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BANKS IN A BUSINESS CIVILIZATION

What distinguishes commercial banks from other enterprises?

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A word at the outset about the nature of this talk. It is built around two questions:

Are there essential differences between the 14,000 banks of the country and the four million other business enterprises?

What light do these differences throw on the development of bank leadership?

My hope is not to find unassailable answers to these questions but rather to stimulate you men to think about the special significance of banking in a competitive economy and especially to think about bank leadership, which in the future will come largely from groups such as the Robert Morris Associates.

For background purposes, let us consider the role that Business plays in this country. We have created in the United States what is essentially a Business Civilization. This fact struck me with full force when, more than twenty years ago, I went to Europe for a year to study industrial conditions. In the evening, after-dinner conversation in mixed company would turn to literature, music, art, international relations, education, economics but never to business, as business. Business was considered petty and demeaning, not worthy of discriminating and cultured minds. It was much more difficult for the businessman to achieve status in European society than the professor, the civil servant, the artist, or the army officer. Here in this country, after a round of golf, the club house talk veers to business. Business cuts into the conversation after the card game. Business is our meat and wine. Business is in the warp and woof of the social fabric of America. Business, with its dynamism, is the source of much of the zest that characterizes our national life as a whole.

The nature of commercial banking

It is the competitive struggle in the market place that creates the economic driving force of America. Four million separate enterprises or competitive units, exclusive of agriculture, compose the business sector of our economy. Among these four million industrial and commercial enterprises there are 14,000 that differ sharply from all others. These are the commercial banks of the country. These banks—employers of your Robert Morris Associates—are, in important respects, in a class by themselves. What sets them apart?

First, with very few exceptions, all four million enterprises must do business with the 14,000 commercial banks. This is because we live in a credit and checkbook economy. Whether he be a manufacturer, merchant, mine operator, or broker, the businessman cannot operate without using a bank. The services rendered by a bank are a *sine qua non* in the conduct of every modern business. This gives to banks great social opportunities and heavy responsibilities.

There is another major distinction to be drawn between commercial banks and other types of business concerns. Banks have unique opportunities, when other enterprises come to them for credit, to get to know them and to help them. They get an inside look at the other man's business. In business, as in medicine, this is the age of the specialist. Like the general practitioner in medicine, the banker is a general practitioner. He has opportunities to keep abreast of the problems of the dairyman, the retailer, the tanner, the building contractor. By reason of the fact that he must continuously exercise business judgment in a wide variety of fields, he acquires skills that enable him to assist in the sound development of both the individual enterprise and the community in which it operates. He may help in a positive way by extending credit and also in a negative way by refusing to grant credit. No other group of enterprises possesses the unique opportunities of banks to know what goes on in individual businesses of the country and to transmute this knowledge into sound credit action and wise business counsel. It is more than alliteration to say that banks can be builders of businessmen.

Let us stop for a moment to reflect about the present system of credit extension. Credit is essential to businessmen. They cannot get along without it. It is the yeast in the economic dough. If a businessman, seeking credit from his bank, is denied a loan or is not satisfied with the terms, he can under our competitive system try his case in another bank. The bank wishes, if it is at all possible, to extend credit because it stands to gain from the transaction. Loans are the principal source of its earnings. You credit men who hand down the verdict have come to know your business customers pretty well. Your judgment as to their business acumen and moral probity is a better screen than one based on political influence or rationing. Mistakes are made, but by and large it is a successful method of achieving distributive justice. If an applicant for credit cannot obtain it at any bank, the chances are that he is not credit-worthy. Roland Robinson in his book, *The Management of Bank Funds*, has this to say about the capacity of banks to handle this important social function of extending credit.

> "Almost every other function performed by commercial banks could be as well done by some other agency. Banks have no profit advantage in other lines; in some aspects, such as investment management, commercial banks probably are at a distinct disadvantage when their position is compared with that of other institutional investors.
>
> "However, banks can lend. That is the business they are best fitted for by tradition, organization, and position. No other existing agency could take their place. Without bank credit, a good share of the small and moderate-sized business would wither and die. Lending is not only a good social service, it is profitable. It is, indeed, the most profitable aspect of commercial banking."*

The role that commercial banks thus play,

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through the exercise of the credit function, in the discovery and development of new enterprise talent, is a vital function in our competitive economy. It is a method by which we aid the resourceful and efficient and snub the incompetent and untrustworthy. Banks can be proud of their role in assisting new managerial talent to constantly well up from beneath. The role is, to be sure, hazardous. Robinson in the work just referred to comes to the conclusion that bank lending has its "sobering aspects." Many of the concerns seeking bank credit are relatively small, they are moderately young, and they tend to make less than average profits. On the other hand, they are repeat customers of banks and, since they are growing concerns, are more likely to use bank credit than those well stabilized.

Finally, banks differ from other types of business in still another important respect—they operate not only as individual enterprises but also as a banking system. Congress recognized this and deemed it necessary to supervise their group or system behavior. Public authorities do, of course, supervise individual banks. Witness the work of bank examiners, state and federal, in appraising the assets and management of the individual bank. But this is not the type of supervision now under discussion. We are here concerned with a quite different type—that exercised by means of general credit controls.

Role of the Federal Reserve system

Why does the free enterprise system of banking not automatically give us appropriate group behavior and thus make unnecessary general credit controls? If we rely wholly upon competitive forces to furnish credit in the volume and with the timing needed to maintain steady prices, high level employment, and a rising standard of living, it is highly likely that we would have more instability than we now have. The tendency would be for bank loans to expand when profit possibilities are greatest—generally in a period of rising prices and inflationary pressures. Conversely, when the profit outlook has deteriorated—usually in a period of deflation, recession or falling prices—the tendency would be for banks to press for collection of loans. When banks make new loans they expand the money supply. When the loans are repaid the money supply is reduced.

Since the demand deposits of banks are by all odds the largest part of the country's money supply, this natural tendency of each bank to follow its own self-interest creates profound changes in the quantity of money. These large changes in the quantity of money in turn have profound effects on economic growth and stability. We have had impressive demonstrations of these facts in recent years. Economic instability may well prove to be the Achilles heel of our enterprise system. In an attempt to overcome this weakness, Congress has created the Federal Reserve System and passed the Full Employment Act. The Federal Reserve System has been given a mandate, with commensurate power to influence the supply, the cost, and the availability of money and credit. It is important that the instruments of credit policy—open market operations, discount rates, and reserve requirements—be used with flexibility by those in authority. It is equally important that they be fully understood and accepted by commercial banks. Indeed, enlightened, long-run self-interest dictates that all elements in the economy—labor leaders, farmers, manufacturers, and merchants, as well as bankers—should come to understand what the Federal Reserve System is trying to do and why it acts as it does. Some bankers have objected in the past to central bank discipline. At present, objections seem to be at a minimum. Further efforts to achieve thorough understanding of the workings of the economy should be made. Current programs of bank leaders to improve understanding not only by bankers but by business generally are highly commendable. Just as bankers are builders of individual businesses, so they should be leaders in a general war against economic illiteracy.

Summarizing to this point: Banks as individual enterprises are highly important to our national welfare because they service all other business with vitally needed credit and financial counsel, and assist in the discovery and growth of new business talent. Banking as a system can effect profound changes in the money supply. It is, therefore, crucial that bankers understand not only the management of the individual bank but also the operation of the banking system, including the Federal Reserve System, and give to the latter informed cooperation. This is the best way to assure continuance of the vital role that commercial banking now plays in our business civilization. What characteristics of banking leadership are needed to achieve these goals?

Basic elements of banking leadership

Top flight banking leadership in a democratic, competitive economy such as we hope to retain consists, in my judgment, of four basic elements. They are presented here without reference to their order of importance. The first is technical competence—the understanding and mastery of a special field. To have a deep and thorough knowledge of a given field of business—bridge building, newspaper publishing, railroad operation, department store merchandising, or commercial banking—gives to its possessor great opportunity to serve his fellowman and, by the same token, brings rich rewards to the possessor. Organized banking is in the forefront of American business in providing professional training to achieve such competence.

A second basic element is a broad intellectual outlook. I am not now thinking about formal training in college but about what happens in the afteryears to one's intellectual interests. How wide-ranging and vigorous are the mental processes? A few examples will illustrate. Business leaders are helped by a knowledge of history. History gives comprehension of social change by providing a basis for comparison. It gives one a tie to the past, a sense of continuity; it thereby provides a feeling for trends and builds up protection against panic arising from short-run changes.

Broad intellectual outlook includes interest in the field of foreign relations. No young banker who aspires to leadership should be provincial in his outlook. Insight into the nature and policies of other governments will broaden our views, make our prejudices more malleable and help us assist our own country in living with the rest of the world. A knowledge of literature assists one to become a leader. I am impressed with the number of men of large affairs who have increased their knowledge of life by means of literature. Good literature gives sound insight into motives—vicarious insight. An exposition on life from the pen of a master supplies fruitful analogies and spiritual insight and inspiration.

A third basic element is social intelligence. This may be roughly defined as capacity to understand and deal with men, especially men in groups. Frequently men are skilled in person-to-person relationships. Place these men before their professional association or an investigating committee, or a trade union, and they prove to be inept and unsuited for the assignment.

Mass action is increasingly a characteristic of human behaviour, of how objectives are reached. There is increasing interest among social scientists in the art of handling men in groups. Young bankers should take a look at the literature. Studies and experiments are under way in such matters as clear-cut definition of problem, compromise of differences, conduct of group discussion, channels of communication, and the nature and dynamics of group action.

This element of social intelligence ties directly into the field of public relations which is of unusual importance in banking. Time limits prevent an exploration of the historical, psychological, legal, and economic aspects of the public relations problems of banking. Suffice it to say, there is "pay dirt" in the developments just referred to above.

Finally, a fourth element in top-grade leadership is a well-knit set of ethical, moral, and spiritual values. These values set up a central drive, within the leader, of interest in and respect for the other fellow—his personality and worth as an individual. To those of you who would become leaders I say, if you have a spark of interest in your fellowman, fan it into a flame. If you succeed, there follows an integration of your many loyalties, some of which hitherto, no doubt, have been conflicting. If you are entirely successful you will achieve the inner poise and strength so necessary in these days of economic doubt, social tension, personal frustration, and seeming defeat.

Banking, no less than other areas of business, can take more leadership of the sort here envisioned. I realize I have given you a counsel of perfection; this is as it should be in a democracy. In a democracy, "life is a becoming, never an arrival." Democracy has been referred to as a hard central core of agreement, surrounded by a bewildering diversity of objectives and values. I submit for your consideration the thought that the hard core of value in America is contained in Ruskin's line, "There is no wealth except life."

ELECTION OF DIRECTORS

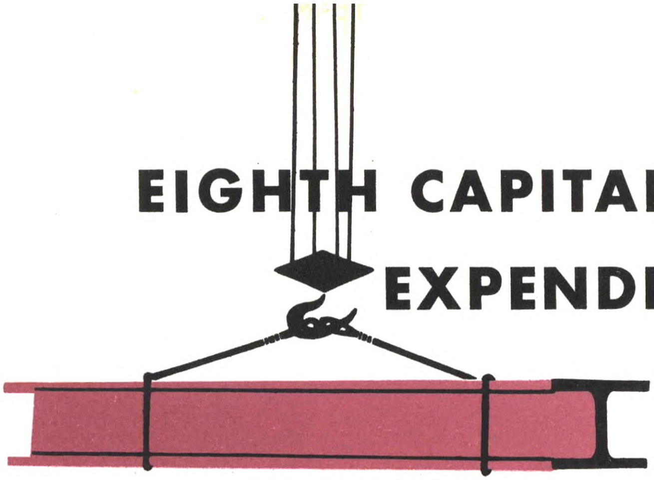
As this issue went to press, the following announcement was made by William J. Meinel, Chairman of the Board of the Federal Reserve Bank of Philadelphia:

"Mr. Wm. Fulton Kurtz, Chairman of the Board, The Pennsylvania Company for Banking and Trusts, Philadelphia, Pennsylvania, was elected unanimously by member banks in Electoral Group 1 as a class A director for the three-year term ending December 31, 1956.

"Mr. Warren C. Newton, President, O. A. Newton and Son Company, Bridgeville, Delaware, was reelected unanimously by member banks in Electoral Group 2 as a class B director for the three-year term ending December 31, 1956.

"Ninety per cent of the Group 1 banks and eighty per cent of the Group 2 banks voted in this election. The interest evidenced by this participation is most gratifying."

EIGHTH CAPITAL EXPENDITURES SURVEY



Preface

The economy of the United States has been operating at practically full stretch ever since 1946, a year of demobilization readjustment. At various times during the eight-year-old boom, usually around the turn of the year, it appeared that the boom was about to burn out. The biggest threat occurred in 1949. But the 1949 recession, if it may be called that, turned out to be little more than an inventory readjustment. Once again near the turn of the year we are approaching a period when a number of businessmen feel that the trend of business is about to change, that the boom has now really run its course.

In the light of recent developments, everyone is diligently surveying the business scene in search of telltale evidence of what may lie ahead. And so are we. We have just completed our eighth annual survey of capital expenditures in the Philadelphia area in the hope that it may give us a clue as to prospective changes in the business climate. We asked local industrialists how much money they spent on capital improvements during the past year and how much they were planning to spend in the year ahead. We asked them about their inventory policies, whether they were planning to increase, decrease, or maintain inventories at present levels. We also asked whether they expected their employment to rise, fall, or hold.

The results are surprising. Business concerns in this area, except for the railroad and utility group, are planning to increase their capital outlays, inventories show a tendency toward softening, and employment is expected to decline slightly. Modifications and exceptions are explained in the following articles.

It is always tempting to read too much into an interpretation of the results of such a survey. Numbers look so accurate and finite, but business can change so fast and unexpectedly. Inventories, for example, are notoriously volatile. When businessmen shift from a mood for increasing inventories at an annual rate of $7 billion, as they did in late 1948, to a mood for decreasing inventories at an annual rate of $5 billion, as they did in late 1949, the shift leaves its effect on the business climate. That amounted to a change of $12 billion.

Capital expenditures change less dramatically. Like icebergs, they build up slowly and melt away slowly. They exert powerful long-run effects on our economy.

Employment is more than men on payrolls. Our survey shows only that; it shows nothing about hours of work, productivity, rates of pay, turnover, male versus female, and other aspects of employment that influence and are influenced by the general trend of business.

CAPITAL FOR INDUSTRIES ON THE DELAWARE

Manufacturing enterprises along the Delaware spent $314 million for plant expansion and new machinery last year. Next year they intend to enlarge and modernize still more. Plans call for an increase of $58 million, or 18 per cent, making a total of $372 million. That's the story in a nutshell, and it does not include the new Fairless mill which is now a going concern.

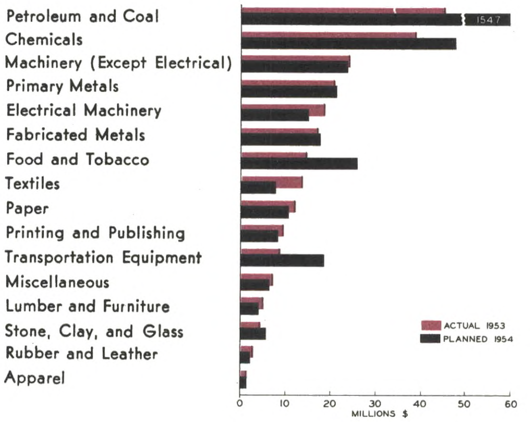
This is not a forecast on our part; it is what local business men told us about their expenditures last year and their plans for next year. The expected increase comes as somewhat of a surprise, since the talk throughout the country is that business activity in 1954 will not quite measure up to 1953. Employment, production, income, and almost anything else you could mention are at, or near, an all-time record. It is more or less the consensus that at long last the post-war boom is over the hill. Next year is not going to be a year of depression—just recession. Perhaps not even recession, but just relaxation.

In line with that thinking, it is rather widely believed that the record $27.8 billion which businessmen throughout the country are spending for new plant and equipment this year is also a peak and that next year's outlays will be somewhat lower. This opinion is reinforced by the belief that post-war capital outlays cannot keep on increasing forever.

If it be true that capital outlays, country-wide,* are heading for a decline and, in Philadelphia, bound for further increases, what is the explanation? If it should turn out that local investment plans do not conform, it is probably because Philadelphia is different. This area is undergoing a kind of renaissance. As an industrial center, the Delaware River Valley has all the natural advantages it has always had—soil, topography, climate, water supply, location, and accessibility to the sea. Some years ago the area went through a period of carelessness—a time when some of these natural resources were allowed to corrode. Now the region is undergoing a major "spit-polish job." Streams are getting a cleaning; removal of silt and sludge is making them more navigable, and the construction of plants for the disposal of sewage and factory wastes is making the waters more potable. High-speed turnpikes facilitate the flow of traffic to the west, the north, and the south.

* As we go to press, Business Week reports the results of the nationwide survey by McGraw-Hill. Their survey shows a prospective decline of 8 per cent by manufacturing concerns for 1954.

CAPITAL EXPENDITURES 1953 AND 1954



The Pennsylvania Turnpike is being extended eastward to the Delaware and ultimately will connect with the New Jersey Turnpike. An improved international airport is nearing completion in Philadelphia and another bridge is about to leave the drawing boards, to span the Delaware to improve accessibility in all directions.

In Philadelphia, old landmarks are disappearing and new ones are taking their place. In central Philadelphia, the Pennsylvania Railroad's Broad Street Station and the "Chinese Wall" have disappeared, making way for a large redevelopment program to be known as Penn Center. Independence Hall is no longer facing obsolete and empty office buildings—they have been removed to make way for green grass, shrubbery, and a shaded walk. The Schuylkill Expressway is moving south from the Pennsylvania Turnpike to central Philadelphia. A high-speed expressway is to be built along the western bank of the Delaware River.

Not only in Philadelphia proper, but throughout the entire Delaware River Valley area great changes are taking place. Upstream, where Bucks County farmers harvested their spinach crops only three years ago, are Levittown and Fairless Hills, which together make a community large enough to rank among Pennsylvania's twelve largest cities. Downstream, just below Wilmington, a steadily rising volume of commerce flows over the Delaware Memorial Bridge—a graceful span of steel connecting Delaware and New Jersey.

Concurrent with all these developments, new plants are springing up in the area, long-established plants are expanding and improving their facilities, and others are moving out of the heavily populated core into the counties surrounding Philadelphia where they have more "elbow room." Manufacturing operations can be carried on more economically in one-story structures than in multi-story plants. Power companies are expanding their productive facilities, as they must, to stay ahead of the rapidly growing demand.

Along with all these developments, population in the Philadelphia metropolitan area has increased about 18 per cent since 1940. Considering all the civic and transportation improvements, on the one hand, and the industrial expansion and modernization on the other, it is difficult to tell which is cause and which is effect. There is no denial of the fact, however, that there has been an awakening—a re-examination of the potentialities of the area and a quickening spirit which permeates the entire region. Perhaps further analysis of the current survey may lay bare other reasons for the prospective increase in local investment.

Expansion in nondurables

It is the manufacturers of nondurable goods who are planning the largest increases in expenditures in the year to come. Their plans call for an outlay of $259 million next year, in contrast with actual expenditures of $209 million last year, which is an increase of 24 per cent; however, plans vary widely from one industry to another, as shown in the accompanying table. Manufacturers of petroleum and coal products contemplate the largest increase in outlays, in actual dollars. As a matter of fact, the large petroleum refineries along the Delaware and the Schuylkill are so dominant that they account for slightly over 40 per cent of the total scheduled outlays for new plant and equipment of all area manufacturers in 1954.

Producers of food and tobacco products plan the largest increases, percentagewise, though in

ESTIMATED CAPITAL EXPENDITURES IN THE PHILADELPHIA METROPOLITAN AREA

(Thousands $)

INDUSTRY	Total actual expenditures Sept. 1952-Sept. 1953	Anticipated expenditures Sept. 1953-Sept. 1954	Percent. change
All manufacturing	314,394.9	371,887.4	+ 18.2
Durable goods	105,321.6	113,013.2	+ 7.3
Nondurable goods	209,073.3	258,874.2	+ 23.8
Food and tobacco	14,742.1	26,026.6	+ 76.5
Textiles	13,626.2	7,750.7	— 43.1
Apparel	1,160.2	1,320.4	+ 12.3
Lumber and furniture	4,874.0	4,019.0	— 17.6
Paper	11,997.5	10,603.8	— 11.6
Printing and publishing	9,409.8	8,347.5	— 11.3
Chemicals	39,027.2	48,018.5	+ 23.0
Petroleum and coal products	116,557.3	154,725.1	+ 32.4
Rubber and leather	2,553.0	2,081.6	— 18.5
Stone, clay, and glass	4,136.1	5,671.7	+ 37.1
Primary metals	20,797.5	21,514.3	+ 3.4
Fabricated metals	17,085.7	17,807.1	+ 4.2
Machinery (excluding electrical)	24,152.3	23,915.2	— 1.0
Electrical machinery	18,664.5	15,163.1	— 18.8
Transportation equipment	8,570.0	18,642.7	+117.5
Miscellaneous	7,041.5	6,280.1	— 10.8

actual dollars they are completely overshadowed by the petroleum refineries. The chemical companies are also planning to increase their capital outlays substantially, and the manufacturers of apparel are the only other producers of nondurables planning further expansion.

Declining capital outlays are reported by the printers and publishers and by manufacturers of textiles and paper products. The largest declines in the nondurables group are reported by the textile people, who reported a 43 per cent decline for next year.

Producers of durable goods, as a class, plan modest increases of 7 per cent for 1954; but, again, there is anything but uniformity among the various members in this group. Plans vary from decreases of almost 20 per cent in the electrical machinery industry to a huge increase of 117 per cent among producers of transportation equipment. "Transportation equipment" is a term totally devoid of glamour, like the word "durables." In the Delaware River Valley region, transportation equipment means such things as automobile assembly plants, motor trucks, streamlined trains, dry-cargo merchant vessels and oilers, rotary aircraft, motorcycles, bicycles, and horse-drawn vehicles.

In our survey taken last year (September 1952), producers of transportation equipment showed a sharp contraction in capital outlays —a decline from \$25 million to \$8½ million. The latest survey shows that their actual expenditures were \$8½ million, but for next year they plan to increase it to \$18.6 million. Producers of stone, clay, and glass products also plan a sizable increase (37 per cent). This group of industries also produces a great variety of products consisting of such things as cement, building stone and crushed stone, glass bottles, window glass, chinaware, chemical and laboratory glassware, etc.

Electrical machinery, consisting of radios, television, electric motors, transformers, switch gear, and the like, shows a somewhat surprising 19 per cent decrease. Perhaps the reason is that electrical machinery manufacturers went $2 million over their year-ago estimates for actual outlays of $18.5 million. Producers of primary metals and manufacturers of finished metal products (the latter embracing a bewildering variety of things), contemplate only small further increases in capital outlays, as the table shows, and manufacturers of machinery (exclusive of electrical machinery) report practically no change.

FUTURE CAPITAL OUTLAYS BY RAILROADS AND UTILITIES

Railroads and utilities in the Philadelphia metropolitan area spent $120 million for new plant and equipment during the year ended September 1953. For the year ending September 1954, they plan to spend $118.5 million—a decrease of less than 2 per cent. Among concerns within the group, plans differ—as they do among manufacturers. The railroads plan reduced capital outlays, and the utilities plan to invest just as much or slightly more in 1954 than in 1953.

Construction vs. equipment

One thing which the table does not and cannot reveal (in order to preserve the identity of individual companies reporting to us) is that the bulk of scheduled increases in money outlays for next year is for new plants and plant additions rather than for new machinery and equipment. That most of the increase should be for plant rather than equipment is indeed a surprise. This is contrary to the findings of a year ago and it is also contrary to trends in recent surveys made by others which show a diminishing emphasis on plant construction and greater emphasis upon modernization of equipment. Frankly, we do not know what accounts for the reversal of the local trends.

Will the plans stick?

What are the chances that manufacturing concerns in the Delaware Valley area will actually spend the $372 million as scheduled? In our survey made in 1952, industrial concerns reported that they planned to increase capital outlays by 4 per cent over the preceding year. Actually, they increased their expenditures 14 per cent, as the latest survey shows. Perhaps the only thing that proves is that construction usually costs more than you think.

Going back to earlier years, in making a comparison of actual expenditures with projected expenditures, we get little comfort as to the reliability of the predictions. In the fiscal year ending September 1951, Philadelphia manufacturers spent about 25 per cent more than they had estimated at the beginning of the year. Similarly, in the fiscal year ending September 1950, they spent about 12 per cent more than they had estimated at the beginning of the year. In each of the three years preceding, however —that is, in the years September 1947, 1948, and 1949, they spent slightly less than the reported estimates.

Does more investment mean more capacity?

We have been asked frequently whether the moneys invested in new plant and equipment result in that much increased manufacturing capacity. Consequently, in our latest survey, we asked the firms specifically whether their expenditures would result in an increase in the capacity of their plants. Almost half of those who replied to this question said yes and the other half said no. Those who said no, presumably were making expenditures for the purpose of either improving the quality of their products or for the purpose of reducing cost of production, but not to increase the volume of output.

Sources of funds

With respect to sources of funds, our latest study shows little change from peceding surveys. A fraction over 88 per cent of the planned $372 million to be spent next year is to come out of the resources of the companies making the expenditures; 9 per cent of the funds are to be obtained from banks, and the remainder from other sources. Among other sources the securities market is negligible.

All industries, of course, do not conform to the general pattern just cited. For example, textile manufacturers plan to get 24 per cent of their funds from banks; manufacturers of electrical machinery, 28 per cent; and producers of petroleum and coal products, 15 per cent from banks. Apparel manufacturers are in a class by themselves in the sense that they are the only major industry group that is entirely independent of outside sources for funds, but the total amount they are spending for expansion and renovation is not large; in fact, it is the smallest, as the table shows.

A final observation

The amount of money that American business has spent on new plant and equipment in the post-war period is staggering. During the past four years (1950 to 1953, inclusive) alone, it amounted to $100 billion, according to reports of the Department of Commerce and the Securities and Exchange Commission. This includes enterprises in manufacturing, mining, railroads, transportation other than railroads, public utilities, commercial, trade, service, finance, communication, and construction. The only areas excluded are agriculture and outlays charged to current account.

Each year there are those who think we are over-built and that henceforth such expenditures are sure to decline. To be sure, the day will come, and may be at hand, when expenditures will decline; but it is easy to overlook several aspects of the large money outlays. First, the cost of new machinery and equipment and construction costs have been steadily rising. For example, the printer who buys an automatic letter press today pays about $26,000 to replace an old press bought for $12,000. Similarly, today the full-fashioned hosiery manufacturer has to lay out $37,000 for a knitting machine (legger) in contrast with $17,000 for a machine bought in 1941. Of course, the machines are not identical, and this is the second point—the new knitting machine has more sections, it is a higher gauge (probably a 63 instead of a 51, which means that it knits a finer-mesh stocking) and there are other improvements.

Another reason for high volume of capital expenditures is that they consist, in part, of special plant and equipment for national defense. Construction contracts of almost $3 billion for national defense have been awarded in the United States between July 1951 and June 1953, according to a recent release by the Assistant Secretary of Defense. Then, too, it is easy to overlook the impact of technological change and obsolescence. Both machinery and factory buildings, particularly the former, are seldom kept in use until they are completely worn out. As soon as a new machine tool or a new lift truck appears on the market the manufacturer will make a sharp-pencil calculation, technically known as an economy study, and if the results are in favor of the new machinery, out goes the old equipment.

History shows that industrial equipment has increasingly high mortality. A noted economist made the observation, almost a half century ago, that wholesale destruction of productive equipment as a result of a war, earthquake, or similar major catastrophe was, in fact, not much worse than the destruction of productive equipment that goes on constantly by reason of depreciation and obsolescence. In our day the ravages of obsolescence and depreciation are much greater than they were in his day.

Technical notes

The first six surveys covered manufacturing concerns in Philadelphia County only. The latest and last year's include the Philadelphia metropolitan area; that is, the eight counties consisting of Philadelphia, Bucks, Montgomery, Delaware, and Chester on the west side of the river, and Camden, Burlington, and Gloucester counties on the east bank of the Delaware. Currently, this area employs 617,000 people in manufacturing industries (September 1953). Representative manufacturers in the major industries of this region were asked how much money they had spent from September 1, 1952 to September 1, 1953 on (a) new construction, and (b) on equipment; also what expenditures they planned to make in the next year beginning September 1, 1953. Replies were received from approximately 500 concerns, and the sample was "blown up" to give the trend of all industry in the area.

INVENTORIES—A TROUBLE SPOT?

Since early 1950, inventory holdings have been trending upward. In terms of past records, this is a fairly long period of uninterrupted accumulation of stocks. Recently, the rate of accumulation has slowed considerably, and many observers look for some liquidation in the near future.

In view of this concern over future inventory changes and in the interest of securing additional information about business in the area, the Federal Reserve Bank of Philadelphia included questions on inventories in its annual capital expenditures survey this year. Four hundred and sixty-one firms, representing about half of the total manufacturing employment in the eight-county area, answered these questions. Several conclusions are apparent after summarizing their replies:

1. By far the largest number of firms expect to maintain their inventories at present levels over the next few months, seasonal considerations aside. But about four times as many firms intend to decrease their inventories as intend to increase them.

2. Larger firms, particularly among durable goods producers, show a greater tendency to want to decrease inventories.

3. Half of the firms intending to alter their inventory positions expect the change to be substantial.

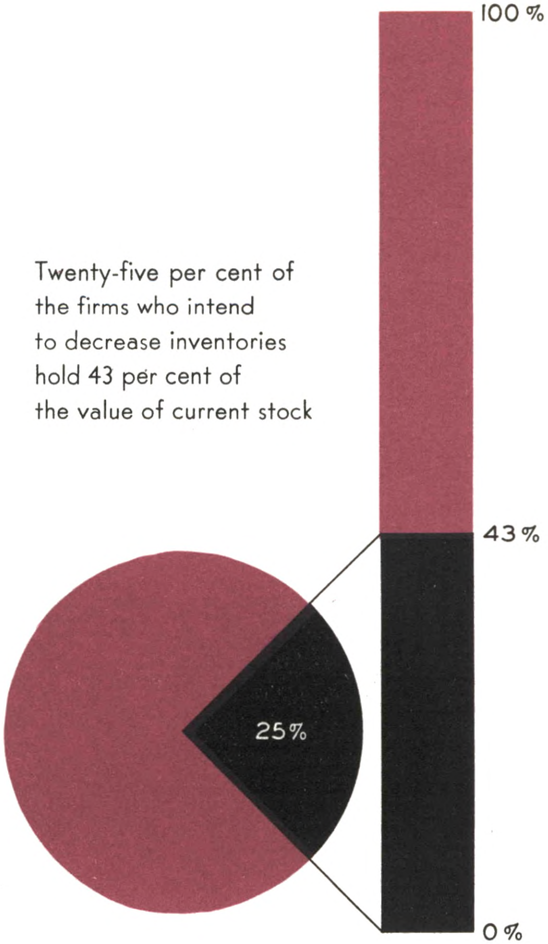
4. The most frequent comments made by producers expecting to decrease inventories have to do with slackening business and a now plentiful supply of raw materials.

Most say present levels are right

Of the 461 manufacturers replying to our questions, 319 or about 69 per cent, intend to maintain inventories at present levels except for normal seasonal changes. But 116 firms or 25 per cent plan to draw down stocks, and only 26 firms expect to increase their inventories. This seems to indicate that a clear majority of the producers surveyed are satisfied with their current inventory positions or are at least adopting a "wait-and-see" policy for the next few months. On the other hand, of those intending to change their inventory policies, the ratio is better than four to one for a decrease.

. . . but many of the larger durable goods firms are cutting down

In analyzing manufacturers' inventory intentions, as revealed in the survey, two additional observations are important from the standpoint of potential effect on aggregate demand. First, durable goods producers intending to decrease inventories have a more than proportionate share



of current inventory holdings. That is to say, they have been the big accumulators of stocks in the recent past. Second, nearly half the producers planning to decrease their inventories say the change will be substantial.

There is a fairly sharp cleavage between manufacturers of durable and nondurable goods. About 30 per cent of the durable goods producers, holding 64 per cent of durable goods stocks, say that they are going to draw down their stocks over the next three months. On the other hand, 21 per cent of the manufacturers of nondurables, who hold 13 per cent of total inventories of this group, predict a short-run decline in their stocks. Over-all, 25 per cent of the firms surveyed who expect a decline in inventories hold 43 per cent of current stocks; whereas the small group of producers who expect to enlarge inventories, at present hold a less than proportionate share of total inventories.

Roughly half of the manufacturers of durable and nondurable goods who expect a decline believe that the drop will be substantial. In other words, 12 per cent of the firms surveyed are going to decrease inventories substantially, as compared with about 3 per cent of the producers who intend to increase inventories substantially.

Apparel producers and transportation equipment makers most pessimistic

As the table shows, there are some fairly sharp differences in the inventory plans among manufacturers of nondurables. Within this group, for example, of the 24 printing firms surveyed, only two smaller companies intend to decrease inventories—and none substantially—as compared with three moderate-sized printing firms who are going to increase their stocks. Conversely, 10 of the 26 apparel producers answering our questions intend to allow their stocks to run off a bit. None, at the moment, intends to increase its stocks.

Industrial classifications on the durable goods side show much less difference of opinion. The percentage of firms intending to allow inventories to decline varies between 44 per cent for transportation equipment manufacturers and 26 per cent for electrical machinery makers, and in no durable goods industry group are there more firms who plan to increase stocks rather than decrease them.

PERCENTAGE DISTRIBUTION OF MANUFACTURERS' SHORT-RUN INVENTORY PLANS

	No Change	Increase	Decrease
All manufacturing	69	6	25
Durable goods	64	6	30
Nondurable goods	74	5	21
Food and tobacco	85	10	5
Textiles	64	4	32
Apparel	62	—	38
Lumber and furniture	79	—	21
Paper	77	4	19
Printing and publishing	83	10	7
Chemicals	78	7	15
Petroleum and coal products	100	—	—
Rubber and leather	76	5	19
Stone, clay, and glass	73	—	27
Primary metals	64	8	28
Fabricated metals	57	8	35
Machinery (excluding electrical)	62	5	33
Electrical machinery	65	9	26
Transportation equipment	50	6	44
Miscellaneous	72	4	24

Business activity and inventories: cause and effect

Most of the manufacturers who are decreasing inventories point to an expected worsening of business conditions as a cause. Comments such as "customers aren't buying," "falling prices," or "inventory too high for anticipated sales" are typical. Next to these comments, the most frequently used reason for decreasing stocks has to do with the now plentiful supply of raw materials. Apparently, for the past two years or so when raw material shortages were characteristic in many industries, producers over-bought in order to provide an adequate supply and insure uninterrupted production. With normal supply lines now feeding in raw materials, the need for this extra buying has diminished.

On the plus side, most of those who plan to increase inventories give as their reason rising sales which warrant larger stocks. The next most important cause for firms to increase inventories is new products. A small minority of firms expects some involuntary increase in inventories. These are going to continue purchasing stocks at the present rate, but expect a temporary slowdown in sales.

Over-all, nine out of ten of the 116 manufacturers who intend to decrease inventories, and three out of four of the 26 who intend to increase inventories are doing it as a reflection of current business activity or a prediction of future sales volume. It is well to remember that their aggregate action will help to determine business levels as well as reflect their individual estimates of these levels.

INDUSTRY LOOKS AT EMPLOYMENT

Manufacturers in the eight-county area plan little change in employment over the next six months. There may be some cutbacks in certain "hard goods" industries which have expanded their work forces tremendously in the past year, but these will be offset to some extent by increased employment in "soft goods." Over-all, it looks as though September's employment of 617,100 in manufacturing may be shaved a fraction—eight-tenths of a per cent—by next spring.

This outlook for industrial employment is based on estimates received from 500 firms which participated in our current survey of capital expenditures and inventories. They employ more than half of all workers in manufacturing in this area.

From September 1952 to September 1953, 15,000 workers were added to the payrolls in this area. Since the Korean outbreak, 90,000 have been added to work forces. It is estimated that a substantial part of this added employment has come as a direct or indirect result of Government spending for defense purposes. At the moment there is reason to look forward to reduced defense spending. The economy appears to be facing a period of slow transition away from near war-time footing. This survey indicates that for the next six months, the transition will be a smooth one.

Almost half of the reporting firms anticipate no change in manpower requirements. Nearly one in three companies surveyed expects to increase employment, and the remainder—about 20 per cent—think their employment will decline. The decreases, however, are somewhat larger than the increases, so that employment, which stood at 617,100 in September, may drop 1900 by December and 4900 by March.

Three industries, transportation equipment, primary metals, and fabricated metals—all heavy industries—foresee a cut of 8200 in their forces by March. Of this cut, 5400 will come from transportation equipment industries. About half of the reporting firms in transportation equipment expect to reduce their forces by next March. About 40 per cent in primary metals and 25 per cent in fabricated metals expect to take similar actions. These declines, if they take place, would still leave these industries, in the aggregate, with 4800 more workers than in September 1952 and 38,600 more than at the start of the fighting in Korea.

ESTIMATED EMPLOYMENT IN THE PHILADELPHIA METROPOLITAN AREA

(000's omitted)

INDUSTRY	September 1953	December 1953	March 1954	Percent. distribution Sept. 1953
All manufacturing	617.1	615.2	612.2	100.0
Durable goods	312.3	309.4	305.7	50.6
Nondurable goods	304.8	305.8	306.5	49.4
Food and tobacco	55.9	56.8	55.9	9.1
Textiles	55.9	56.0	56.9	9.1
Apparel	60.4	60.3	60.8	9.8
Lumber and furniture	9.3	10.0	10.1	1.5
Paper	21.9	22.0	22.0	3.5
Printing and publishing	33.8	34.0	33.5	5.5
Chemicals	37.4	37.3	37.7	6.0
Petroleum and coal products	24.2	24.2	24.3	3.9
Rubber and leather	15.3	15.2	15.4	2.5
Stone, clay, and glass	13.2	13.1	12.9	2.1
Primary metals	38.3	37.2	36.5	6.2
Fabricated metals	49.7	48.9	48.7	8.1
Machinery (except electrical)	48.9	49.4	50.1	7.9
Electrical machinery	60.8	61.3	62.0	9.9
Transportation equipment	58.8	56.9	53.4	9.5
Miscellaneous	33.3	32.6	32.0	5.4

On the other hand, machinery and electrical machinery manufacturers plan to increase work forces by about 2400 over the next six months. These and other small changes within the durable goods sector will work to partially offset the employment reduction planned by transportation equipment, primary metals, and fabricated metals makers. For the durable goods industries as a whole, however, employment is expected to decline by 6600 by March.

Nearly all of the industrial classifications within the nondurable goods group plan to increase employment slightly over the next six months. Textile manufacturers, who intend to hire about 1000 workers by next March, lead the list. The printing and publishing industry is the only nondurable group which foresees a decline in employment. It is estimated that total employment in nondurables will show a gain of 1700 by March.

CURRENT TRENDS

Someone with a sense of humor summarized the business outlook: *business, look out!* Yet, quite recently, excellent earnings reports, a rising stock market, and generally good business have produced optimistic comments on the outlook, despite some impending trouble spots. This optimism comes as a refreshing contrast to recurring predictions of readjustment.

In fairness, though, it should be recognized that almost all those who foresee a downturn emphasize that the decline will be slight. They are not really pessimistic. When pressed, they might say that the decline in industrial production should be no greater than 15 per cent, and very probably less.

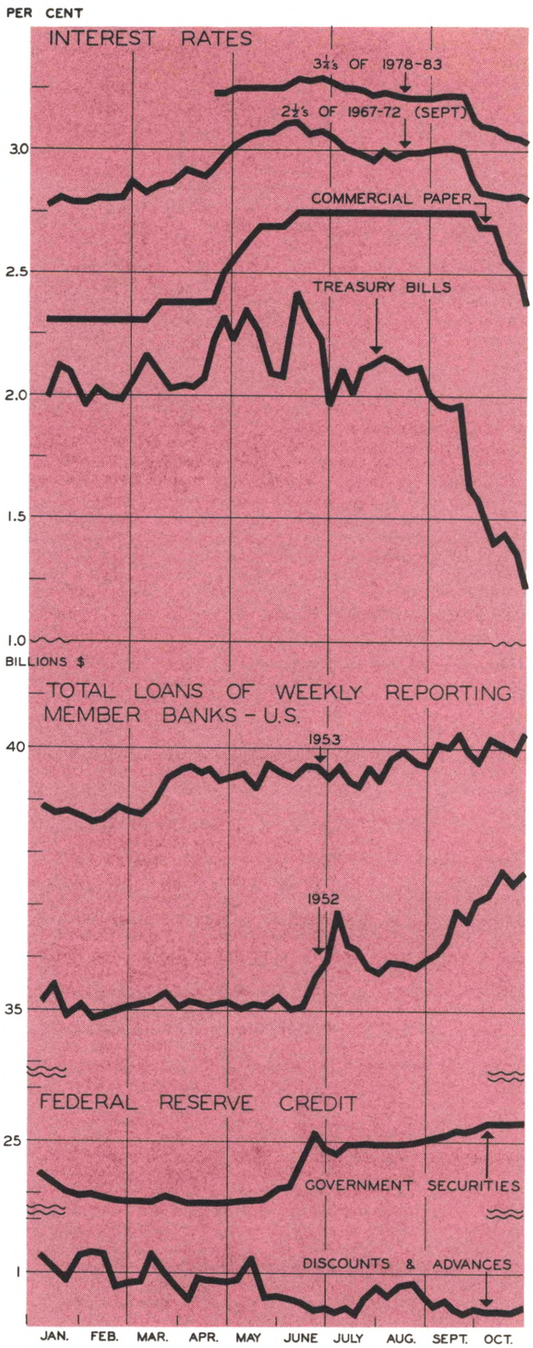
The following table is presented to give a rough idea of the relative size of those recessions (or depressions) which most of us can remember. It may help to put into perspective the downturn which many observers are now predicting. These figures show the percentage declines in a few major indicators during four periods.

	1921	1932	1938	1949
Personal income . . .	n.a.	51%	12%	5%
Mfg. employment . .	31%	45	23	14
Ind. production . . .	33	54	33	17
Wholesale prices . .	44	40	15	8
Stock prices	32	85	44	17

Note: Percentage declines were measured from peak to trough and do not necessarily constitute the same time periods in each case.

A drop of 15 per cent in industrial production, although it seems large, would be a little less than the decline during the 1949 downturn. It would be less than half the decline in the 1921 and 1938 recessions and, of course, much less than the drop during the Great Depression.

But we have come a long way since 1949.



The economy is now operating on such a high level that declines of 1949 magnitude would still leave us better off than at any other time in our history except for the past few years. Judging by most of the indicators in the table, we would be about back to where we were at the time of the Korean outbreak—at the crest of the post-war boom. Industrial production, wholesale prices, manufacturing employment, stock prices, would be at mid-1950 levels. Personal income and gross national product would be even better—a little higher than they were in the third quarter of 1952.

This is not a forecast, of course, and it is unrealistic to assume that 1949 history would repeat. But even rough figuring like this suggests that if a readjustment is ahead, it may involve a readjustment of our concept of "good business" as much as anything else.

A glance at the money market

Business has been slow to confirm the predictions of a downturn, but changes have taken place rapidly in one important area of the economy—in the money market. Interest rates reached a peak in early June. During the past five months, as the chart shows, they have declined substantially and rapidly, particularly since mid-September. The most precipitous drop has been in the rate on Treasury bills—at one time almost 2½ per cent and now 1.31 per cent. Yields on long-term Government 2½ and 3¼ per cent bonds have also dropped. Rates on prime commercial paper have followed the downward movement, as have Federal funds. The Federal Reserve discount rate remains at 2 per cent.

One of the reasons for the change has been that bank loans have not risen as much as expected. Last year, loans of weekly reporting member banks started to go up around the end of July. This year they started to climb at about the same time, but thus far their increase has amounted only to $1.4 billion as compared with $2.5 billion in the same period of 1952.

Another reason for the change in money rates is that the Federal Reserve has been increasing its holdings of Government securities. The System has bought off and on since last May. These reserves are in addition to those freed by the reduction of reserve requirements in July. The volume of member bank borrowing from the Federal Reserve Banks has remained fairly low.

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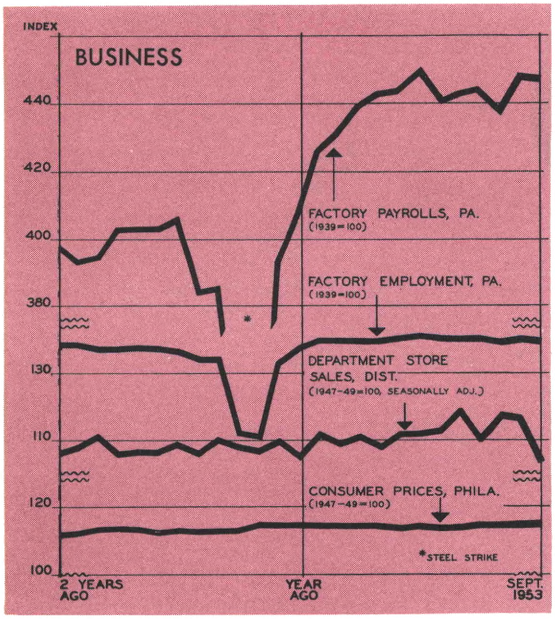
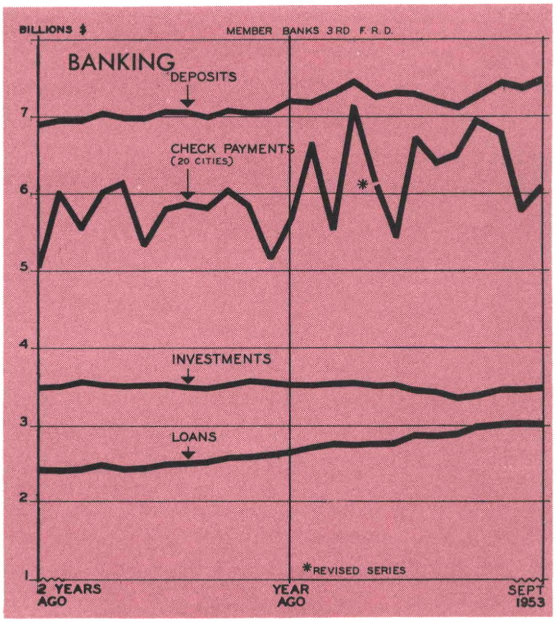
FOR THE RECORD...





SUMMARY	Third Federal Reserve District, Per cent change: September 1953 from mo. ago	Third Federal Reserve District: September 1953 from year ago	Third Federal Reserve District: 9 mos. 1953 from year ago	United States, Per cent change: September 1953 from mo. ago	United States: September 1953 from year ago	United States: 9 mos. 1953 from year ago
OUTPUT						
Manufacturing production	− 1*	0*	+ 8*	− 1	+ 2	+12
Construction contracts‡	0	− 4	+12	− 3	0	+ 3
Coal mining	+10	−27	−17	+ 7	−15	− 6
EMPLOYMENT AND INCOME						
Factory employment	− 1*	+ 2*	+ 7*	0	+ 2	+ 7
Factory wage income	0*	+ 7*	+17*	.....	.....	.....
TRADE**						
Department store sales	−11	− 2	+ 4	− 5	− 2	+ 3
Department store stocks	0	+ 8	.....	− 2	+ 7	.....
BANKING (All member banks)						
Deposits	+ 1	+ 4	+ 4	+ 1	+ 4	+ 4
Loans	0	+13	+14	0	+13	+14
Investments	+ 1	− 2	− 2	+ 1	− 2	− 2
U.S. Govt. securities	+ 1	− 2	− 3	+ 1	− 2	− 3
Other	0	0	+ 1	0	0	+ 1
Check payments	+ 5§	+ 9§	+11§	+10	+ 9	+ 8
PRICES						
Wholesale	.....	.....	.....	0	− 1	− 2
Consumer	0†	0†	+ 1†	0	+ 1	+ 1

*Pennsylvania †Philadelphia §20 Cities
**Adjusted for seasonal variation. ‡Based on 3-month moving averages.

LOCAL CHANGES	Factory*: Employment, Per cent change Sept. 1953 from mo. ago	Factory*: Employment, year ago	Factory*: Payrolls, mo. ago	Factory*: Payrolls, year ago	Department Store: Sales, mo. ago	Department Store: Sales, year ago	Department Store: Stocks, mo. ago	Department Store: Stocks, year ago	Check Payments: mo. ago	Check Payments: year ago
Allentown	0	−1	+1	+ 1	.....	.....	.....	.....	+ 5	+11
Harrisburg	0	0	−1	0	.....	.....	.....	.....	+ 5	+ 1
Lancaster	0	+8	−2	+13	+ 5	−1	+10	+ 6	+ 7	+ 3
Philadelphia	0	+2	0	+ 8	+31	−3	+ 9	+ 8	+ 5	+10
Reading	−2	−1	−6	− 2	+ 6	−5	+ 9	+ 7	+ 3	+15
Scranton	0	−1	+2	+ 5	.....	.....	.....	.....	0	− 7
Trenton	−1	−1	−3	− 1	+26	−3	+ 4	0	− 1	+12
Wilkes-Barre	0	0	−2	− 3	− 1	−1	+ 6	+ 2	+ 4	+16
Wilmington	0	+7	0	+ 9	+25	−2	+12	− 2	+27	+ 4
York	0	+8	−3	+18	−11	+5	+ 7	+10	− 9	+18

*Not restricted to corporate limits of cities but covers areas of one or more counties.