

Business Conditions

1968 November



Contents

Trends in banking and finance	
Near record credit	
growth in third quarter	2
Big changes in cattle feeding	9
Auto trade with Canada—	
An experiment in freer trade	12

Trends in banking and finance

Near record credit growth in third quarter

Total credit at the nation's commercial banks rose more than \$16 billion, on a seasonally adjusted basis, in the third quarter. This increase, at an annual rate of 18 percent, was higher than in any quarter since early 1958. The growth rate was 6 percent in the first half of this year and 12 percent for all last year.

Despite some easing in credit policy in the wake of midyear fiscal action, this summer's credit bulge reflected no intent to further stimulate an already overheated economy. Rather, it resulted from a combination of large borrowing by the Treasury and the desire of both banks and nonbank dealers to carry large amounts of Treasuries and other securities in anticipation of a general decline in interest rates.

Large commercial banks and government securities dealers are the principal channels through which the U. S. government markets its securities. These institutions take into their own positions a large part of new Treasury issues at prices determined at the time of the

offering. The securities are then gradually sold to more permanent investors. Bank credit is expanded while banks hold the securities and maintain increased loans to nonbank dealers for the purpose of carrying securities. To assist in the distribution of securities, the Federal Reserve normally supplies enough reserves to support the temporary expansion of total deposits and conducts

All components of commercial bank credit rose sharply in third quarter*

	1965	1966	1967	1968	
				First half	Third quarter
	(percent)				
Total credit	10.2	5.8	11.6	6.2	18.0
Loans	14.8	9.2	8.3	7.1	16.6
U. S. government securities	-5.9	-6.1	11.4	2.7	19.8
Other securities	15.8	6.5	26.1	6.5	22.1
Time and savings deposits	15.8	8.6	16.1	5.0	18.1

*Seasonally adjusted annual rate of change.

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its operations in a way that will help keep market conditions fairly stable.

The Treasury raised about \$6.5 billion of net new money through the sale of securities in July and August. This was almost \$1 billion less than in the same months of 1967. The effects on bank credit were nevertheless large because the sales were superimposed on continued high levels of private and municipal borrowing and because the governments remained in the hands of temporary holders longer than usual.

Banks and U. S. securities

Since World War II, as loan demand has risen and more attractive investments become available, holdings of government securities have occupied a shrinking place in the asset portfolios of banks. Loans account for about three-fourths of the roughly \$200 billion in overall growth in bank credit in the last decade. The rest of the growth has been in non-federal securities—mainly tax-exempt issues of state and local governments. Bank holdings of U. S. issues have changed little, on balance. At most banks, they are the minimum amounts needed as collateral for public deposits and borrowings.

This trend has been interrupted in two kinds of situations: 1) when in periods of declining economic activity, funds provided through stimulative credit policies have exceeded private demands for credit; and 2) when banks have acted as a temporary distribution channel in Treasury financings—a process normally complete about 30 days after the securities are issued. There have been times—as in early 1958—when both situations occurred simultaneously, producing huge surges in banks' investments. Such times have usually been short, however.

In the three months ended September 25, bank portfolios of governments rose \$3 bil-

lion and other securities rose \$3.5 billion, seasonally adjusted. Loans to government securities dealers for purchasing and carrying securities were also up sharply. Much of the unusual increase in bank credit in the third quarter reflected these factors.

Since many banks have little interest in governments for their investment yields, their willingness to acquire governments depends on the prospects of trading profits, combined with the cost and availability of funds. Crucial to the profitability of the operation is the trend in the market price of the securities, which is inversely related to interest rates.

Role of expectations

The situation at midyear was one of "maximum temptation mixed with maximum opportunity." Interest rates had declined from the peaks reached in late May, and following the adoption of the surtax, there was widespread confidence that this trend would continue. Such a decline was expected to result both from the cooling effects of higher taxes on private credit demands and from a substantial share of the burden of fighting inflation being shifted from monetary to fiscal policy. Widespread discussion of possible "overkill" from the fiscal program reinforced expectations that interest rates would fall and security prices rise.

Moreover, funds to finance additional investments were increasingly available. Market rates had declined enough by the end of June to make bank CDs offered at or below ceiling rates competitive again with other money market instruments. In less than two months, large negotiable CDs increased \$2 billion—about a half billion more than the attrition in the spring. With funds available, banks built up inventories of government and municipal securities, hoping to reap capital gains or pin down currently high yields for times ahead.

The importance of the speculative motivation for purchases of securities is evidenced by the concentration of the investment expansion in the largest banks—the banks doing most of the dealer business. In July and August, for example, banks in the Seventh District with deposits of more than \$500 million reported an 11-percent increase in Treasuries and a 7-percent rise in other securities. Smaller banks reduced their governments slightly. During the same period in 1967, when the Treasury raised even more cash in the market, the largest banks reported a relatively smaller increase in holdings of Treasury issues and a net decline in other securities. Other banks bought both types. Although monetary policy was still aimed at an expansion of activity in the summer of 1967, interest rates were rising.

Rate trend reversed

Interest rates stopped tending downward in early August, after about ten weeks in

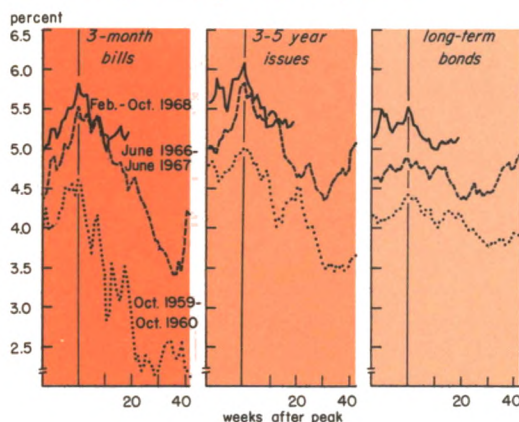
which the yield on three-month bills dropped nearly a full percentage point. Reductions in both the discount rate in late August and in the prime rate in late September failed to produce more than minor rallies in the securities markets, partly perhaps because of the modest sizes of the reductions. With the business climate remaining generally strong, the market began to reassess the prospects for slower credit demands, at least in the period immediately ahead. In addition, inventories of undigested securities exerted a depressing effect on the securities markets, partly because financing costs remained high.

By early October, rates were moving up in nearly all sectors of the market. Whether this reversal indicates that earlier expectations about business activity and private demand for credit were wrong or merely premature remains to be seen. But uncertainty about the impact of the surtax—both in size and timing—tended to sustain bank credit at a high level. Banks and securities dealers hesitated to liquidate their inventories as long as they foresaw a reduction in pressures a few months off. And the Federal Reserve had either to continue accommodating the related credit volume or abandon its traditional market stabilizing function in connection with Treasury financings. Given sustained credit demands, the growth of bank loans and investments could be slowed significantly only by policies that would drive interest rates above Regulation Q ceilings, effectively halting the flow of funds into bank time deposits.

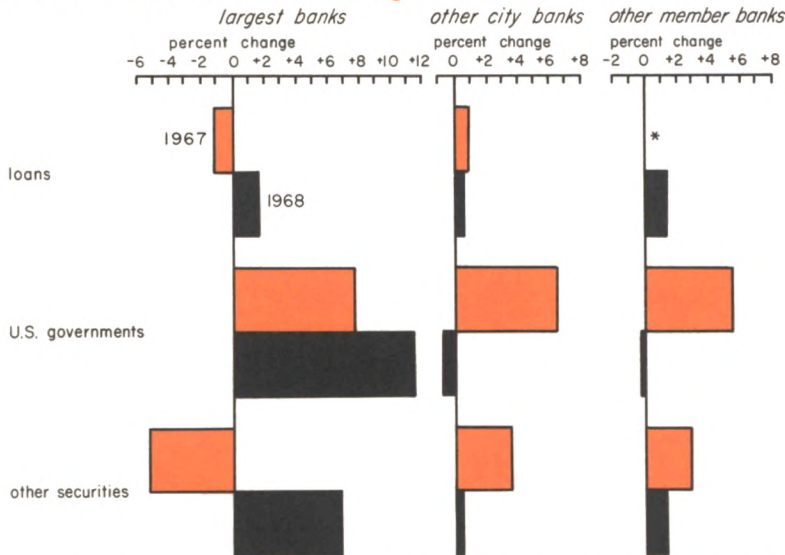
Other sources of funds

Deposits, however, were not the only way large banks financed loan and investment growth. To finance their positions in securities, they borrowed heavily in short-term money markets—mainly the federal funds and Eurodollar markets. Much of their bor-

Yields on governments have declined less since May than after earlier cyclical peaks in yields



Investment expansion last summer concentrated at district's largest banks†



†Changes are from last Wednesday in June to last Wednesday in August. Largest banks are those with deposits over \$500 million. Other city banks are all other weekly reporting banks.

*No change.

rate on federal funds, having risen above 6 percent when Regulation Q ceilings effectively barred banks from issuing CDs last spring, remained near this level throughout most of the third quarter. Strong demand for this very short-term financing reflected continuing expectations of lower rates.

Gross federal funds purchases of the 46 large banks ranged between \$4 and \$6 billion a day in August and September. These huge transfers of funds did not, of course, add to the overall capacity of commercial banks

rowing was at rates higher than the investment yields on the securities. Obviously, security prices were expected to rise enough to compensate for this "negative carry."

The basic reserve position of a bank shows a deficit when its borrowings from the Federal Reserve and its purchases of federal funds exceed its excess reserves and sales of federal funds. The basic reserve position of the 46 major banks for which the Federal Reserve has daily information tightened markedly. The average deficit of these large banks rose to \$2.7 billion in the third quarter, compared with \$1.2 billion in the first six months of the year. Only about \$250 million of the difference reflected increased borrowings from Federal Reserve banks. The rest was covered by net purchases of federal funds—one-day borrowings from other banks. The average

to create credit. Through this mechanism, however, many small banks transferred sizable amounts of funds, at high returns and with complete liquidity, to large city banks that, in turn, invested the funds in securities and assumed the market risks.

Not included in the basic deficit measure are funds borrowed in the Eurodollar market. Only banks with branches abroad have access to that market, with the net effect that Eurodollar borrowing often amounts to little more than a transfer of funds within the small group of very large banks holding sizable foreign deposits. For individual banks within the group, the market is nevertheless an important alternative source of money. Eurodollars borrowed for a few days are close substitutes for federal funds. With longer maturities, such borrowings provide an alter-

native to the issuing of CDs.

Total Eurodollar borrowings in September averaged about \$7 billion. Higher rates are usually paid for these funds than on CDs of comparable maturities. Like federal funds, however, these borrowings do not entail the costs associated with reserve requirements and FDIC assessments that apply to deposit liabilities.

Slowdown ahead?

Most analysts agree that the recent rate of expansion in bank credit is too fast for balanced economic growth. Even though some part of the recent surge may reflect a substitution of bank for nonbank-generated credit, the volume of expenditures associated with so much credit would, if long continued, be highly inflationary.

With the Treasury's borrowing of new

funds largely out of the way for this year and seasonal surpluses on the horizon for the first half of next year, trends in the months ahead will largely reflect demands for funds by business, consumers, and state and local governments. Even if these demands do not decline, it seems unlikely that they will be strong enough to offset the sharp reduction in requirements from the federal sector.

At the same time, U. S. securities still in dealer inventories will continue to be digested. If economic activity slackens and a downtrend in interest rates is resumed, the process will be accomplished profitably. If, on the other hand, activity should strengthen with rates again moving upward, quick liquidation of inventories would minimize losses. Resolution of the uncertainties in either direction will tend to slow credit expansion to a more normal pace.

Big changes in cattle feeding

The cattle industry has changed substantially in recent years. Demand for high-quality meat—especially beef—has increased with the population and its growing affluence. In response to the increased demand, production of fattened cattle has been sharply expanded. And with the growth in production of fed beef have come dramatic changes in the structure and location of cattle feeding.

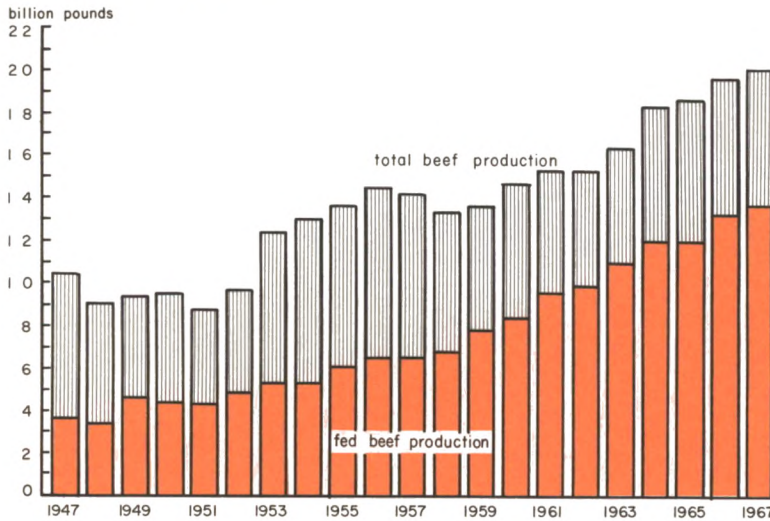
Population has increased about 40 percent since World War II, and per-capita income has more than doubled. During those years, the average person increased his consumption of poultry and meat roughly a fourth. Because of a decided consumer preference, beef accounted for most of the gain.

Per-capita beef consumption increased nearly 40 percent—rising from around 63 pounds in 1947 to 106 pounds in 1967. Total beef consumption, increasing at an average annual rate of about 4 percent, more than doubled. Growing and changing demands of consumers, reflected in quality preferences and prices at retail counters, have emphasized the need both for greater beef production and for different types and qualities of beef.

Different types—better quality

Beef cattle, which accounted for only about half of all cattle two decades ago, now account for about four-fifths. Dairy cattle have declined as the demand for milk has

Fed beef output paces increase in total beef production



decades ago. Production of prime and good grades has also expanded, although not as dramatically as the choice grade, and the proportions of total production have held fairly stable. Production of the lower grades—standard, commercial, utility, and canner and cutter—has changed little. These grades now account for less than a third of the total beef output, compared with nearly half in the mid-1940s.

eased and, therefore, have been of diminishing importance as a source of beef. With relatively more beef animals, a larger proportion of calves are grown to maturity, as compared with slaughter for veal, and more heifers have therefore become available for fattening and slaughter. Heifer-beef production has more than quadrupled in the last 20 years, rising as a proportion of the total from about 10 percent in the late 1940s to nearly 20 percent in recent years. Conversely, cow-beef production, while showing little overall change in the total compared with 20 years ago, has declined from about 40 percent of total beef to about 20 percent. The decline is due largely to the decline in dairy cattle. Steer-beef production has been fairly constant as a proportion of the total.

Production of choice-grade beef has about tripled in the last 20 years. In recent years, choice beef has accounted for about half the total, compared with just over a fourth two

Substantial upgrading in the quality of beef largely reflects the rapid expansion of cattle feeding. Cattle on feed in January 1947 numbered some 4 million head, and estimated marketings that year totaled about 7 million head. By 1960, about 7 million head were on feed in the 39 most important feeding states and fed-cattle marketings exceeded 13 million head. Further increases brought marketings last year to more than 20 million and the number on feed at the beginning of 1968 to more than 11 million.

Production of fed beef is now nearly four times the volume in the late 1940s and accounts for almost all the increase in beef production. About two-thirds of the nation's beef output last year was fed beef, compared with about a third in the late 1940s.

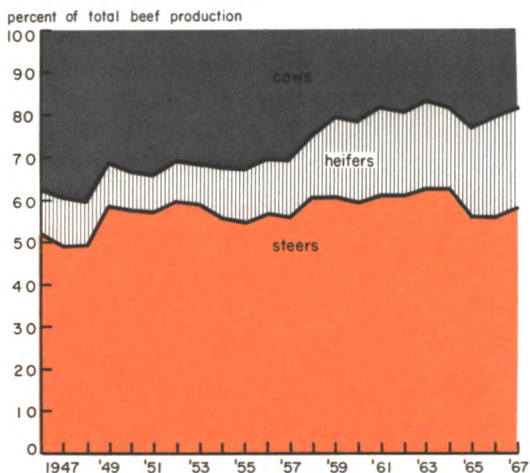
Commercial lots increase output

Much of the increase in the output of fed beef has been associated with the develop-

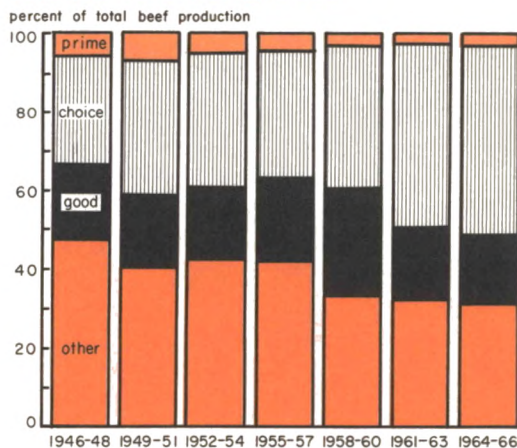
ment and expansion of commercial feedlots—those with capacities for 1,000 head or more. Until the early 1950s, small-volume farmer-feeders and ranchers accounted for nearly all the nation's fed-cattle production. Farmer-feeders with capacities for less than 1,000 head still produce more than half the fed beef, but commercial lots have grown very rapidly. The number of cattle fed in commercial lots has increased about 40 percent in the last four years—about six times as fast as the number fed by farmer-feeders.

While accounting for only about 1 percent of all producers, commercial feedlot operators marketed nearly 46 percent of the fed cattle sold in the 32 major cattle feeding states last year, compared with about 38 percent in 1964. Furthermore, much of this feeding was concentrated in the very largest feedlots. According to the U. S. Department of Agriculture, the 72 largest feedlots—those with capacities for 16,000 head or more—

Heifer slaughter accounts for more of total production



Production of choice beef increases relative to other grades

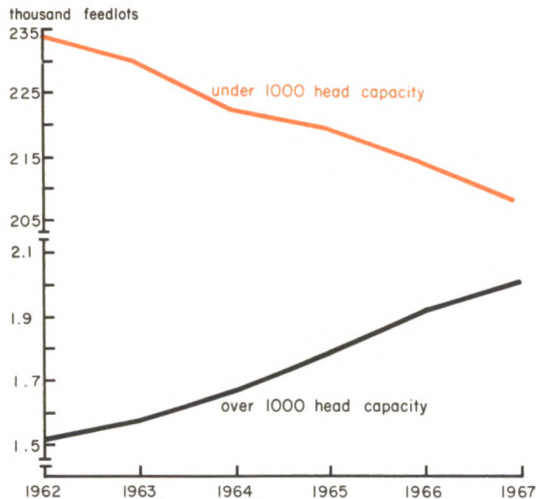


marketed about 14 percent of the fed cattle in 1967. The largest 225 feedlots—those with capacities over 8,000 head—accounted for around a fourth of the marketings.

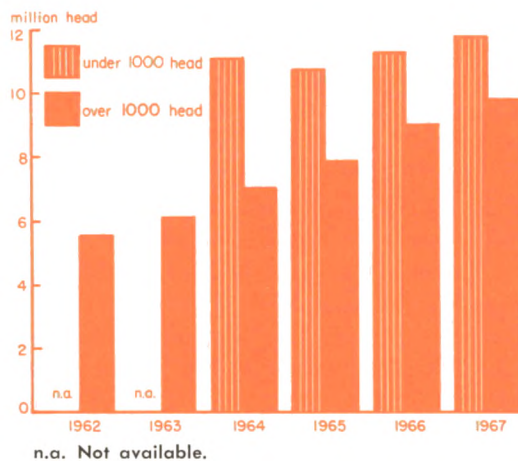
The movement toward larger units in cattle feeding can no doubt be traced to many of the same forces affecting agriculture as a whole. Large operations are increasingly necessary to obtain the benefits from many of the new cost saving technologies and management practices. Recent improvements in equipment for harvesting and storing grain and forage and handling feed and manure, for example, have made it not only feasible but almost necessary for feedlots to become larger.

Substantial cost savings are possible in cattle feeding as operations are increased in size. Estimates of the savings vary, but all are large. A study conducted in Oklahoma in 1965 indicated that the cost per pound of gain, excluding feed and feeder cattle, was about a third lower for 15,000-head feedlots

Large feedlots expand sharply



Marketings from large feedlots account for most of the increase



than for those of 300 head. An earlier study at the University of California, utilizing similar assumptions, indicated costs were about a fourth lower for lots of 22,500 head than for lots of 3,700 head. Savings were realized primarily from spreading the cost of land, buildings, and equipment over the larger number of head. Large operations can often realize economies in the purchase of cattle and feed, negotiation of better terms for the sale of fattened animals, and more efficient conversion of feed to beef.

Shifts in location

Significant shifts have also been made in the locations of cattle feeding. The Midwest has long been prominent in cattle feeding, but its prominence has been declining in recent years. In the mid-1950s, the North Central states accounted for more than 70 percent of the cattle on feed in the 26 most important cattle feeding states. By early 1968, this proportion had declined to about 65 percent, even though the total number of cattle in feedlots in this region had increased about 70 percent. Nearly all this relative decline occurred in states comprising the Seventh Federal Reserve District—Illinois, Indiana, Iowa, Michigan, and Wisconsin. States of the district accounted for about 40 percent of the cattle being fed in 1955 and only about 30 percent in January 1968.

California and several of the Plains, Southwest, and Mountain states marked up relative increases. California, now the third ranking cattle feeding state, has showed a doubling in cattle numbers since the mid-1950s—from 482,00 head to more than 900,000 head. Texas, now the fourth ranking state, had an even greater increase, rising from 132,000 head in 1955 to more than 810,000 at the beginning of this year—a more than sixfold increase.

Why the change?

Many of the forces contributing to the growth and change of cattle feeding have also contributed to changes in its locations. Uneven expansion in population and the resulting impact on demand for beef has no doubt played a part. For the past 15 years or so, several states of the West and Southwest have been among those showing the fastest growth in population. Since 1960, the eight states with the fastest increase in cattle feeding have had an increase in population of about 14 percent, compared with 9 percent for the nation as a whole.

Growth in population has been only one factor influencing the relocation of cattle feeding, however. One of the more important has been the development of large-scale commercial feeding itself and the relationship of this development to location. Large-scale feeding operations were pioneered in Cali-

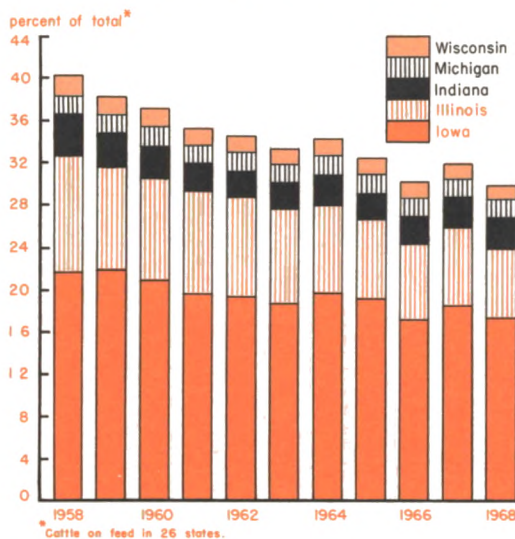
fornia and Arizona, both still important feeding states. From the Southwest, large-scale operations spread through the Plains and Mountain states—the same states with the fastest increases in production of fed cattle. Last year, commercial feedlots accounted for well over half the number of feedlots in California, Arizona, and New Mexico and about 98 percent of the fed cattle marketed in those states. There are fewer commercial lots in the Mountain and southern Plains states, but they account for two-thirds to nine-tenths of the fed cattle marketed in these states.

Production of fed cattle in the Corn Belt continues to be dominated by the relatively small farmer-feeders. Less than 1 percent of the feedlots in the Corn Belt have capacities as large as 1,000 head, and less than 10 percent of the cattle marketed in this area are fattened in these commercial lots.

Why commercial feedlots, with their inherent economies of size, have not become more important in the Midwest is uncertain. Custom has no doubt been an influence. Traditionally, cattle feeding in this region has been the vehicle through which Midwest farmers marketed their crops while providing themselves employment in the off-season. If that practice has been important in deterring the development of large feeding operations, economic pressures will probably override it in time. But two other factors—high overhead costs and a severe climate—will certainly remain.

Land is much higher priced in the Midwest than in many areas where commercial feeding has grown rapidly. Many other overhead costs are influenced to a great extent by the severe climate. Fairly expensive shelter is often required to cope with temperature extremes, and surfacing of feedlots is usually desirable because of the heavy precipitation.

District states' prominence in cattle feeding declines



With feed costs accounting for much of the cost of fattening cattle, access to abundant, and preferably low-cost, feed supplies is another factor influencing the location of cattle feeding. California, Colorado, and some other states have had large increases in cattle feeding based on the byproducts of such crops as sugar beets and citrus fruits.

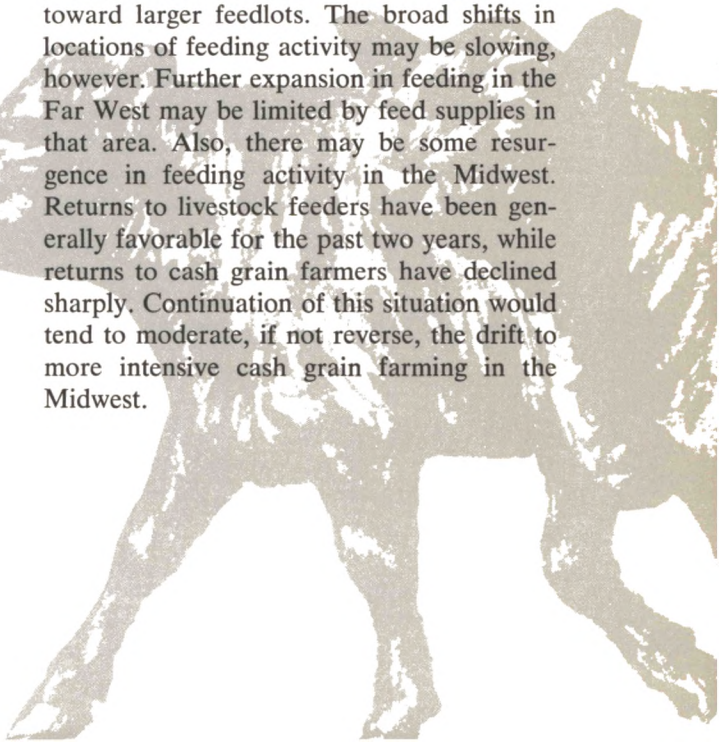
Changes in the production of grains reflecting improved technology, greater mechanization, and government programs have borne importantly on cattle feeding in other areas. Wheat and cotton acreages were restricted by government programs in the early 1950s, but farmers were allowed to use the acreage for other crops. With the development of hybrid grain sorghum and no penalty on feed grain crops, feed production expanded rapidly in wheat and cotton areas of the Plains states. By the end of the decade, feed grain output in these states had about doubled, encouraging the increase in cattle feeding in those areas.

Changes in grain farming have influenced other areas differently, however. Instead of spurring increases in cattle feeding in the Midwest, technological innovations have made the highly productive land there even more suited for intensive cropping. In the past, accepted cropping practices called for row crops to be rotated with small grains or hay—practices that often encouraged supplemental livestock programs to make use of crops that could not otherwise be marketed easily. But with the development of new management practices, hybrid seeds, herbicides, and insecticides, livestock programs have be-

come less important in the Midwest.

Primarily as a result of these developments, crop farmers in the Midwest have tended to increase production faster than livestock farmers. Average corn yields per acre in Illinois, for example, have risen from 80 bushels to 100 bushels in the last eight years. Because of rising yields and increased government payments to crop farmers, returns on the capital of cash grain producers in the Midwest have averaged well above returns to livestock feeding operations. According to Department of Agriculture data, this has been the case in most years since 1960.

Whether recent trends in cattle feeding will continue is an open question. The demand for beef appears certain to continue rising with further increases in population and incomes. And this will no doubt lead to increases in beef production and even greater proportions of the nation's cattle being fattened in feedlots. The efficiencies of large-size feeding operations are almost certain to result in a further extension of the trend toward larger feedlots. The broad shifts in locations of feeding activity may be slowing, however. Further expansion in feeding in the Far West may be limited by feed supplies in that area. Also, there may be some resurgence in feeding activity in the Midwest. Returns to livestock feeders have been generally favorable for the past two years, while returns to cash grain farmers have declined sharply. Continuation of this situation would tend to moderate, if not reverse, the drift to more intensive cash grain farming in the Midwest.



Auto trade with Canada — An experiment in freer trade

The United States and Canada are well embarked on an important experiment in free trade. In January 1965, the two governments agreed to seek the following objectives for their auto industries:¹

- Creation of a broader market for automotive products in which the benefits of specialization and large-scale production could be achieved.

- Liberalization of trade barriers and other impediments to such a market, the intention being for the auto industries in both countries to participate equitably in an expanding market.

- Development of conditions in which market forces can operate effectively in attaining the most economic pattern of investment, production, and trade.

As an experiment in the means of moving toward freer trade between the two markets—united by proximity, cultural background, and similarities of consumer tastes but separated by nationalistic political and economic sentiments—the agreement is a landmark in U. S.-Canadian relations.

Background of the agreement

The two countries have long been important trade partners. Last year, for example, the United States bought more than 63 percent of Canada's total exports and supplied more than 72 percent of its imports. About a fourth of all U. S. exports go to Canada,

and a comparable proportion of U. S. imports originate there.

The closeness of these economic ties has been a source of concern to many Canadians, however. Of particular concern have been the underlying patterns of trade between the two countries. Traditionally, Canada's exports to the United States have consisted mostly of raw materials and primary products, while its imports from the United States have consisted mostly of finished manufactured goods. With world demand for manufactured goods increasing faster than for primary products, Canada's imports from the United States increased faster than its exports—particularly in the 1950s—opening an ever-widening deficit in its trade with this country. That the deficit was more than offset by an inflow of American capital only deepened Canadian concern about an "American takeover" of its industry.

To reverse the trend, Canada embarked on a policy to promote industrial development. The automobile industry, where the import-export imbalance was most pronounced, became a primary target. Canada's deficit in automotive trade was about \$400 million in 1960—more than 60 percent of its trade deficit with the United States. Efforts to increase the production of automobiles and parts were hampered, however, by the size of the Canadian market. Although wage rates in the Canadian automotive industry were about 30 percent lower than those in the United States, production costs were higher

¹The agreement was implemented in this country by the *Automotive Products Act of 1965*.

because the small Canadian market precluded the economies of large-scale production. With production costs higher than in the United States, there was an incentive for Canadian auto manufacturers—mostly subsidiaries of U. S. auto companies—to import components from the United States.

It was clear that for Canada to increase auto production and employment and improve its balance of automotive trade, special measures would have to be taken. In 1962 and 1963, the government initiated programs returning to auto manufacturers part of the duties paid on imported motor vehicles and original-equipment parts. Refunds were paid to the extent that Canadian produced exports were increased.

Under this stimulus, automotive exports to the United States increased sharply the following year, but the program met resistance from U. S. producers. Some parts manufacturers charged that the Canadian program was an illegal export subsidy and demanded that the United States impose countervailing duties. With the situation threatening to turn into a “tariff war,” the trade agreement was negotiated and the Canadian government canceled its controversial export incentive plan.

Features of the agreement

The two auto markets are very similar. Consumers have much the same preferences in automobiles, which are supplied largely by the same four companies. The aim of the trade agreement, therefore, was to create a single North American market in automotive products.

The agreement eliminates duties on cars, buses, and trucks as well as on parts and accessories used as original equipment. (Tires and tubes as well as such special-purpose vehicles as electric buses and fire engines are

Factory list prices of the same car in the United States and Canada

Year	United States (U. S. dollars*)	Canada
1964	3,995	5,209
1965	4,026	5,256
1966	4,127	5,145
1967	4,169	5,184
1968	4,283	4,655

*Canadian prices converted into U. S. dollars at U. S. \$0.925=Canadian \$1.00.

Note: Prices quoted are for two-door hardtop with eight-cylinder engine and standard equipment, 1964-68.

SOURCE: *Second Annual Report of the President to the Congress on the Operation of the Automobile Products Trade Act of 1965.*

not covered by the agreement.)

Before the agreement, duties in Canada ranged from 17.5 percent of the value of vehicles and many parts to 25 percent of the value of certain components, such as engines and automatic transmissions. In the United States, duties ranged from 6.5 percent of the value on passenger cars and trucks under \$1,000 to 25 percent of the value on trucks valued over \$1,000.

To soften the impact of tariff reductions on previously protected industries, the agreement provided for assistance to companies and workers hurt or displaced by increased imports. In addition, the agreement provided for transitional arrangements in Canada circumscribing the extent to which automotive products could be imported duty free. Only manufacturers agreeing to maintain at least the same “Canadian value added” as in the 1964 model were allowed to import duty free.² Canadian auto manufacturers also

²Canadian value added measures the value of Canadian labor, capital, and materials contained in an article. It is computed roughly by subtracting the cost of imported materials and components from the manufacturer’s selling price of the article.

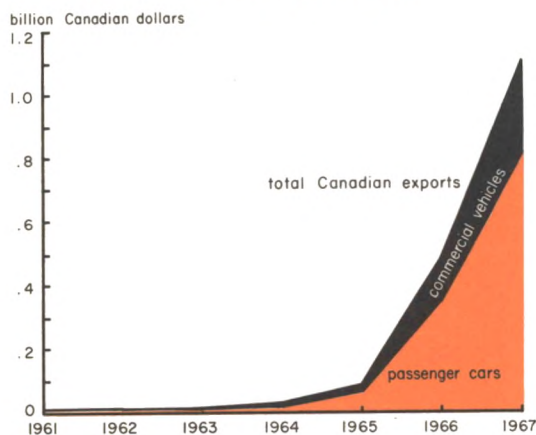
undertook a separate commitment to increase the Canadian value added in the production of vehicles and parts by at least \$241 million (Canada \$260 million) by 1968. This increase was to be in addition to the increase resulting from normal growth of the Canadian market.

These provisions were intended to allow the Canadian auto industry to achieve levels of output high enough to realize economies of large-scale production, bring its costs more in line with industry in the United States, and eventually compete effectively in a unified market. To ensure the achievement of these objectives, the agreement provided for periodic reviews and consultations by the two governments. Two such reviews have been completed and their results submitted to Congress.

Effects of the agreement

The agreement has had a profound effect

Canadian exports of motor vehicles to United States rises sharply after trade agreement



SOURCE: Dominion Bureau of Statistics.

Production of motor vehicles, United States and Canada, 1963-67

Year	United States		Canada	
	Cars	Trucks and buses (thousand units)	Cars	Trucks and buses
1963	7,644	1,464	532	99
1964	7,746	1,562	560	111
1965	9,335	1,803	707	140
1966	8,605	1,792	702	201
1967	7,413	1,611	721	226

SOURCE: Automobile Manufacturers Association and Dominion Bureau of Statistics.

on production and trade in automotive products in the two countries. In Canada, auto manufacturers have undertaken large investments to increase Canadian value-added. It has been estimated that Canadian assembly capacity has been increased more than 50 percent and purchases of Canadian produced parts more than 65 percent. Production of some models has been discontinued, demand for them being supplied by duty-free imports from the United States. At the same time, production of other models has been increased, in some cases, for export to the United States.

Chrysler Corporation of Canada, for example, discontinued production of Valiant and Chrysler models and increased production of Dodge Darts in 1966 and Plymouths in 1967. Output of Plymouths rose from 23,466 in 1964 to 108,458 in 1967. Ford Motor Company of Canada curtailed production of its Comet and Fairlane models and increased production of Falcons more than fivefold—from 13,796 in 1964 to 77,942 in 1967.

Overall, production of cars and trucks in Canada increased 40 percent, while exports to the United States increased 420 percent in value. Employment in the Canadian auto

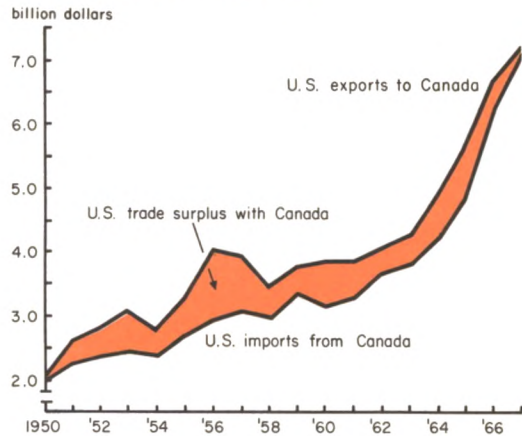
industry increased 23 percent—from an average of slightly more than 69,000 in 1964, to nearly 84,000 in 1967.

Specialization of production facilitated longer, more efficient production runs and helped narrow the price differential in the two markets. The difference in wages paid in auto production also narrowed. Recent contracts between the UAW and two Canadian auto manufacturers call for equalization of wage-rates between the two countries by 1970.

In this country, effects of the agreement on auto production and employment were largely hidden by changes in domestic demand for automobiles and increasing preferences for foreign cars. United States production of motor vehicles increased sharply in 1965 and remained high in 1966. Production declined last year, partly as a result of strikes at one of the major producers and partly as a result of declining domestic demand and rising imports from Europe and Japan.

Employment in the U. S. auto industry increased over 100,000 between 1964 and 1966. After a decline in 1967, it was again at

U. S. surplus in trade with Canada declines



SOURCE: U. S. Department of Commerce.

a near-record high in mid-1968. Some dislocation of labor, nevertheless, resulted from the agreement. By mid-1968, the Automotive Assistance Board, set up under the Automotive Products Trade Act, had certified 2,500 autoworkers as eligible for assistance. Only 1,850 of those found to be unemployed because of the agreement actually applied and received benefits, however, and most of them were recalled to work or found employment elsewhere. Less than 300 were drawing benefits under the trade act at midyear.³

Trade between the two countries in auto products increased sharply after the removal of tariffs. The value of U. S. auto exports and imports has more than quadrupled since the agreement went into effect. Imports from Canada have increased far faster than exports to Canada, however, substantially reducing the U. S. surplus in automotive trade.

³In Canada, 5,601 workers were declared eligible, 2,534 applied, and 936 received benefits.

Employment in automotive products manufacturing, 1967-68

Period	United States (annual average in thousands†)	Canada
1963	741.3	60.3
1964	752.9	69.3
1965	842.7	80.0
1966	861.6	84.9
1967	815.9*	83.8
June 1967	836.7	n.a.
June 1968	878.7	n.a.

†Except for absolutes in June 1967 and June 1968.

*Data reflect the affect of strike in September and October.

SOURCE: U. S. Department of Labor and Dominion Bureau of Statistics.

Conclusion

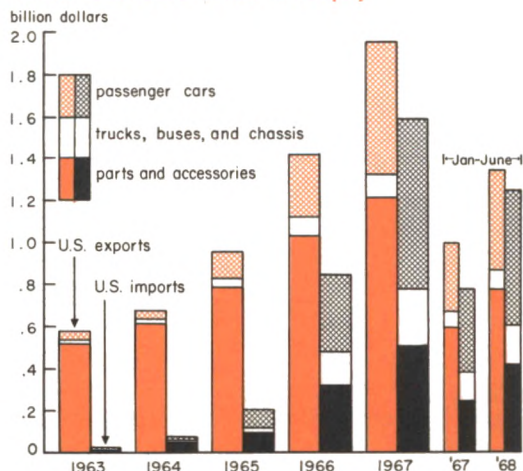
The agreement, while eliminating tariffs on automobiles, does not bear all the usual marks of free trade. The provision allowing duty-free imports of parts and finished products only by manufacturers complying with "Canadian content" requirements has been criticized as discriminatory against parts produced in this country. It has been alleged that as manufacturers shifted production and procurement to Canada to increase the Canadian content of their products, many jobs were lost to U. S. workers. Some critics have even argued that the agreement made it possible for Canada to accomplish in the name of "free trade" the very objectives it originally sought through its tariff-rebate plan.

In some instances, the criticism is simply not borne out by statistical evidence. In others, it appears the critics may be right. Certainly, Canada has benefited more so far than the United States. In view of the general concern over the deterioration of the U. S. trade surplus, a reduction in the surplus this country has traditionally had in its automotive trade with Canada is particularly disturbing.

Objective evaluation of the agreement cannot be based on short-run considerations alone, however. Nor can the alternatives the agreement avoided be disregarded. Given the determination of the Canadian government to move toward closer balance between the production and consumption of auto products, that government could have imposed content requirements or duties far in excess of those allowed by the agreement. Many other governments have done so.

There was a real threat of a trade war that

U. S. auto trade with Canada rises sharply



SOURCES: Dominion Bureau of Statistics and U. S. Bureau of the Census. (Data converted at U. S. \$0.925 = Can. \$1.0.)

would have not only reduced trade in automobiles but also propagated economic inefficiencies.

Adoption of a concept embodying important features of free trade, with provisions to cushion adjustment during the transition period, was a major step toward the efficient allocation of resources that, in the long-run, will benefit consumers in both countries. Great progress toward rationalization in production has been made in the two countries since the agreement went into effect. Hopefully, the adjustment of the Canadian auto industry to operation in a unified market will be completed soon and the remaining vestiges of restrictions on automotive production and trade between the two countries can be eliminated.