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FEDERAL RESERVE BANK  
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## Credit Legislation

. . . recently passed, helps solve some problems, but not all. It is only a part of the coordinated program needed to fight inflation.

## F. O. B.

. . . versus basing point pricing has become a burning issue for industry and Government. Many of the real problems are obscured.

# CREDIT LEGISLATION

Congress, in its special session, passed legislation dealing with credit and housing. By giving the Federal Reserve System additional powers it has taken a step in the direction of combating inflationary pressures. But it would be a mistake for the public to expect too much from the legislation; inflation can be checked effectively only by a coordinated attack on all fronts.

Power to raise reserve requirements further will help the Federal Reserve System absorb increases in bank reserves which may arise from its operations in supporting the Government security market and from other sources. To the extent that the growth in bank reserves can be restrained, the System can restrict credit expansion and a further increase in the money supply.

Regulation of instalment credit will help somewhat to correct one of the potent forces in our present inflation—the huge demand for durable consumers' goods. Stricter credit terms will tend to curb the growth of consumer credit and relieve somewhat the upward pressure on the prices of consumers' durables still in short supply.

The housing and mortgage legislation may have inflationary implications. If lenders respond to the new provisions, the flow of mortgage credit is likely to increase. But the building industry already is operating close to capacity, and without additional labor and materials there can be little increase in construction. If an easier flow of credit would permit builders to bid scarce resources away from other producers, it might increase the volume of construction. The principal result, however, is likely to be higher prices for homes.

## HIGHLIGHTS of CREDIT LEGISLATION

BANK RESERVES	CONSUMER CREDIT	MORTGAGE CREDIT
<p>Board of Governors given authority to raise reserve requirements against demand deposits of member banks by 4 additional percentage points; for member banks:</p> <ul style="list-style-type: none"> <li>—in central reserve cities to 30%.</li> <li>—in reserve cities to 24%</li> <li>—outside of central reserve or reserve cities to 18%</li> </ul> <p>and to raise requirements against time deposits of all member banks by 1½ percentage points to 7½%.</p> <p>Expiration of authority: June 30, 1949.</p>	<p>Board of Governors given authority to exercise controls over consumer instalment credit.</p> <p>Expiration of authority: June 30, 1949.</p> <p style="text-align: center;">* * * *</p> <p>The Board's regulation, effective September 20, includes:</p> <ul style="list-style-type: none"> <li>—one-third down payment on automobiles</li> <li>—one-fifth down payment on 11 other items</li> <li>—15 months to pay off credit of \$1,000 and less</li> <li>—18 months to pay off credit from \$1,000 to \$5,000.</li> </ul>	<p>Enlargement of secondary mortgage market facilities.</p> <p>Restoration of part of, and additions to, FHA guarantee program under Title VI.</p> <p>Establishment of a system of yield insurance for investments in new rental housing.</p> <p>Liberalization of Title II loans and loans for repair and modernization under Title I.</p>

## THE BACKGROUND

CONSUMER CREDIT now totals more than \$14 billion. This is \$4 billion more than the pre-war record established almost seven years ago when, under temporary wartime authority, the Federal Reserve System was given the responsibility of regulating consumer credit. The purpose of those controls was to help prevent a diversion of resources to the production of consumer goods at a time when resources were needed for defense, and to help prevent inflation by dampening consumer demand.

For almost two and a half years after controls were established consumer credit declined. By early 1944 the total outstanding had decreased by about one-half to somewhat less than \$5 billion. Of course the establishment of consumer credit controls was by no means the only reason for the reduction. Automobiles, washing machines, radios, and other consumer durables became increasingly hard to get. And most consumers exercised good judgment, refraining from bidding up prices of scarce items and preferring instead to build up their bank accounts and War Bond holdings for the future.

Nevertheless, credit controls played an important part. During 1942 they were strengthened to include most durable and semi-durable consumers' goods, to cover charge account sales and single payment loans, to reduce further the maximum payment period, and to raise minimum down payments. These regulations continued for the rest of the war.

Shortly after V-J Day, the terms were relaxed somewhat. The maximum payment period was increased from twelve to fifteen months except for durable goods which were still in exceedingly short supply. And again in December 1946 the regulation was changed, terminating all controls except on instalment credit for a selected list of durable goods. By that time, total consumer credit was back to the 1941 level, but because durables were still scarce, instalment sales credit had not yet risen substantially.

Eleven months later, when consumer credit was \$2 billion more than in 1941, the System's authority was discontinued and Congress declined to grant further authority. Since controls

were terminated last fall, consumer credit has continued to mount. The growth has been especially marked in instalment sale credit, particularly for automobiles, as the supply of consumers' durables has increased. Some consumers have used up their accumulated holdings of liquid assets, are currently saving less, and are buying increasingly on the instalment plan.

The abolition of controls has been another factor in the growing volume of outstanding credit. A hypothetical example will show the substantial effect of easier terms: assuming a given volume of instalment sales, a reduction of down payments from one-third to one-tenth can increase outstanding credit by 35 per cent; an extension of repayment time from 15 to 24 months can increase credit balances by 56 per cent. The actual extent of the relaxation in credit terms has varied among goods and among lenders. New automobiles now generally can be paid for over a period up to 24 months, but down payments still remain substantial. On the other hand, major appliances are being bought at some stores with 10 per cent down and 12 to 18 months to pay. Banks, in general, have "held the line" more successfully than mail order houses, department stores, and others. However, sales transactions probably are generally on a more conservative basis than advertisements and other surface conditions may indicate.

This was the background of the problem facing Congress. Three facts stood out: consumer credit was at an all-time high, credit terms were more liberal, and prospects were for more of the same. Consumers apparently expect to continue buying in large volume over the rest of the year and in doing so seem willing to spend beyond their income. Heavy incurrence of debt on easy terms in a period of high prices, high incomes, and full employment tends to intensify the boom and is dangerous both to the individual and to the economy as a whole. Congress, accordingly, authorized restoration of controls on instalment credit until next July.

BANK RESERVES are the instrument which the monetary authorities have been using to attack the excessive supply of money to spend compared with a limited supply of goods to be bought.

The money supply—privately owned currency and bank deposits—now amounts to \$166 billion. It was increased tremendously during the war as the Treasury found it necessary to finance part of the war costs by selling securities to commercial banks. And it has risen further since the war as banks made loans to businesses and individuals.

Bank reserves provide a limit to this process of expanding earning assets and creating deposits. The traditional method of attacking inflation through the monetary mechanism, therefore, has been to restrict the total amount of reserves or to require banks to hold a larger volume of reserves against their deposits. But the effectiveness of both these methods has become limited by the System's policy of supporting the Government security market. For if the supply of reserves were drastically curtailed or reserve requirements raised sharply, banks would be forced to sell Government securities. In the absence of support, such sales could cause a serious drop in Government security prices. On the other hand, the System's responsibility for supporting the market means that banks can obtain reserves easily by selling Governments, and can use these reserves as the basis for expanding their earning assets and the money supply.

The Federal Reserve System thus has been faced with a dilemma arising from two conflicting objectives: restricting expansion of the money supply and supporting the Government security market. Yet, despite this fundamental difficulty, the System and the Treasury have been able to exercise a considerable degree of restraint. The main device has been the Treasury's cash surplus. For when the Treasury collects more than it spends, it reduces bank deposits and bank reserves; and when it uses the surplus to pay off Government securities held by the Reserve Banks, it makes this reduction permanent.

A second method has been to raise rates on short-term Government securities, making these issues more attractive to banks and other investors. The Reserve Banks thus have been able to sell short-terms, thereby tending to reduce bank reserves. As short-term rates rose, the discount rate has been increased to discourage banks from making a profit by borrowing on short-term Governments. Inasmuch as few banks are borrowing from the Reserve Banks,

however, this move has been primarily of psychological value. Finally, reserve requirements of member banks in the central reserve cities have been raised from 20 to 24 per cent.

But while these efforts were reasonably successful during the first half of this year, the prospects were not so bright for the second half. Strong forces are likely to be pushing bank credit and the money supply to even higher levels. On the other hand, the most potent weapon in combating monetary expansion—a Treasury surplus—will not be available. Before the new legislation was passed, reserve requirements were at their legal limits—with the exception of two percentage points for central reserve city banks. And as banks and other lenders need funds to meet private credit demands, they are likely to sell Governments. The Federal Reserve, in turn, probably will be called on to supply most of these funds by buying the Governments in support of the market.

So additional measures were needed to prevent the further growth of the money supply. The bill presented to Congress called for additional authority to raise reserve requirements against demand deposits of member banks by as much as ten percentage points and against time deposits by a maximum of four percentage points. Congress granted the Board of Governors the temporary authority to raise maximum reserve requirements against demand deposits by as much as four additional percentage points, and against time deposits by one and a half additional percentage points.

MORTGAGE CREDIT has been one of the most inflationary parts of the whole credit picture. Yet many people have felt that a shortage of mortgage credit on easy terms has been hindering efforts to meet our huge needs for housing. Despite record construction many needs, particularly for rental units and low-price homes, still remain unfilled.

There is no doubt that some potential home buyers have been forced out of the market, not only by astronomical prices but also by inability to obtain credit on easy terms. Some commercial banks have reached their limit of mortgage loans. Banks and other lenders have become more discriminating; they have been asking larger down payments and shorter maturities, and they have become increasingly dissatisfied with a 4 per cent rate.

Legislation also contributed to a tightening of mortgage money. As far back as June 1947 the R.F.C. Mortgage Company, which had been supplying a secondary market for G.I. mortgages, was abolished. Last April, Congress required the Federal Housing Administration to base its guarantees of one-to-four-family home mortgages under Title VI on appraised value instead of current construction costs; then it later allowed Title VI to expire completely. Title II loans were still available, but the terms were not as easy as those on Title VI loans. In June, Congress restored authority to maintain a secondary market for G. I. mortgages by allowing the Federal National Mortgage Association to buy both FHA and G.I. mortgages to a limited extent.

The combination of greater caution exercised by lenders and the more restrictive measures imposed by Congress led some people to fear that tight mortgage credit would kill the construction boom. Yet, non-farm mortgage debt continued to rise rapidly during the first half of the year, establishing a new record high in June. Nevertheless, Congress passed new housing legislation, tending to ease the supply of credit.

Title VI, section 608, insurance on loans for large rental projects was restored and extended

until March 31, 1949 with an additional amount of \$800 million for insurance authorization. But whereas the 90 per cent guarantee was formerly based on necessary costs of construction, it is now based on FHA's estimate of replacement costs as of December 31, 1947. Renewed authority of the FHA to guarantee loans under Title VI, section 603, however, was not included in the legislation.

To compensate partly for not restoring Title VI, section 603 guarantees, Congress liberalized many of the provisions of Title II loans. Maximum loan values were raised and maturities in some cases were lengthened. A new section was added to Title VI, providing 80 per cent guarantees on the total value or \$6000 for each single-family unit for loans to large-scale builders of low-cost, single family units. The new device of yield insurance provides that FHA may pay investors in rental housing for families of moderate income  $2\frac{3}{4}$  per cent on the investment, plus 2 per cent a year for amortization. And the Federal National Mortgage Association's authority to maintain a secondary market for FHA and G.I. loans was further strengthened. It may now buy 50 per cent instead of 25 per cent of the mortgages made by a lending institution since April.

## THE OUTLOOK

*What is the new legislation likely to accomplish?*

CONSUMER CREDIT CONTROLS will help somewhat to hold down the demand for consumers' goods. The unprecedented volume of spending by consumers, at the expense of their past and current saving and of their future income, has been a strong inflationary force. While output of most consumers' durables is at an all-time high, the supply of some is still far short of demand. Automobile production is merely filling replacement needs, making little progress in meeting accumulated demands.

Of course, controls will force consumers to rely more on their current income and past savings in attempting to satisfy their demand for durable goods. But this is exactly what they should do. Consumers, and especially those in a precarious financial position, are not helped by incurring at high prices debts which may have to be paid off when prices and incomes are much

lower. It is better both for the individual and the economy to save when incomes are high, and to use some of the savings to supplement incomes when they are low.

Some merchants may not sell as much. But again, the controls serve to protect sellers and lenders as well as consumers. Easy credit terms in times of boom, when almost any business can thrive, leave nothing for a slump when relaxation of terms might help to stimulate sales.

The new regulations are not as stringent as those previously in effect, but are stricter than the terms generally prevailing just before controls were restored. Automobile purchases require one-third down, while purchases of eleven other articles require 20 per cent down. The maximum payment period depends on the size of the credit extended—fifteen months for

amounts of \$1,000 and less, eighteen months for amounts between \$1,000 and \$5,000.

Consumer credit controls thus will help to prevent further inflation and will place consumers, sellers, and the general economy in better position to meet any ensuing readjustment. Even with controls, however, total consumer credit may continue to increase. The regulation applies only to instalment credit on a selected list of durable goods, covering less than one-half of total consumer credit. And as more and more consumers' durables come on the market, even instalment credit may still increase. The important point is that if it does increase, it is not likely to rise as rapidly as in the absence of controls. Yet, consumer credit is only one part of the credit picture. Consumer credit regulations will help to combat inflation, but it would be a mistake to expect too much from them.

**BANK RESERVE REQUIREMENTS** attack a much broader aspect of the problem. They influence the total amount of money people have available to spend.

The Board of Governors is now authorized to raise reserve requirements on demand deposits of central reserve city member banks to 30 per cent, of reserve city banks to 24 per cent, of country banks to 18 per cent. All member banks can be required to maintain reserves equal to  $7\frac{1}{2}$  per cent of their time deposits. If the new authority were fully utilized, such increases would involve about \$4 billion of additional required reserves.

As Chairman McCabe stated before the Senate Banking and Currency Committee, "The basic purpose of increasing the authority over reserve requirements would be to enable the System to acquire more—if necessary many more—long-term Government securities to maintain the long-term yield level. New reserves created by such System purchases—or in other ways—could be absorbed through increases in reserve requirements and thus be made unavailable for multiple credit expansion."

Higher reserve requirements would have two other restraining effects. To the extent that banks sold Governments to meet the new re-

quirements, they would be disposing of some of their soundest and most liquid assets. The resulting decline in their liquidity would tend to make them even more cautious toward doubtful credit risks. Moreover, the decline in earning assets might cause them to raise their rates to customers, thus tending to cut off some of the demands for credit. The second effect is the purely arithmetical one of reducing the credit expansion ratio. If reserve requirements, for example, are 20 per cent, \$1 of reserves supports \$5 of deposits; but with a requirement of 25 per cent, \$1 of reserves supports only \$4 of deposits.

As with consumer credit, we should not overestimate the importance of raising reserve requirements as a method of combating inflation. It is only one part of a broad anti-inflationary financial program which would include Government lending and guaranteeing, budgetary, debt management, and Federal Reserve policies. Just as higher reserve requirements cannot do the job alone, so financial policies cannot be considered in isolation. They must be part of a comprehensive anti-inflationary policy on all fronts.

**MORTGAGE CREDIT** in greater amounts and on easier terms may counteract much of the anti-inflationary effects of other credit legislation. Building today, like most other activities, is about at capacity levels. The recent legislation, therefore, may stimulate the flow of mortgage credit without materially increasing the volume of construction.

How much the new provisions will increase the supply of credit will depend largely on the response of lenders. One big question mark is whether, despite the easier terms provided by the legislation, lenders will find the returns on mortgages attractive enough. If the FHA were to raise interest rates, this factor might be overcome. But here is a case where an increase in interest rates instead of being deflationary, as usually believed, could be inflationary. This would be true because the demand for credit is so strong that it would be little affected by a moderate increase in the cost of credit, while the supply probably would be increased. It serves to emphasize the fact that the attack on inflationary mortgage credit must be largely through its supply.

# F. O. B. . . .

THE BASING POINT SYSTEM is currently the subject of a controversy in which many of the real issues have been obscured in a partisan debate of many years' standing. The controversy and confusion are illustrated by recent headlines in the press, such as "Local Monopolies in Steel Charged," "Steel Costs Rising \$2 to \$4 in Detroit," "Prices at St. Louis Mills Are \$4 to \$15 per Ton Higher Than at Chicago," and "Higher Costs Ahead for Many Consumers." In time, after careful investigation, it will be easier to see the ground we have covered and the direction in which we are headed. Perhaps it will become clear that the loss of the basing point system to industry is much less serious than some now believe, and that one of the greatest real gains resulting from the abolition of the system is an opportunity for a re-examination of fundamental economic policies.

The Supreme Court's decision in April, sustaining the Federal Trade Commission's cease and desist order against the use of the basing point pricing system in the cement industry, promises to have far-reaching effects. The basing point system has been in use in perhaps a score of important industries, including builders' supplies, farm equipment, lead, iron and steel, and others, many of which now face a serious change in established practice. Steel producers already have shifted from delivered price quotations to f.o.b. mill prices, which require the consumer to pay the freight. Their action has unleashed a storm of argument, mainly directed against the abolition of previously existing pricing methods.

In the months to come, the basing point decision will be the subject of Congressional inquiry. Its possible consequences for industrial organization and location will be carefully studied by many groups. It is not the purpose of this article to anticipate the conclusions of those studies or to make predictions of future developments. All that can be done at this time is to suggest some of the problems that are involved and help clear the air for further study.

Most of the arguments on the basing point system have been stated in terms of steel. The steel industry is by far the most important group using the system and it has been in the center of the controversy from the beginning. A cease and desist order was issued against steel's

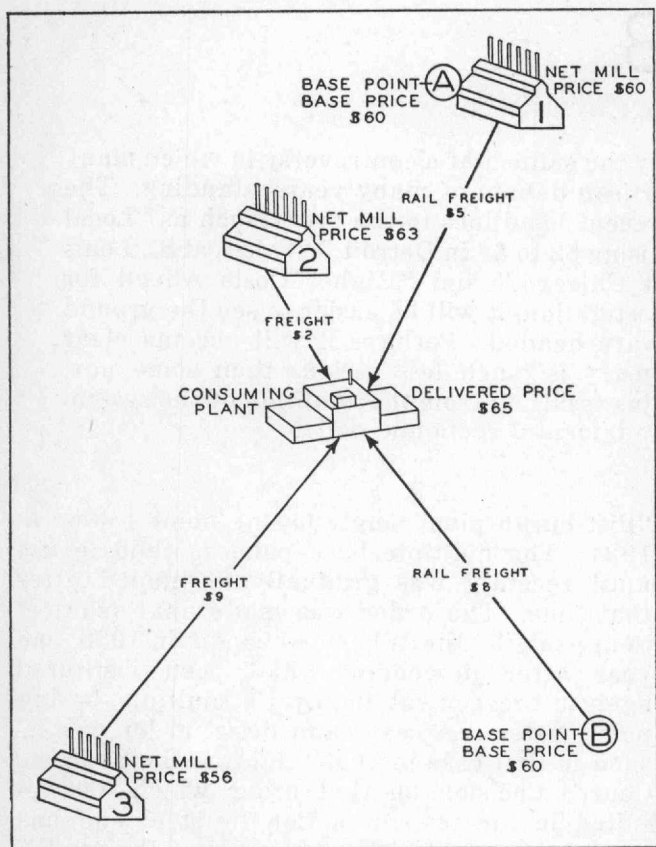
"Pittsburgh plus" single basing point system in 1924. The multiple base point method in use until recently was gradually developed after that time. The order was made final (subject to appeal) by the Wheeler-Lea Act in 1938, one year after proceedings had been instituted against the cement industry's multiple basing point system. A cease and desist order was issued in that case in 1943, and it is the Supreme Court's decision on that order which has resulted in the present action by steel and has brought the issue to the attention of the public.

## The Basing Point Pricing System

The Federal Trade Commission gives the following skeleton outline of the basing point system's operation:

"For each particular steel product a number of points have been selected at which 'base prices' are quoted. The delivery price at any other point is computed by adding to the base price at each basing point the railway freight charged from that point to point of delivery and adopting the smallest of these totals. The steel may actually be shipped from a great distance or from next door to the customer's plant, but the delivered price is the same in all cases, that is, the customer pays as if the steel were always shipped from the 'governing' basing point, i.e., that giving the lowest delivered cost according to formula."

The following diagram is one illustration of the system (prices and rates are fictitious, of course):



The delivered price at the consuming plant is calculated from the price at the nearest base point (A) and rail freight from A to the consuming plant. Net selling price of the mill located at the basing point (if it ships by rail) is \$60. For Mill 2, the net selling price is \$65 less \$2 freight costs. For Mill 3, the selling price at the mill is \$56. In every case the delivered price at the consuming plant is the same.

There are two elements in the price determination: the "base price" and the transportation charge. Net selling price of the producing mill depends upon its geographical relationship to the base and the relationship of the base to the consumer. The mill's net selling price varies with the location of customers, but—and this point is crucial—regardless of varying relationships, regardless of the location of the producing mill, under the basing point system the price quoted to an individual consumer by any steel company will always be the same. And that

identity of price is predetermined. This is the crux of the F.T.C. objection.

It is the Federal Trade Commission's contention that the basing point system constitutes industry-wide price-setting in violation of the anti-trust laws and that it results in systematic price discrimination by individual producers. Articles and editorials appearing in the press in recent weeks have reported four main lines of argument in opposition to the F.T.C. ruling: (1) Abolition of the system will upset an established and necessary practice which is a natural outgrowth of economic conditions peculiar to the steel industry. (2) The outlawing of freight absorption will diminish competition in the industry. (3) Abolition of the basing point system will increase the price of steel to consumers. (4) A new pricing system will disrupt industry and trade by creating new competitive relationships and will ultimately force relocation of producers and consumers. It will also work some hardship on the railroads.

## Argument 1

*"The basing point system is a natural development"*

The first argument raises basic issues concerning the relationship of Government and business and the kind of economy we wish to have. It is really an argument against existing laws and attitudes, rather than against the specific action of the F.T.C.

It is frequently maintained that the character of the steel industry made the basing point system a "natural" development. High transportation costs, the peculiar location of markets and raw material sources, expensive and immobile equipment, and large fixed costs are such that "a knowledge of the level at which competition must be met in quoting prices at a definite location is valuable in preventing completely disorganized markets that might prove disastrous to the industry."<sup>1</sup> In other words, it was the opinion of the industry that predetermined prices were necessary to the industry's well-being; and the decisions of the steel companies with respect to price policy, from the beginnings of "Pittsburgh-plus" in 1880 to the multiple basing point system of the present day,

<sup>1</sup> U. S. Steel Corporation: *Some Factors in the Pricing of Steel*. TNEC Exhibit 1416, 1941.



were to a large extent based on that assumption.

It is the opinion of the Government, however, expressed in legislation, that price competition is necessary for the proper functioning of the industry and the economy. Perceiving the potential evils inherent in price-setting, the Government "naturally" took steps to eliminate the basing point system. To the Federal Trade Commission, that system was a contravention of the otherwise "natural" course of events.

Obviously, it is useless to try to determine whether Nature is on the side of the industry or the Government in this matter. The outcome would depend upon one's opinion as to what should be the basic character of the economy, and that opinion, of course, is the subject of a much larger controversy. By the same token, it is not helpful to argue that the basing point system should be retained because it is a "natural" development; for without supporting the implicit assumptions, such an argument resolves into a mere assertion of opinion.

In fact, if its proponents could see some of the implications of the argument, they might abandon it very quickly. For, if it were granted that the characteristics of the steel industry necessitate predetermined, uniform pricing, that the steel industry is (as some imply) akin to a "natural monopoly," a good case could be made for the regulation of the industry as a public utility. This, of course, is a far cry from what industry or the Government would recommend.

## Argument 2

*"The outlawing of freight absorption will diminish competition."*

The second argument rests upon the presumption that the basing point system made competition possible by allowing every mill to sell to a customer at the same price, regardless of its location. It implies that with the abandonment of the system, mills located far from a particular consumer will no longer be able to meet the price of nearby competitors because it will not be possible to "absorb" the freight to the distant basing point. The fact that all prices are uniform (when the system is working perfectly) is cited as evidence of a highly competitive situation.

It is true that a one-price system is characteristic of competitive markets, but the existence of uniform prices in a given locality does not prove the presence of competition. *Predetermined* uniformity of prices is just as likely to signify collusion. Freight absorption may have enabled distant firms to "compete" only because the nearby firm agreed to abide by the formula.

Competition in all areas is still possible under f.o.b. mill pricing. All that is necessary is that the mills quote prices at the origin equal to the former net mill price after "freight absorption." Price discrimination is unlawful as part of a mutual arrangement for the elimination of price competition, but the Commission's order and the Supreme Court decision did not prohibit freight absorption to meet "individual competitive situations." In those cases where the disadvantage is so great that a firm cannot profitably serve a particular area, competition will force it out of the race for customers in that locality. But it is extremely doubtful that such business would have been sought after even under a system of delivered prices.

It is possible that in isolated cases f.o.b. pricing may encourage a "local monopoly" on the part of one advantageously located mill. Such cases have been reported recently. Naturally, consumers will prefer to buy from the mill whose delivered price is lowest. The "local monopoly," however, cannot raise its prices above the level warranted by its freight advantage. Moreover, especially when steel supplies become larger, the "monopoly" will be under constant pressure from lower-cost mills which may reduce their prices to compensate for poor location.

The basing point system at times made for the payment of "phantom freight" by the consumer, a charge calculated but not paid by advantageously located non-basing point mills. F.o.b. pricing will eliminate this charge and give such mills a real competitive advantage.

## Argument 3

*"Abolition of the system will raise the price to the consumer."*

The third argument seems to imply that with the end of the basing point system, transportation charges had to be added to previously existing delivered prices. Theoretically, there were several other possibilities. Competition might

have forced the seller to lower his f.o.b. mill price to the level of his old net selling price, leaving the cost to the buyer unchanged. Or, the buyer might patronize a nearby mill, thus reducing transportation costs. Granted that some customers might be so situated with respect to all mills that their costs did rise, is it not likely that some other buyers would benefit by the elimination of "phantom freight" previously added to their cost? A recent announcement by one large steel company, in fact, stated that delivered prices to some consumers would be relatively lower after the change.

Transportation costs, of course, are but one element of the basing point system. To argue, as some do, that abandonment of delivered price quotations will give a fillip to inflation is to ignore the base price itself. F.o.b. pricing certainly will redistribute transportation costs but it can not, in itself, increase the total steel bill. The evidence strongly suggests that base prices were set without regard to the production costs of individual plants, but high enough so that every firm could make a reasonable profit. Abolition of the system also means abolition of base prices; but if net mill prices had remained the same, the total cost of steel to the consumer need not have risen. Recent increases in the prices of steel products were the result of considerations other than those attending the end of the basing point system. In 1936, as a matter of fact, a change in price-making policy was opposed on the ground that removal of the basing point formulas would lead to ruinous price-cutting and a downward deflation spiral.

The basing point system as a mere formula has little to do with the level of steel prices. However, it would not be fair to conclude the argument there. To the extent that it is a vehicle for price administration, the basing point system has a great deal to do with price. During the depression, price-setting formulas tended to keep prices up, offsetting in some degree the severe financial pressures which caused a partial breakdown of the system through "chiseling" and "price cutting." In recent months, although upward pressures have driven some steel into "grey markets," the price policies of the steel companies probably tended to keep steel from rising as much as the prices of most other goods.

Several weeks ago it was announced that steel

prices at the mills would rise to meet increased costs. If this indicates that the surrender of the steel companies on the basing point issue also means the end of all uniform pricing policies and all price leadership, it is probable that demand will soon pull steel prices up beyond the increases which have been put into effect thus far. This could have been allowed to happen with the basing point system intact; by no twist of logic can the abolition of the system be said to have caused generally higher prices. But those who expected the return of competition to help the consumer are destined to be sadly disappointed—for the time being at least.

In the light of this probability, it might be asked why the Government chose this particular time to force the issue. The answer is that the Government did not choose this time. The Federal Trade Commission started the fight on the basing point system some twenty-five years ago. That the Supreme Court would pick an inflationary period to uphold the cease and desist order is unfortunate, but it obviously could not be foreseen. Besides, there was nothing to prevent industry from abandoning the system at any time. The decision of the steel industry to abandon it now is voluntary—a reversal of its previous policy.

#### Argument 4

*"Adoption of a new pricing system will disrupt industry and trade."*

The fourth argument contends that the abolition of uniform pricing will upset historical competitive relationships and lead to wholesale relocation of industry. Undoubtedly, f.o.b. mill pricing in steel will benefit steel consumers who are near their source of supply and steel producers who are near their markets. How great this benefit will be and to what extent it will encourage relocation of plants depend on many factors. For a steel consumer it will depend on: (1) the differential (if any) between rail transportation rates from the old basing point and transportation costs from the mill, and his competitors' differentials; (2) the importance of steel costs in the total cost of his product; (3) transportation rates on his product; (4) the relative importance of other location factors, including labor force, other raw material supplies, and many others. For a steel producer, the possibility of relocation is limited by the need for access to raw materials and tremendous

immobile plant facilities. Large surplus-steel areas, like Pittsburgh, may attract new steel-using industries or, when maintenance of volume becomes a problem, may be forced to make price concessions. The location of new steel-making facilities, of course, will be profoundly influenced by pricing policy.

It is clear that no general statement concerning changes in the structure of industry can be made without a painstaking study of many individual situations. Some costs and some prices will change. New relationships will develop against the backdrop of technological innovations. How different they will be from those in existence only time and investigation can tell. It is possible, however, that although the change may be discomfoting it will result in a more efficient industrial organization.

An example of this may be found in transportation. It has been said that the railroads will suffer some loss of revenue because of f.o.b. mill pricing. This is possible. Although adequate facilities are still lacking, truck and barge transportation will be encouraged. Moreover,

under the basing point system, since it is a matter of price indifference to a consumer where he buys his steel, situations arise in which Chicago consumers buy steel in Pittsburgh at the same time that Pittsburgh consumers buy the same specification steel in Chicago. Thus freight is "cross-hauled"—with good results for the railroads but at considerable cost, especially when transportation facilities already carry a heavy burden. The elimination of "cross-hauling" may create some problems of freight rate revision, but it cannot be denied that the nation's industrial machine will be the better for it.

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The difficulty of the change-over to f.o.b. mill pricing is aggravated by a tight steel supply and increased transportation costs. Many will feel injured by the new system, but it would be well to remember that many may be benefited as well. The full impact of the change on our economy will not be apparent for some time, and investigators should not be misled by pat arguments which seem to furnish easy answers to complex problems.





# Distribution and Prices

Wholesale trade Unadjusted for seasonal variation	Per cent change		
	July 1948 from		1948 from 7 mos. 1947
	Month ago	Year ago	
<b>Sales</b>			
Total of all lines.....	- 4	+ 3	+ 3
Dry goods.....	+ 9	- 6	- 7
Electrical supplies.....	-10	+16	+ 3
Groceries.....	+ 3	+ 5	+ 8
Hardware.....	-33	- 6	- 3
Jewelry.....	-19	+27	+10
Paper.....	- 9	-10	+ 1
<b>Inventories</b>			
Total of all lines.....	- 2	+14	.....
Dry goods.....	- 3	+11	.....
Electrical supplies.....	- 6	- 3	.....
Groceries.....	- 4	+12	.....
Hardware.....	- 3	+30	.....
Jewelry.....	+14	- 2	.....
Paper.....	+ 5	+42	.....

Source: U. S. Department of Commerce.

Prices	July 1948	Per cent change from		
		Month ago	Year ago	Aug. 1939
<b>Basic commodities</b> (1926=100).....	326	-1	+ 7	+226
<b>Wholesale</b> (1926=100).....	169	+1	+12	+125
Farm.....	195	-1	+ 7	+220
Food.....	188	+4	+13	+180
Other.....	151	+1	+13	+ 89
<b>Living costs</b> (1935-1939=100)				
United States.....	174	+1	+10	+ 76
Philadelphia.....	173	0	+ 9	+ 76
Food.....	211	+1	+12	+127
Clothing.....	193	0	+ 6	+ 95
Fuels.....	136	0	+ 9	+ 41
Housefurnishings.....	199	+1	+ 9	+ 98
Other.....	148	+1	+ 7	+ 47

Source: U. S. Bureau of Labor Statistics.

Indexes: 1935-1939 = 100	Adjusted for seasonal variation						Not adjusted		
	July 1948	June 1948	July 1947	Per cent change			July 1948	June 1948	July 1947
				July 1948 from		1948 from 7 mos. 1947			
				Month ago	Year ago				
<b>RETAIL TRADE</b>									
<b>Sales</b>									
Department stores—District.....	288	283	257	+ 2	+ 12	+10	207	266	185
Philadelphia.....	240	250	230	- 4	+ 4	+ 8	161	235	154
Women's apparel — District.....	245	258	239	- 5	+ 2	+ 2	157	219	153
Philadelphia.....	239	276	241r	-13	- 1	+ 2	148	226	150r
Furniture.....				-13*	+14*				
<b>Inventories</b>									
Department stores—District.....	237p	248	205	- 4	+ 16	.....	225p	235	195
Philadelphia.....	209p	218	197	- 4	+ 6	.....	192p	205	181
Women's apparel — District.....	206	190	198	+ 9	+ 4	.....	186	181	178
Philadelphia.....	239	203	243	+18	- 2	.....	201	191	204
Furniture.....				- 1*	+ 7*				
<b>FREIGHT-CAR LOADINGS</b>									
<b>Total</b> .....	136	139	138	- 2	- 2	- 5	138	143	141
Merchandise and miscellaneous.....	121	124	130	- 3	- 7	- 5	121	126	130
Merchandise—l.c.l.....	70	76	86	- 8	- 19	-15	70	76	86
Coal.....	163	182	146	-10	+ 12	- 6	155	164	139
Ore.....	199	203	216	- 2	- 8	+ 3	298	299	324
Coke.....	190	195	165	- 3	+ 15	- 1	175	181	152
Forest products.....	90	89	98	+ 1	- 9	- 8	101	101	110
Grain and products.....	121	116	113	+ 5	+ 6	-16	162	100	152
Livestock.....	72	77	92	- 8	- 22	-23	61	70	79
<b>MISCELLANEOUS</b>									
Life insurance sales.....	191	200	191	- 4	0	+ 1	185	204	186
Business liquidations									
Number.....				+26*	+107*	+47*	43	34	21
Amount of liabilities.....				-21*	+ 73*	+51*	48	60	28
Check payments.....	249	243r	223r	+ 3	+ 12	+12	239	267	214

\* Computed from unadjusted data.

p—Preliminary.

r—Revised.

# BANKING STATISTICS

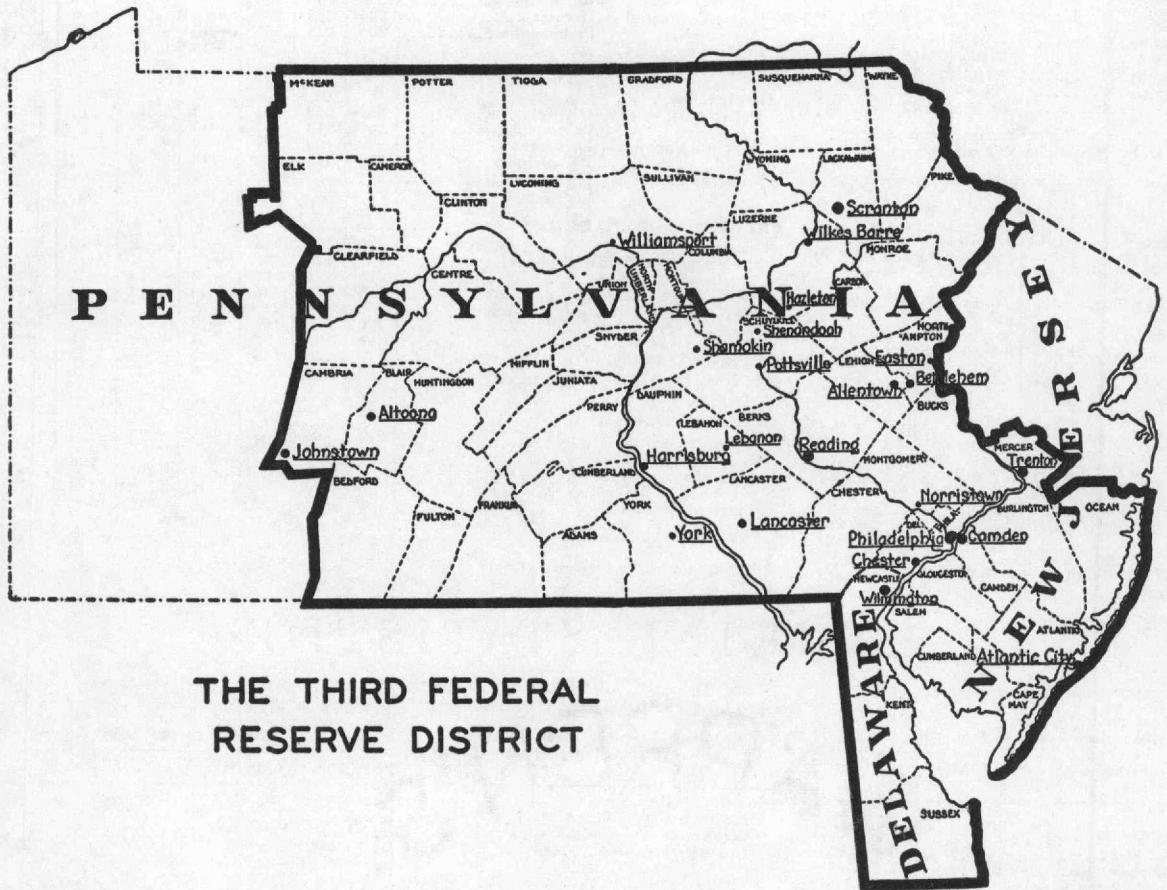
## MEMBER BANK RESERVES AND RELATED FACTORS

Reporting member banks (Millions \$)	Aug. 25, 1948	Changes in—	
		Four weeks	One year
<b>Assets</b>			
Commercial loans.....	530	+ 6	+ 83
Loans to brokers, etc.....	19	+ 1	- 3
Other loans to carry secur.....	13	.....	- 3
Loans on real estate.....	85	+ 4	+ 7
Loans to banks.....	2	.....	- 11
Other loans.....	267	+ 6	+ 52
Total gross.....	916	+17	+125
Total net.....	909	+17	+121
Government securities.....	1341	-12	-114
Other securities.....	283	+ 3	+ 25
Total investments.....	1624	- 9	- 89
Total loans & investments.....	2533	+ 8	+ 32
Reserve with F. R. Bank.....	491	+19	+ 26
Cash in vault.....	43	- 1	.....
Balances with other banks.....	100	- 1	+ 4
Other assets—net.....	56	+ 2	+ 1
<b>Liabilities</b>			
Demand deposits, adjusted.....	2033	+21	- 9
Time deposits.....	443	- 2	+ 21
U. S. Government deposits.....	61	+ 4	+ 36
Interbank deposits.....	344	+ 3	+ 6
Borrowings.....	11	- 3	+ 6
Other liabilities.....	28	+ 3	+ 3
Capital account.....	303	+ 1	.....

Third Federal Reserve District (Millions of dollars)	Changes in weeks ended				Changes in four weeks
	Aug. 4	Aug. 11	Aug. 18	Aug. 25	
<b>Sources of funds:</b>					
Reserve Bank credit extended in district.....	+5	+ 1	+ 2	- 6	+ 2
Commercial transfers (chiefly interdistrict).....	.....	+29	+101	- 83	+47
Treasury operations.....	-6	+ 6	- 25	- 3	-28
Total.....	-1	+36	+ 78	- 92	+21
<b>Uses of funds:</b>					
Currency demand.....	.....	+ 3	- 3	- 4	- 4
Member bank reserve deposits.....	-1	+33	- 20	+ 13	+25
"Other deposits" at Reserve Bank.....	.....	.....	+101	-101	.....
Other Federal Reserve accounts.....	.....	.....	.....	.....	.....
Total.....	-1	+36	+ 78	- 92	+21

Federal Reserve Bank of Phila. (Dollar figures in millions)	August 25, 1948	Changes in—	
		Four weeks	One year
Discounts and advances.....	\$ 21.5	\$- .1	\$+ 12.1
Industrial loans.....	5	.....	1.3
U. S. securities.....	1532.9	+17.9	-144.8
Total.....	\$1554.9	\$+17.8	\$-134.0
Fed. Res. notes.....	\$1635.8	\$+ 8.0	\$- 6.1
Member bank deposits.....	831.7	+25.0	+ 34.6
U. S. general account.....	167.3	+ .2	+108.7
Foreign deposits.....	28.0	- 1.5	- 12.0
Other deposits.....	2.8	+ .8	+ .7
Gold certificate reserves.....	1111.3	+11.1	+244.1
Reserve ratio.....	41.3%	- .5%	+7.2%

Member bank reserves (Daily averages; dollar figures in millions)	Held	Re- quired	Ex- cess	Ratio of excess to re- quired
<b>Phila. banks</b>				
1947: Aug. 1-15.....	\$419	\$414	\$ 5	1%
1948: July 1-15.....	395	391	4	1
July 16-31.....	396	391	5	1
Aug. 1-15.....	396	392	4	1
<b>Country banks</b>				
1947: Aug. 1-15.....	\$383	\$339	\$44	13%
1948: July 1-15.....	412	367	45	12
July 16-31.....	411	370	41	11
Aug. 1-15.....	416	370	46	12



THE THIRD FEDERAL RESERVE DISTRICT