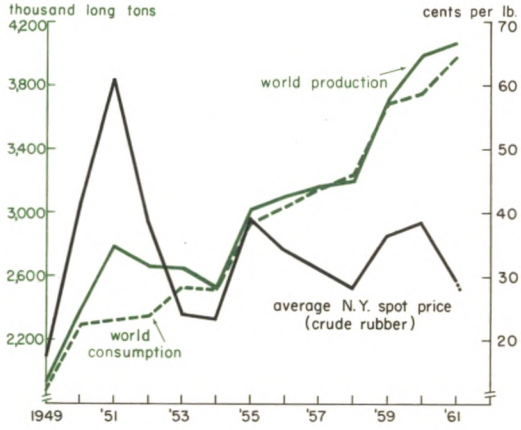
Changes in patterns of industrial activity and improvements in technology also have tended to reduce Western dependence upon many primary commodities. In the United States, Western Europe and even Japan, postwar industrial growth has been most pronounced in the highly complex chemical, electronic and metal products industries which have required substantially greater inputs of capital and skilled labor in relation to inputs of primary raw materials. Technological advance also has facilitated greater economies in the use of raw materials and has led to increased substitution of new or "processed" materials for traditional ones normally supplied by the primary producing countries.

World supplies of many basic commodities continued to rise with advances in agricultural productivity in both temperate and tropical zone countries, improvements in mining technology and the emergence of new areas of production. In many instances the development of new supply sources was an integral part of the long-range economic development programs of the newly emerging nations in Africa and Asia.

Some key commodities

Although world production and consump-

Rubber



tion of *rubber* (both crude and synthetic) have remained approximately in balance in recent years, the New York spot price of crude rubber has declined from an average of about 37 cents a pound in both 1959 and 1960 to about 28 cents in recent months. Rapid gains in production and improvement in the quality of synthetic rubber in Western industrial countries have exercised a dampening effect on crude rubber prices.

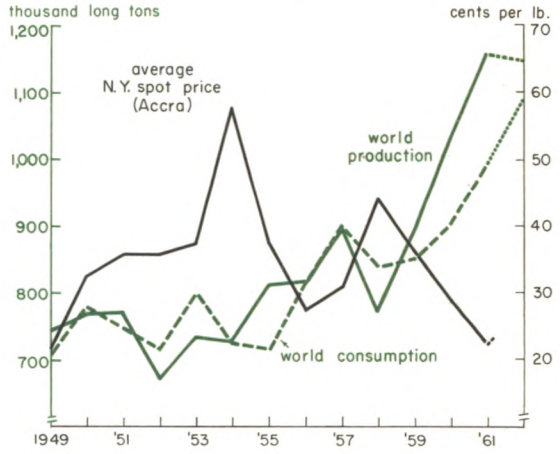
Output of synthetic rubber in the United States has risen nearly 220 per cent from the average of 1948-50 and now accounts for over 70 per cent of all new rubber consumption in this country, compared with about 42 per cent in the early postwar period. Large net sales of rubber from the United States and British strategic stockpiles also have tended to depress crude rubber prices. The U. S. Government has launched a long-range program to dispose of about 500,000 tons of crude rubber. Under a recent revision, rubber sales will be suspended for one month whenever the average market price for the preceding month was below 28 cents a pound.

World *cocoa* production reached a record 1.2 million long tons in the 1960-61 crop year reflecting exceptionally favorable growing conditions in Ghana and Nigeria. This was the second consecutive year in which world cocoa output exceeded 1 million tons and represented an increase of roughly 29 per cent over the 1958-59 crop.

Consumption of cocoa also has expanded vigorously but not as fast as production. In 1961 cocoa consumption equaled an estimated 1 million long tons, representing an increase of about 18 per cent since 1958. This has resulted in steadily increasing surpluses —totaling 50,000 long tons in 1959, 100,000 in 1960 and about 200,000 in 1961. The cost of carrying these surpluses has largely fallen upon producing countries where national cocoa marketing boards have attempted to support prices by withholding production from marketing channels.

Under the impact of heavy crop carry-overs and aggressive selling by leading African producers, the New York spot price of Accra cocoa slid from an average of 36 cents a pound in 1959 to just under 20 cents in September 1961—the lowest in 11 years. By December, however, the price had recovered

Cocoa



to 28 cents a pound, reflecting estimates of a lower cocoa crop for 1962 and a growing belief that leading cocoa producing and consuming nations would sign an international cocoa agreement. As drafted by the U. N. Cocoa Study Group, the agreement would attempt to stabilize cocoa prices by applying export quotas on cocoa beans, cocoa butter and other cocoa derivatives. Since the first of the year, cocoa prices have weakened noticeably with the New York spot price declining to about 22 cents a pound in response to upward revisions of the 1962 crop forecast.

The problem for *coffee* is essentially simi-

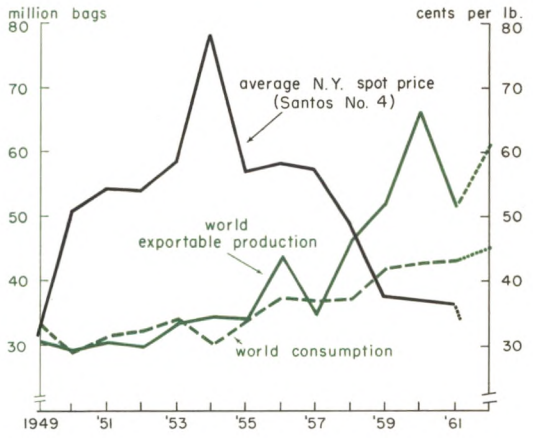
lar to that of cocoa. In recent years, bumper crops and aggressive selling by new African producers have kept coffee prices under pressure. The New York spot price for a key grade of Brazilian coffee (Santos No. 4) declined from an average of 57 cents a pound in 1957 to about 37 cents in both 1959 and 1960. During 1961 the price declined slightly from an average of 37 cents a pound in the first part of the year to 34 cents by the end of the year.

World exportable production of coffee rose rapidly from an average 31 million bags (132 pounds each) a year in the early Fifties to a peak of 66 million in the 1959-60 crop year. Production for the 1961-62 season is estimated at 61 million bags—or roughly double the average level of production a decade earlier. During this period, however, world coffee imports, which provide a rough indication of demand, increased from an average 33 million bags a year to an estimated 45 million in the current year, or 36 per cent.

As a result, surplus coffee stocks in producing countries have risen from virtually nil a decade ago to a record 64 million bags as of June 30, 1961, with an addition to the carry-over of roughly 16 million bags indicated for the current crop year. In Brazil, which has accounted for the bulk of the stockpiling, and Colombia surplus coffee stocks are tightly controlled by government agencies but in other producing regions this is done largely by individual growers and merchants. In some of these countries, producers are now experiencing major difficulties in financing their coffee inventories.

One may be puzzled by the relative stability of spot coffee prices since mid-1959. To a large extent, it reflects the effects of the International Coffee Agreement signed in September 1959 to supersede the Latin American Coffee Agreement. The agreement, whose members account for over 90 per cent of the world's production of coffee, attempts to stabilize the market by assigning export quotas among members in relation to expected demand in traditional foreign markets.

Coffee



In spite of these efforts, coffee prices have declined about 11 per cent since the first part of 1961 and the current price structure remains highly precarious in view of the enormous world coffee surplus. A sharp price drop would doubtless occur if Brazil curtailed stockpiling and decided to push exports more vigorously, especially in the United States, to regain exports lost to the new African producers.

Against this background of uncertainty, coffee growers have tried to develop ways for strengthening the present international agreement and have enlisted the support of key consumer countries—notably the United States. In December 1961 a committee of the U. N. Coffee Study Group, representing 44 producer and consumer nations, submitted a draft of a five-year support plan which would

replace the present international pact due to expire this year. In addition to providing for export quotas geared closely to world imports, closer policing of surplus coffee stocks and penalties for selling "below the established minimum prices," the plan would provide for an import control system under which consumer countries would be obligated to maintain import restrictions against shipments from nonmember countries or from member producer countries who had violated their export quotas.

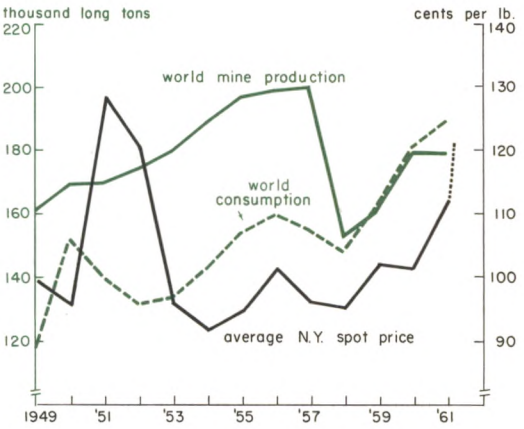
The price of *tin* "went through the roof" in June 1961 when the buffer stock manager of the International Tin Council, which manages the International Tin Agreement, announced in London that he had exhausted his stocks of tin through sales aimed at keeping the price from rising above the ITA ceiling price of £880 a long ton ($1.10 a pound). The ITA floor price for tin was £730 a long ton ($.91 a pound). The buffer stock manager has authority to buy tin when demand is weak and sell when demand is strong so as to smooth out price fluctuations. Purchases are made with funds advanced by ITA producer members.[1]

By August the New York spot price of tin reached a high of $1.25 a pound under continued heavy buying. In subsequent months the price has retreated to the current level of about $1.20 a pound, which is still 20 cents above the price prevailing at the end of 1960.

All this may seem strange since production or supplies were free to rise owing to the fact that during the second half of 1960 the Tin Council had removed all export quota restrictions imposed upon producer members. Nonetheless, world mine production in 1961 is estimated to be unchanged from the previous year's output or just under 180,000 long tons. Meanwhile, the demand for tin has been rising. In 1960 world tin consumption reached a record 181,000 long tons—up 10 per cent over 1959—with a further increase of 5 per cent estimated for 1961.

The failure of tin output to respond to demand and price increases is traceable to a number of factors. Production flexibility has been severely impaired by nationalization of mines in Bolivia and Indonesia and political turmoil in the Congo. In other important tin producing countries, notably Malaya, Nigeria and Thailand, a broadening range of attractive investment alternatives compete against

Tin



tin for scarce capital resources. Finally, uncertainty regarding the outlook for tin prices has been stressed as a further deterrent to increased output in these countries. According to trade sources, tin prices would probably

[1] In January of this year the International Tin Council voted to extend the ITA on a provisional basis until the end of June and to raise both the ceiling and floor prices which govern operations of the buffer stock manager. The ceiling price was increased to £965 a long ton ($1.21 a pound) and the floor price to £790 a long ton ($.99 a pound). Ratification by member countries is required.

stage a hasty retreat from present levels if Bolivia, Indonesia and the Congo entered the market with increased offerings or the United States began to sell tin from its substantial stockpile. In September 1961, Government officials asked Congress for permission to release 50,000 long tons of tin from the stockpile. Although Congress adjourned without taking action, it is expected to give further consideration to this proposal during the current session.

Effects on development and trade

The pattern of ebbing prices for many of the world's important primary commodities stands in sharp contrast with the firmness of prices of manufactured goods sold by Western industrial nations. With few exceptions, primary producing countries are getting less for their exports and are paying more for their imports, while at the same time their long-range economic development programs have become increasingly more ambitious. Hence, the problem of how to carry out the development programs which were largely predicated on the expectation that the pattern of rising export earnings of the early 1950's would continue. Financing has been met in part by increased loans from the various international lending agencies, grants and credits extended by major Western governments, plus a high level of private foreign investment. The primary producing countries have furnished the balance by drawing down their foreign exchange reserves.

A number of countries, however, have been compelled to defer or curtail planned development projects as well as adopt rigorous import and foreign exchange controls to protect badly depleted foreign exchange reserves and contain internal inflationary pressures resulting from deficit financing.

For major Western industrial countries lower primary commodity prices had a two-fold effect. On the one hand, it improved their terms of trade—they had to sell less to purchase a given quantity of raw materials—and thus helped to offset the impact of large capital outflows on their over-all balance of payments positions. On the other hand, growth in exports of manufactured goods was slowed as some primary producing countries cut back imports to conserve foreign exchange reserves. The burden of these cutbacks largely fell upon capital goods manufacturers, particularly in the United States, creating additional problems for industries that had large excess capacity.

Further complicating the situation was the risk that the Soviet bloc might offer more "trade and aid" deals to hard-pressed primary producing nations. Many of these countries not only produce a number of important items in short supply in the Soviet bloc—citrus fruits, rubber, cotton, sugar, cocoa—but also offer a convenient market for Soviet machinery, petroleum and technical assistance. Substantial long-term barter transactions already have been conducted with Egypt (cotton) and Cuba (sugar), and possible deals with African cocoa producers have been rumored in European trade circles.

Stronger price props?

During the last twelve months, world-wide concern for the economic problems of primary producing countries has sharpened considerably and renewed efforts have been directed toward finding ways for improving the effectiveness of existing commodity price stabilization agreements and adopting support schemes for commodities not presently covered by international agreements. As noted above, United Nations study groups have drawn up drafts of an international cocoa agreement and a stronger international coffee

agreement for approval by member consuming and producing countries. Leading oil producing nations in Latin America and the Middle East are vitally interested in adopting a strong pact to stabilize crude oil prices in the international market.

Another noteworthy development has been the marked shift in the U. S. Government's attitude toward organized intervention in international commodity markets. In the past this country had generally confined its support to international stabilization schemes covering commodities which it produced or exported in large amounts—it is a member of the international sugar and wheat agreements. But in May 1961 the Administration informed the U. N. Commission on International Commodity Trade that it was willing to consider "any reasonable proposal" for attacking the problems of international commodity markets. Three months later, at the Inter-American Economic Conference in Uruguay, the United States agreed to participate in a "workable international coffee agreement" and to use its good offices to urge "participation by other coffee consuming countries." It also promised to consider participation in the International Tin Agreement and examine the problems of other commodities important to the export earnings of Latin American countries.

The Administration has followed this up by attempting to link the objective of greater stability for international commodity markets with its over-all foreign aid program. In December the Secretary of State said: "There is no sense whatever in taxing Americans for foreign aid if we meanwhile pursue trade policies which undermine the prospects for economic development. It should be remembered that a drop of a few cents in world commodity prices could wipe out any contribution we might make through our aid in helping the underdeveloped country concerned."

Questions and problems

The determination to seek stronger props for basic commodity prices raises some interesting questions. Does it reflect concern over "instability" or simply "low" prices? Understandably, primary producing countries would like to see prices restored to the high levels prevailing roughly a decade ago but these prices were abnormally high, reflecting the shortages of the early postwar period as well as the "scare" buying of the Korean emergency. Are consumer interests to be adequately safeguarded or represented in the new price propping arrangements? Finally, what is to guide capital investment if production and marketing of primary commodities are subject to strict controls?

Commodity price stabilization has been comparatively successful where production or distribution is concentrated in a few powerful hands, e.g., nickel and diamonds, or where the price propping agency has access to virtually unlimited financial resources, e.g., the U. S. Commodity Credit Corporation. But when production is widely dispersed, as in the case of sugar, tin, cocoa and coffee, the formulation of closely knit price stabilization schemes is a much more difficult undertaking.

To be effective, such schemes would have to have the power to regulate production in all important producing areas and control exports and imports through strict quotas.

The task has been complicated, however, by the emergence of many new producing areas during the postwar period. It is worth noting that certain African cocoa and coffee producers have been reluctant to join stabilization schemes championed by the long-established producing areas in Latin America.

Any price increases resulting from support

operations would doubtless intensify the search for substitutes, e.g., plastics and aluminum for tin, as well as encourage the development of new sources of production. These factors might ultimately necessitate further restriction of output in established supply areas participating in the agreement. In addition, there would have to be complete cooperation on the part of consuming countries to embargo imports from nonmember supply areas as well as producing members who had violated their export quotas. Primary producing nations feel that consumer nations should accept this responsibility. Yet, the temptation to buy at the "best" price is hard to resist.

Formation of the European Common Market has introduced an additional element of uncertainty into the price stabilization picture. As the Common Market external tariff comes into effect, African countries, which were the former overseas territories of the European "Six," will have a decided advantage over Latin American nations. Many African nonferrous metals and tropical agricultural products will enter the Common Market duty free or at low rates while those from Latin America will be subject to the higher common tariff as well as quota restrictions. Both Latin America and the United States continue to "petition" the Common Market to amend the situation but the Latin American nations are becoming impatient and have suggested that the United States impose trade curbs on European goods as a retaliatory measure.

The foregoing does not appear to be consistent with the desired goal of freer international trade which the Western countries continue to support as general policy. It would be unfortunate if the move toward stronger commodity price stabilization arrangements produced nothing more than increased hostility among all nations. It also would be unfortunate if these schemes maintained a price umbrella over inefficient producers.

Western industrial nations are actively considering a program of increased economic aid to offset declines in foreign exchange earnings experienced by primary producing countries and the adoption of freer trade policies with respect to agricultural products and industrial raw materials. This seems to offer a more practical approach for solving the problems posed by declining international commodity prices. But balance of payments difficulties confronting Britain and the United States severely limit the amount of additional assistance that may be forthcoming from these two countries. In the circumstances, other European creditor nations are being urged to assume a larger role in foreign aid and investment.

The achievement of lasting benefits, however, will require the adoption of appropriate domestic measures in the primary producing countries. These would include curbs on inflation so that rising costs do not price exports out of world markets, removal of restrictions on foreign private investment, greater diversification of export earning activities and tailoring development programs more closely to current prospective levels of foreign exchange earnings.

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