

business review



FEDERAL RESERVE
BANK OF
PHILADELPHIA

STATE AND LOCAL GOVERNMENTS UNDER PRESSURE

Spending often exceeds revenue, and debt increases. This sums up the situation as governments in the Third District states strive to meet a strong popular demand for their services.

A FORESIGHT SAGA

These are busy days for business forecasters. Over the years, the technology of forecasting has improved but the foreseeable future remains unforeseeable. Forecaster! What of 1958?

CURRENT TRENDS

Business activity has increased less than seasonally this fall. Nevertheless, our merchants look for a good Christmas season.

*Additional copies of this issue are available
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Federal Reserve Bank of Philadelphia,
Philadelphia 1, Pa.*

STATE AND LOCAL



GOVERNMENTS UNDER PRESSURE

A Brief Look at Some Problems Confronting Governmental Units in the Third District States

The school board had another stormy meeting. The question of the new building came up again and it touched off a controversy.

“Our present school is too small to accommodate all the new children in our neighborhood,” the principal spoke out. “We have to build another—and soon.”

Then the treasurer rose to his feet. “What you say is true, sir. But how are we going to pay for a new building? Ends barely meet as it is and we still owe a lot of money on the gym we built in 1953. We’ll have to have higher taxes before we take on anything more.”

“Wait a minute! I don’t think the public will stand for that,” interjected a third member. “We’ve already raised taxes twice and people are beginning to grumble.”

And so it went. The board had a tough problem. It badly needed something it didn’t know how to pay for. Small consolation, perhaps, but the board’s problem is a typical one. It is faced, these days, by governmental units at all levels.

The Federal Government’s budgetary problem has been in the limelight all year. State and local governments, however, have been pinched at least as much—if not more.

While the headlines tell of Washington, state and local operations have been quietly growing in importance throughout the postwar years. The latter expenditures, as a per cent of gross national product, have risen from under 5 per cent in 1946 to almost 9 per cent today. In the same period, state and local spending has jumped from 18 to 36 per cent of all Government outlays.

With this growth has come a full share of financial pains and problems. The following chart illustrates the pressures on public pocketbooks in the Third District states of Delaware, New Jersey, and Pennsylvania. Since 1953, state and city expenditures have exceeded revenue. Governments have been spending more than they take in, and they have gone into debt to do it.

BY POPULAR DEMAND

State and especially local governments are close to, and intimately concerned with, their people. They provide services that benefit the public directly. Roads, schools, police and fire protection, and water facilities may be more prosaic than foreign aid or missiles, but they are also more personally practical.

So to find the reasons behind the increased demand for state and local services in the Third District states (as elsewhere), we have to look primarily to the people themselves.

In the first place, there are more people for governments to serve. Population in our three states has risen by about one-fourth since 1946. But it is more than just increased numbers. Per capita income is higher—up 69 per cent in 10 years. People are living better and they expect more—feel they can afford more—from state and local governments.

As we have already indicated, the need for spending on schools is great. The sustained baby boom has swollen enrollment by an average of 27

per cent in the three states since the war. Classrooms are bulging as each fall has brought a record turnout of scrubbed, scared, first graders.

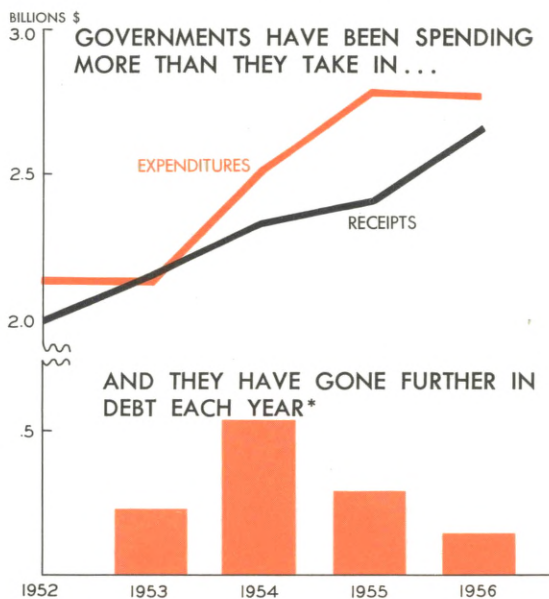
People are moving more now than they ever did. Here, two distinct but related trends stand out—the shift from the farm to the city and from center city to the suburbs.

These population movements have had a heavy impact on local governments. Cities are strained by the influx of migrants from the country. These people, seeking or learning new jobs, are generally at the bottom of their earning capacity. As a group, they are likely to require more from, and contribute less to, local governments than the long-time residents.

In the suburbs, with “split levels” and “ranchers” springing up on every postage-stamp lot, local governments are equally hard pressed. They find

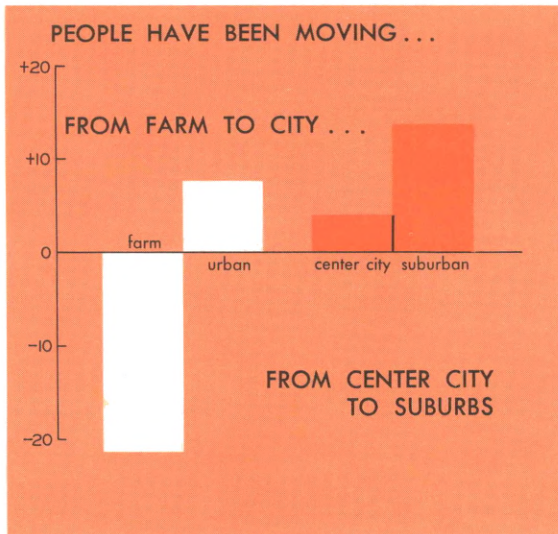
THE PINCH ON PUBLIC POCKETBOOKS

Data for state and city (over 25,000 population) governments in the Third District States

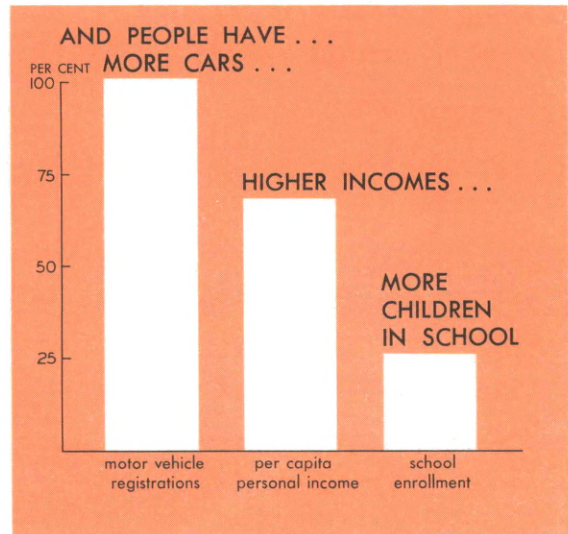


* Annual increase in debt outstanding

THE PUSH BEHIND STATE AND LOCAL SPENDING IN OUR THREE STATES



States of Delaware, New Jersey and Pennsylvania. Percentage population change—1940 to 1950 census



States of Delaware, New Jersey and Pennsylvania. Percentage increase 1946-1956

they suddenly must provide a whole spectrum of services for their new commuting legions.

The automobile is both symbol and substance of the strong demand for state and local services. It has come to stand for increased income and suburban living. In a concrete way, however, the automobile itself has helped to drain government treasuries. In the three-state area, the number of motor vehicles has doubled in the last 11 years. This extra traffic means that new roads have to be built and existing ones wear out faster.

Other factors, too, have forced up state and local spending. Inflation has played a part; so has improved technology that makes things better but more expensive. The stuttering pace of building during the depression and World War II created a backlog of worthwhile projects that had to be whittled down. But the pressures from the people that we have mentioned have been primarily responsible. They also have determined the pattern

of spending, or “where the money goes.”

Third District state and large city expenditures seem to have leveled off during 1956. (See chart, page 4.) Yet it would be unrealistic to assume that the pressures have abated. The absence of an increase last year is probably a temporary breather—due in part to the high cost of borrowing—rather than a basic change in demand.

In fact, the pressures on state and local spending will probably intensify in the years ahead. Long-run national estimates call for more of everything and surely our three states will trend in the same direction.

The question is: how will governments meet this demand? It is a vital question, one that eventually could threaten their role, for the public will brook no failure. If state and local governments can't or won't meet these needs, the people will call on the Federal Government to take over.

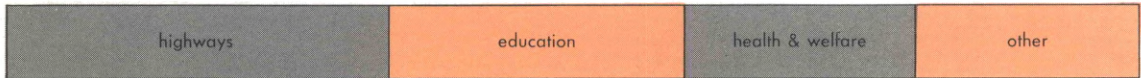
The answer for state and local governments is,

IN THE THIRD DISTRICT STATES:

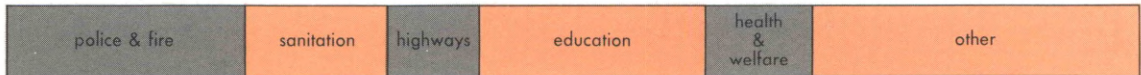
WHERE THE MONEY GOES

Percentage distribution of general expenditures

STATE GOVERNMENTS



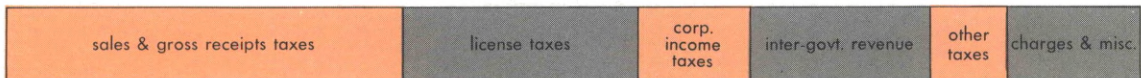
LARGE CITY GOVERNMENTS



WHERE IT COMES FROM

Percentage distribution of general revenue

STATE GOVERNMENTS



LARGE CITY GOVERNMENTS



Both uses and sources of state and local funds have a strong popular flavor. Much of the money is spent on things people can see, use, and appreciate—highways, schools, and sanitation, etc. People also supply the bulk of their governments' revenue by paying taxes, charges, and fees.

at once, both simple and complex. It is simply stated—"raise more money." It becomes complex when the words "where" and "how" are added.

Let us look at the "where" and "how" for state and local governments in the Third District states. Of course, these governments differ widely. State laws are different and many local situations are unique. We'll have to discuss the state-wide averages, and what we say may well not apply to specific communities.

Excluding Federal grants and aid, there are only two ways state and local governments can get the money they need—"earn" it themselves (current revenue) or borrow it from someone else.

THE ABILITY TO "EARN"

Basic revenue for state and local governments

comes either from the people and firms within the state or higher governmental units. The split for our state governments is currently about 88 per cent internal, 12 per cent Federal. Since we are interested in the ability of our three-state economy to support state and local government we'll ignore inter-governmental transfers and concentrate on internal sources.

We must, however, have complete revenue figures for all our local governments. To get them we have to go back to 1953 when the Census Bureau made a special study.

Using these data, how do our three states measure up? How much revenue do our governments take out of the local economies, and how does this compare to the national average?*

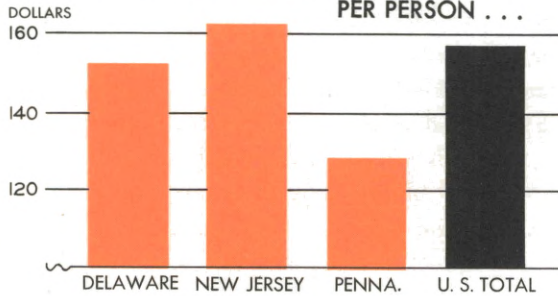
*In the following analysis Federal income tax payments are omitted on the assumption that they are roughly proportional to income.

In Pennsylvania, state and local governments took \$129 of general revenue from each man, woman and child during 1953. The Delaware figure was \$153. Both states were below the national average of \$157. In comparison, each New Jersey citizen contributed \$6 more than the average.

Revenue figures, however, become more meaningful when related to the potential of the population to provide revenue. This is done in the following chart which shows the proportion of individual income which goes to state and local governments. All of the Third District states fall below the na-

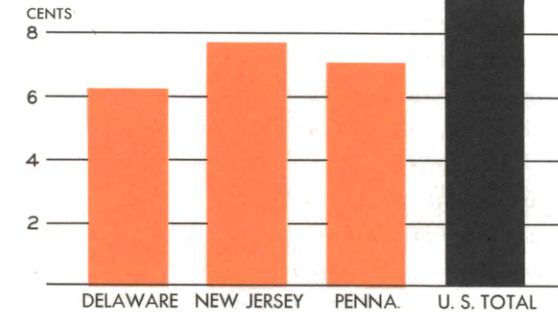
THE FINANCIAL BURDEN OF OUR GOVERNMENT WAS RELATIVELY LIGHTER . . .

WHETHER REVENUE WAS FIGURED PER PERSON . . .



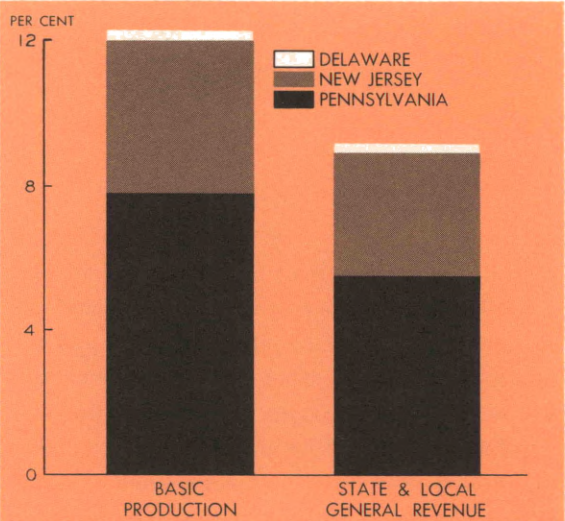
1953 per capita general revenue (own sources) of state and local governments

OR PER DOLLAR OF INCOME



1953 general revenue (own sources) of state and local governments per \$1.00 of resident individual income

PRODUCTIVE CAPACITY AND STATE AND LOCAL REVENUE



We have constructed a measure of basic manufacturing, agricultural, and mineral production. The Third District States account for over 12 per cent of the national total. On the other hand, state and local revenue in the three states amounts to about 9 per cent of the U. S. figure.

tional average. In other words, state and local revenue takes a smaller share of income here than it does in the nation.

Let us shift our analysis from income to basic productive capacity. We have constructed a measure of output which includes value added by manufacture, value of farm products sold, and the value of mineral production for 1953. The Third District states account for more than 12 per cent of total production of the United States. Yet our state and local government revenue is only about 9 per cent of the national figure.

People at work generate much of the capacity to support governments. Therefore, the percentage of the population of working age should be significant (barring short-run differences in levels of unemployment). In this category, too, the Third District states show up favorably. All three have a

higher-than-average percentage of their total population between the ages of 17 and 65.

**PER CENT OF TOTAL POPULATION
BETWEEN 17 AND 65 YEARS
1955**

New Jersey	61.1%
Delaware	59.4
Pennsylvania	58.9
United States	57.1

Most of the figures we have been using are several years old and much can change in that time. There is some evidence that the spread between actual revenues of our governments and our ability to produce revenue, relative to the nation, has narrowed. Up-to-date figures on states and cities having over 25,000 population indicate that the three-state share of national revenue is virtually unchanged from 1953 to 1956. On the other hand, Third District personal income and value added (revenue supporters) have not increased as fast as the national figures.

It looks as though our state and local governments have been making more use of their revenue potential in the last three years—but only slightly more. Undoubtedly, the ratio of actual to potential revenue in Third District states still trails the nation by a significant margin.

Of course, just because other governments take a certain proportion of income is no reason why we should here. We have only tried to show comparisons. We make no attempt to indicate what is the proper proportion.

BUILDING “ON TIME”

What if state and local governments need something expensive that they can't afford out of current revenue or savings? What do they do then? In many cases, they buy on the instalment plan. They borrow money, build or buy what they need, and pay for it in the future.

Borrowing makes sense, too, for it enables gov-

ernments to provide necessary facilities quickly and pay for them while they are in use and generating revenue.

There are several different kinds of limitations on how much our governments can rely on borrowing in the future. Some governments have placed a ceiling on the interest rate they or their subordinate units may pay. An illustration is the state of Delaware whose public issues are limited to 3 per cent. In periods of tight money these restrictions could prevent some governments from borrowing.

There also are legal limits on the total amounts governments may owe. If you were to read the body of the Pennsylvania constitution, for example, you would find that the state's . . . “debt created to supply deficiencies in revenue shall never exceed in the aggregate, at any time, one million dollars.” The same document restricts municipalities' outstanding debt to 7 per cent of the assessed value of their taxable property.

Debt limits have undoubtedly put a crimp in borrowing ability. But there are ways to get around them.

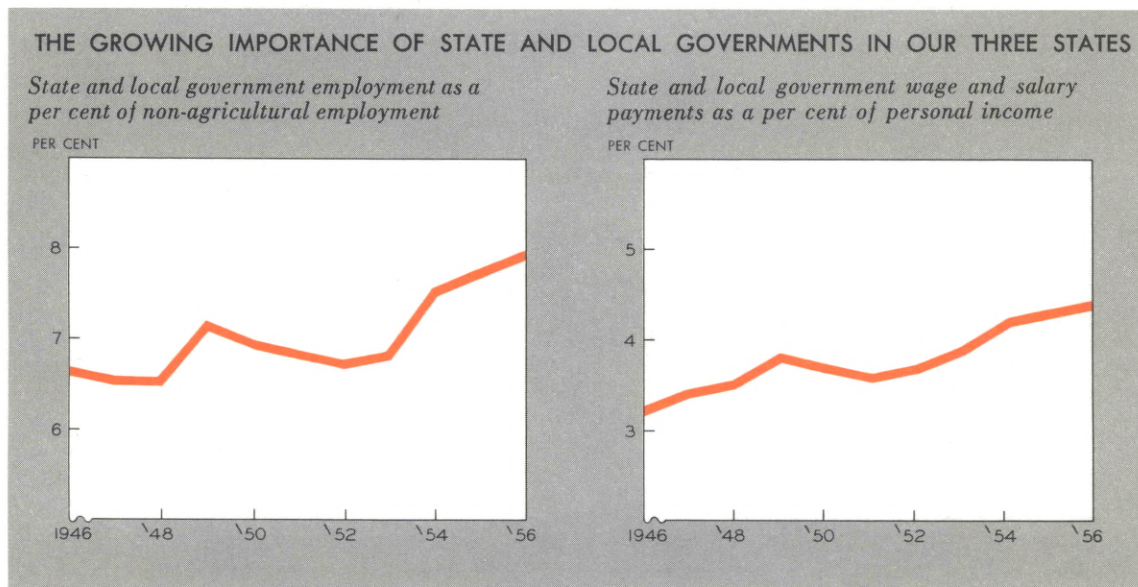
If you looked at the amendments to the Pennsylvania constitution you would see that the state debt limit has been lifted 6 times—most recently to pay a bonus to veterans of the Korean conflict. In all, general obligations of the state now total about \$350 million. Amendments, however, require voter approval. There is another method for both state and local governments to circumvent debt limits and it works like this:

The state legislature passes a law which permits the creation of a special type of governmental unit called an authority. The authority is usually given one specific job to do—building a school or a turnpike, operating a parking lot, etc. It also gets a related source of revenue such as school taxes, turnpike tolls, etc.

The authority is now in business. It can borrow against its anticipated income to build the facilities it needs. The authority's debt is secured by its revenue, not by the "full faith and credit" of its creator. Thus the authority's debt does not count against existing limits.

The majority of state governments now have authorities of one type or another and the idea is

rowing, therefore, is how well they can make repayments. This, in turn, depends in large measure on their capacity to generate future revenue. Our governments typically borrow by issuing long-term bonds—bonds which must be repaid over many years. Investors are attracted to these securities only if they are backed by a solid, sustainable income source.



spreading fast among municipalities.* Pennsylvania is the nation's leading exponent of municipal authorities with over 1,100 now active. More than three-fourths of this total have been chartered since 1950.

Even if all legal restrictions suddenly were abolished, state and local governments could not borrow unlimited amounts. Since they have no money presses they have to line up in the capital market with all the other borrowers. And they are judged, like corporations and individuals, by their ability to repay out of income.

The most effective limit to state and local bor-

*We plan to deal more thoroughly with the subject of authorities in a future issue.

Thus, the two sources of money, "earned" revenue and borrowings, are closely related, and the basic one is revenue.

SHAPING THE FUTURE

Lincoln's famous words "of the people, by the people and for the people" are pointedly descriptive of state and local governments.

"For the people" these governments provide practical services. And popular demands for these services have put strong new pressures on our governments to spend.

We have barely touched on the problems these

pressures have created. It is clear, however, that the problems will continue and that solutions won't be easy.

Important decisions must be made and, in the last analysis, the public must make them. The bulk of state and local revenue is derived "of the people." In other words, the beneficiaries of state and local services also must pay for them. The public must decide if they want the services badly enough to foot the bill. Will they tolerate poor schools and rutty roads in order to shave taxes or are they willing to put up the money for the best?

Each citizen must decide for himself. Once he makes up his mind, there is much he can do. Governments on the state and particularly the local level are run more literally "by the people." The butcher, the baker and the candlestick maker can serve on committees, drum up voter support or even run for local office and they can often see the results of their efforts in government action.

Solution to problems described here depends on the residents of our three states. Only time will tell what they decide to do and how successful they will be.

THE CRAZY-QUILT PATTERN OF STATE AND LOCAL GOVERNMENT

States are masters in their own homes. They hold sway over all matters of internal importance. While retaining over-all control, states have delegated part of their authority. They have created a varied pattern of local governments to which they have given a considerable degree of home rule.

The following table shows the types and numbers of local governments in the Third District states.

Counties:	Municipalities:	Townships:
Delaware 3	Delaware 49	Delaware none
New Jersey 21	New Jersey 333	New Jersey 233
Pennsylvania 66	Pennsylvania 991	Pennsylvania 1,565

According to the census definition, townships differ from municipalities in that they serve inhabitants of a defined area without regard to population concentrations. Municipalities, on the other hand, serve specific population concentrations.

School Districts: (Classified as Independent Governmental Units)	Special Districts: (Port Authorities, Sewage and Water Districts, etc.)
Delaware 15	Delaware 64
New Jersey 489	New Jersey 138
Pennsylvania 2,417	Pennsylvania 34

In addition to the five basic types of governments listed above, there are a number of subordinate agencies or areas on both state and local levels. They include the numerous state and municipal authorities and deal with tasks ranging from turnpike operation to shade tree protection.

A FORESIGHT SAGA

Soon after the trees lose their resplendent fall colors, after the last wisps of smoke from thousands of suburban piles of smoldering leaves have disappeared, after the cheering and shouting have died down in the great football bowls, after the merchants have converted heavily loaded shelves of Christmas joys and toys into accounts receivable—comes the inevitable business forecasting season. It is hallowed by tradition. That's when new calendars are brought out and farmers' almanacs appear.

Business forecasting is not a science; neither is it an art. It is a hazard; but it is an unavoidable hazard. Forecasting takes place—consciously or unconsciously—when a merchant decides to let his inventories run off, when a manufacturer expands his labor force, when the utilities executive builds another power plant, or when the banker makes a loan.

As business becomes increasingly complex and more highly specialized, forecasting becomes more important and at the same time more demanding. The professional forecasters—those who make forecasting their business—have made considerable progress, perhaps more than is generally appreciated, but their mistakes are likely to be remembered longer than their achievements.

ACHIEVEMENTS OF OUR PREDECESSORS

The best forecasting record we know of is Joseph's. He predicted a 14-year cycle. Sure enough, there were seven years of prosperity followed by seven years of depression. So great was the regal faith in his prediction that he was made prime minister of Egypt and distributor of the country's G.N.P. (Gross National Product). That was about 1700 B.C.

The weather

The ensuing 3500 years seem to be the Dark Ages of business cycles and business forecasting. Then, about 1878 A.D., Jevons, an Englishman, came up with a novel theory of business cycles. He observed a striking similarity between 10-year cycles of trade and the appearance of sunspots every ten years. That was based upon an analysis of English trade over the 157 years preceding 1878. Subsequently, solar disturbances and trade cycles parted company, whereupon faith in the sunspot theory waned.

A more recent weatherman was H. L. Moore, who made exhaustive studies of the U. S. Weather Bureau's records of rainfall in the Ohio River Basin, and he found short 8-year and long 33-year cycles of precipitation. Rainfall influences crop yields which, in turn, affect prices and business generally.

Contemporary with Moore was another weatherman—Huntington. He maintained that health is a cause far more than an effect of economic conditions. He claimed that high death rates regularly precede hard times, and a low death rate goes before prosperity.

There can be no doubt that the weather influences business, but the interrelationship has rarely been such that business forecasters could rely on barometric readings to prognosticate business.

The chartists

Meanwhile, the insatiable curiosity of man led numerous investigators to construct curves showing the rise and fall of certain "key" business activities like unfilled orders of the U. S. Steel Corporation, wholesale prices of commodities, industrial employment, etc. These experiments were

usually based upon a rational and reasonable theoretical foundation. For example, steel is a basic commodity in our highly industrialized economy. The largest producer is the U. S. Steel Corporation, and the company obligingly made available its unfilled orders, monthly. It made sense to infer that rising orders portend growing confidence and expanding business activity, and that falling orders foreshadow declining business activity.

Among the curve-men there were those who pinned their faith on a single curve; others used two or more curves in the hope that prospective changes in the business climate might be revealed by "leads" and "lags" in the ups and downs of the several curves plotted on grid paper.

The reader may recall that one business service utilized three curves: one to present purely "business" phenomena, like commodity prices; another to represent money phenomena; and the third to represent speculative activities like stock market prices. The reasoning behind this procedure was that, in the normal course of events, speculative activities precede business events which in turn precede monetary developments, as shown by such things as interest rates. Upon plotting the three curves on ruled paper over a period of years, it was observed that peaks and pits of the three lines maintained the same batting order and recurred at fairly regular intervals, thus confirming the theory. At last a reliable forecasting technique was thought to have been obtained. Why is the chart no longer published? In time, something went wrong; the technique broke down; it failed us.

G.N.P.

And still men kept on trying to develop a reliable method of business forecasting. Before all the curve-men gave up in despair (some are still operating) more and more current business information became available with the passing of time.

Utilizing the ever-growing data available, some of the country's ablest students developed what might be called a comprehensive business balance sheet, or the G.N.P. calculus. This is now so familiar and so widely used that we shall say only that it is not a forecasting device, but a most convenient body of systematized business information estimated on a quarterly basis by the U. S. Department of Commerce and available to any forecaster for use or misuse.

Like an automobile, G.N.P. is a bit intricate if one tries to take it apart but, also like an auto, it is deceptively simple and easy to operate. It is most convenient to public speakers with little time to prepare a talk on the business outlook. Estimates of gross national product are refined and revised periodically, but G.N.P. will not tell you the future of business. Nevertheless, the G.N.P. calculus is reasonably current and affords a remarkable body of business information which aids in the analysis of the current state of business. G.N.P. is a *tableau economique*, a tool, and its usefulness depends upon the skill of the operator. It is not a substitute for judgment, and its inventors never represented it for more than it is.

Model builders

A more recent development is economic model building where the mathematicians step into the arena. Based upon presumably firm, theoretical underpinning, utilizing generous gobs of business data, neatly fitted into a brace of simultaneous equations, the mathematically trained economist or the economically minded mathematician builds a model and solves for the unknown quantity X—the business outlook. Faith in this approach probably varies inversely with one's knowledge of mathematics. Certainly, the mathematicians themselves fully appreciate the limitations of models, and no claims of infallibility have come within the

range of our hearing.

16,000 additions a second

Then came the electronic computer that can perform more than 16,000 additions a second. What a boon to the model builders! More data and bigger equations can be fed into this lightning-fast calculator, and before you can say "Wesley C. Mitchell" the miracle machine supplies an answer.

The chief virtue of these machines, as we understand them, is their unbelievably fast speed. They are not really precocious nor are they prescient. They require the most minute instructions, but once properly instructed and fed with the right numbers, they gallop to an answer with the speed of light (186,000 miles a second, or thereabouts). Within one second these machines do as much work as an able slide-rule manipulator can accomplish in perhaps an hour or more.

Consequently, a model builder astride an electronic computer can really go places. If the first answer doesn't suit him, he can reload the machine with another set of assumptions and the pertinent numbers, and in a few minutes the machine flashes the answer, saving the operator several months of hard mental labor.

Alas, even this ultra modern attack on the age-old problem of business forecasting is not fool-proof. We have heard of electronically equipped model-building forecasters who achieved astonishingly accurate forecasts. They forecast G.N.P. within a small fraction of what subsequently turned out to be the actual state of affairs, in 1953 and again in 1954, but something went haywire in 1955.

Yes, indeed, we have learned much about the behavior of business over the years. We have the benefit of intensive study, careful scrutiny, and much theorizing by very able and highly respected predecessors and contemporaries. We have accumulated and are continuing to accumulate a vast

storehouse of facts—business facts—the behavior of people as producers, as entrepreneurs, and as consumers. By process of trial and error, we have greatly enhanced our knowledge of business cycles, but apparently there is a great deal more to learn.

We are reminded of a statement by Rodberg and Weisskopf, recently reprinted in the *Industrial Bulletin* of Arthur D. Little, Inc.: "The more the island of knowledge expands in the sea of ignorance, the larger its boundary to the unknown."

VISIONS OF OUR SUCCESSORS

Imagine

One may well ponder and wonder what will be the next step in man's effort to penetrate the enlarging boundary to the unknown. Perhaps, now that we have integrated data processing by electronics, we may be on the threshold of instant feeding into a giant computer every business transaction of the country, ranging from the purchase of a newspaper to the ordering of an aircraft carrier, as soon as each transaction occurs. Frankly, we are not sure how much better off the forecaster would be if the four-star edition of the newspaper reported each day freshly estimated G.N.P. numbers as of the close of business. It might please men of action who always seem just a bit annoyed when listening to a business roundup based on four- to eight-week old data. At present the professional forecaster cannot project business from today to a point six months hence. He does not know where we are today, so he must project from where we were, say, a month or two ago, to a given point in the future. Daily closings of G.N.P., like stock-market closing prices, would at least relieve the forecaster of the necessity of forecasting the past—the recent past.

On second thought, a daily G.N.P. summary might complicate, more than simplify, the job of

forecasting. Suppose G.N.P. closed last night at \$442.5 billion, down a fraction from the preceding night, and suppose further that this was the first downturn after several successive days of a bull market in G.N.P. Then there would be almost constant conjecturing as to whether we were entering a new phase of the business cycle. In the present state of affairs, such worries crop up less frequently.

Surely it must have occurred to you, as it has to us, what a catastrophe it would be if we were to succeed in forecasting business accurately. Suppose an economic Einstein were to come up with the formula, analogous to E equals MC^2 , that penetrates the heavy fog of the future of business. What a pickle we would be in! Naturally, businessmen would take appropriate action to profit by the advance knowledge available to them, and as a result the course of business in 1958 would be totally unlike that which it had been destined to be. We shudder to think what would happen. Business would be even less forecastable than it is now in our present state of imperfect knowledge.

THE INESCAPABLE PRESENT

Back to earth

In the absence of a miraculous formula or any other mechanistic device, the forecaster attempting to probe the business outlook for 1958 is forced to operate the best he can. He may gaze at a yard-and-a-half-long wall chart showing business fluctuations from 1836 through 1956 which portrays an irregular succession of good times and hard times. But what of tomorrow? Nature never repeats; no two business cycles are alike.

Or the prognosticator may turn to the November 1957 issue of the Federal Reserve Chart Book, containing 80 pages of charts covering all manner of business and financial statistics. The

Chart Book shows that the Federal Reserve Board's index of industrial production is now at a lower level than a year ago; the October B.L.S. index of wholesale prices (all commodities) was slightly below the August level; the rising index of consumer prices has apparently come to a halt; the downward 1957 trend of freight-car loadings is bringing no joy to the hearts of the railway executives; that for all the ads announcing special bargains, department-store sales are just about even with last year; that corporate profits after taxes have eased off a bit; the flow of personal income, long rising, recently turned down a trifle; that consumers are buying on the cuff at a faster rate than they are repaying instalment loans; farmers are somewhat better off this year than last year; securities prices on the New York Stock Exchange are down considerably from their mid-summer peak; and that G.N.P., which summarizes all business activity, when last reported (third quarter of 1957), was still rising.

"A prophet is not without honor . . ."

So the prognosticator scrambles for evidence of things with presumably prophetic value—businessmen's investment plans, for example. Some people believe that annual outlays for new plant and equipment, currently at a \$37 billion annual rate, are going to decline because the curve has developed an unmistakable plateau-like contour. Moreover, the McGraw-Hill survey of businessmen's plans for such spending next year shows a prospective 7 per cent decline. Our own survey of the Philadelphia area, reported in last month's *Business Review*, also shows a decline.

The flow of new orders likewise should have some barometric value, and numerous organizations probe this field of business activity. These surveys show a decline along with diminishing backlogs of orders.

Automobile production cuts quite a swath in our economy. New-car sales in 1958, according to *one* survey, will be between 5.5 million and 5.8 million cars compared with 5.8 million in 1956 and approximately 5.9 million in 1957. Moreover, the survey reports that a somewhat larger percentage of prospective buyers say their next car will be in the lower price group (under \$2,500).

Many of the foregoing observations have a pessimistic tinge, but before drawing your own conclusions, consider some additional ponderables and imponderables. Hitherto firm resolutions to cut back Federal Government defense expenditures have been challenged by Russian "satellites." Defense expenditures may go higher instead of lower. State and local government expenditures are almost sure to go higher. Outlays have been rising for years, and state and local governments still have huge amounts of unfinished projects.

One of the darkest and largest areas of 1958 is consumer spending. The Michigan Survey Research Center is currently probing this great no-man's-land to find out what consumers plan to do.

Recent reduction of the rediscount rate from $3\frac{1}{2}$ to 3 per cent by the Federal Reserve Banks is also generally interpreted as a development favorable to sustained or improved business activity. Money is no longer so tight as formerly and, as a result, residential construction may expand beyond current levels.

By this time it is apparent that the business forecaster has a bewildering array of knowns and unknowns to evaluate. By no means have all of them been mentioned. All one can hope to do

is to appraise the evidence and then make some assumptions. Assumptions must be made, for example, about the weather in 1958, the attitude of consumers (subject to change without notice), anticipated legislation with respect to taxes, tariffs, government expenditures, etc., the demands of labor unions (and some big contracts are coming up for renegotiation), and prospective changes in international tensions—not to mention business developments abroad. Our economy is not isolated.

The forecaster may also be influenced, consciously or unconsciously, by top-ranking economists, government officials, and business executives who frequently hold forth on the business outlook. Or his thinking may be influenced strongly by such publications as *Fortune* (monthly Business Roundup), *U. S. News and World Report*, or *Business Week*. *Fortune*, in December, made the observation that business is recovering from a case of jittery nerves. *U. S. News and World Report* expects 1958 to be a few notches better than 1957.

As we approach 1958, the business outlook is beclouded by certain irrefutable and disturbing facts—the falling away of new orders and the steadily declining backlogs of orders, the decline in weekly hours of industrial employment, the apparent growth of idle productive capacity, the shrinkage of profits, the disappointing growth in productivity, and a widespread disregard for some of the old-fashioned tests of business liquidity.

Or is business just "taking a breather"? Will increased expenditures for national defense, along with continued expansion in state and local government outlays and easier money be enough to turn the ebbing tide? The plaintiff rests.

CURRENT TRENDS

Business news since early fall has been somewhat less than reassuring. The leveling off process that started earlier has become increasingly pronounced in nearly all sectors of the local economy. All things considered, activity in the Philadelphia Federal Reserve District has not shown the expansion expected at this time of the year.

Among our major economic indicators, only building seems to be responding with a significant measure of improvement over late summer levels. In two areas especially vital at this season—manufacturing employment and department store sales—recent trends have been particularly disappointing.

At factories, a brief rise in employment was reversed after August when small declines developed in both heavy and light industry lines. Working time also decreased, with further cut-backs in over-time operations and in some instances a shortening of the regular workweek. In spite of continuing small advances in average hourly earnings, the weekly income of production workers has fallen a little below the level prevailing last summer.

In department stores, consumer spending ran above 1956 in almost every month through August. And in two months dollar volume on a seasonally adjusted basis set new records. But September and October business fell short of expectations by wide margins. Then, a late Thanksgiving permitting only two Christmas season shopping days, compared with the five in 1956, made the November sales picture look even more unfavorable.

Official sources blame part of the employment and income declines at factories on the epidemic

of illness that struck so hard in our area this fall. And some observers seem to think the same reasoning may apply in the case of department store sales, where shopper attendance fell off so sharply for a time. Whatever unusual factors were involved, the impact on business thinking has been depressing. Some further doubts have been expressed regarding future long-term trends—but of immediate concern are the implications for this 1957 Christmas buying season.

EARLY SEASON PROSPECTS

Holiday business has started under some handicaps this year. For one thing, a late Thanksgiving means shoppers have less time for shopping. If they exercise the traditional prerogative of just looking around for a while after the “Turkey Day” kick off, there also will be less time for buying. And the weather following that holiday has been giving our merchants plenty of cause to lament. The season was scarcely a day old when one of those low pressure “rain-makers” gave us the wettest Saturday we have had in a long time. Before anyone recovered his breath, the whole Delaware Valley and a lot of territory beyond was blanketed by heavy snow that reduced shopping activity to near the vanishing point.

Early season predictions for 1957 Christmas sales at retail stores throughout the country were made recently by the Department of Commerce. They indicated dollar increases over 1956 in 13 major cities throughout the country. Business was expected to show little or no change in 10 cities and might fall short of a year ago in 8 others. Philadelphia was among the cities where total Yuletide sales were expected to be better

than in 1956. The forecast said from 3 to 4 per cent better.

Although the over-all business picture in the Philadelphia Federal Reserve District contains more uncertainties than were present a year ago, our retail merchants are counting on another good Christmas buying season. However, few of them appear as optimistic as that forecast of a 3 to 4 per cent gain would indicate. We have asked department store executives in our major metropolitan areas for their impressions of early season business and for their expectations down to Christmas day.

In the experience of most stores, shopping will be less of a drawn-out affair this season. Buying in earnest started the day after Thanksgiving when some merchants reported the largest dollar volume in their store's history. But then bad weather set in, postponing many sales until later in the season.

We heard more comments on price consciousness than were mentioned in the course of last year's interviews. This was not too surprising, considering the almost uninterrupted advance in the over-all index measuring consumer prices. And in some areas the operations of discount houses specializing in gift merchandise were said to be offering especially stiff competition this year.

Gift merchandise has held the spotlight from the very beginning of the current season. Merchants are also encouraged by the interest in

some of the so-called "big-ticket" items including furniture, television, and appliances. Sportswear and sporting goods were moving in good volume at stores in most of our larger metropolitan areas. On a store-wide basis, toys seem to have picked up most. As one merchant remarked, "It looks like a very good year for the kids, even if some of the old folks have to be satisfied with a little less." Apparel lines have been somewhat sluggish, but in several areas the pace has quickened recently.

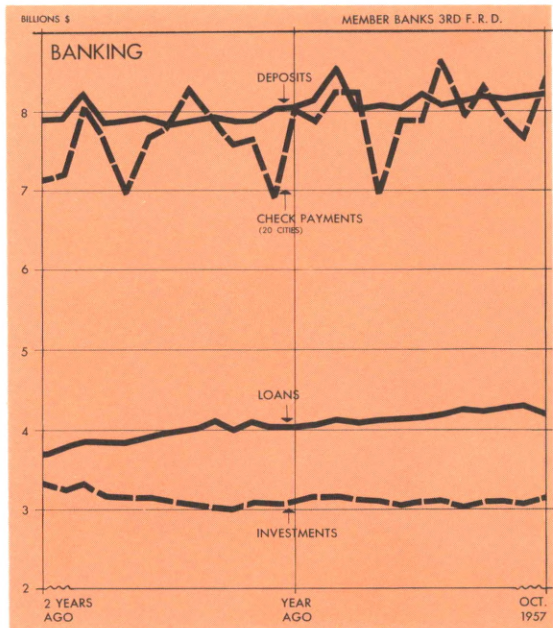
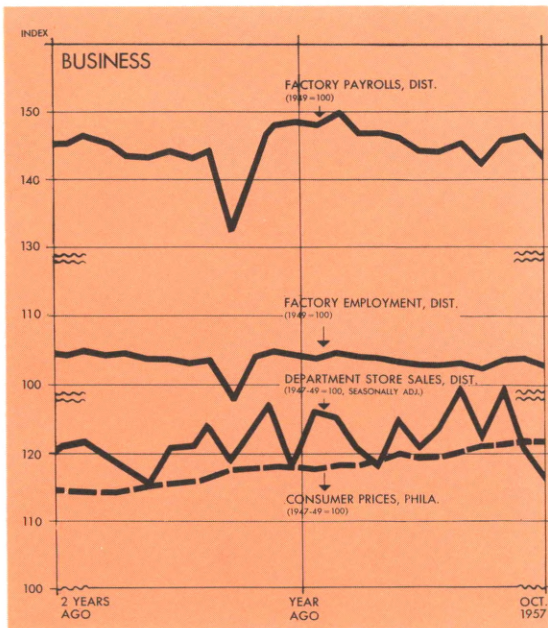
Merchants may count on mid-season promotionals more heavily to boost Christmas sales over the top in this year's shorter buying period. And, with a greater proportion of the holiday business falling in December, there seems to be a good prospect that the month's total may compare favorably with a year ago. All our merchants recognize the historical fact that Christmas sales have set new high records for two successive years. Many of them have indicated that to equal the 1956 figure will constitute a noteworthy achievement.

At this point, very few merchants are willing to commit themselves. They are quick to point out that a great deal of buying remains to be done in this Christmas season. And, as always, a buying rush or the lack of one in the closing days could swing the balance either way. About the most anyone would venture to predict was a small plus or minus in the 1957 season.



THIRD FEDERAL RESERVE DISTRICT

FOR THE RECORD...



SUMMARY	Third Federal Reserve District			United States			Factory*		Department Store		Check Payments	
	Per cent change			Per cent change			Employment	Payrolls	Sales	Stocks	Check Payments	
	October 1957 from		10 mos. 1957 from year ago	October 1957 from		10 mos. 1957 from year ago	Per cent change October 1957 from	Per cent change October 1957 from	Per cent change October 1957 from	Per cent change October 1957 from	Per cent change October 1957 from	
	mo. ago	year ago		mo. ago	year ago						mo. ago	year ago
OUTPUT												
Manufacturing production...	-2	-6	-3	+1	-3	+1						
Coal mining.....	-6	-14	-3	+1	-6	-2						
EMPLOYMENT AND INCOME												
Factory employment (Total)...	-1	-2	0	-1	-3	0						
Factory wage income.....	-2	-4	+2									
TRADE*												
Department store sales.....	-3	-1	+1	-6	-2	+1						
Department store stocks.....	-3	+3		0	+1							
BANKING (All member banks)												
Deposits.....	+1	+2	+3	-1	+2	+2						
Loans.....	-2	+4	+5	+1	+5	+7						
Investments.....	+2	+1	0	+3	+1	-2						
U.S. Govt. securities.....	+2	+1	0	+3	-1	-3						
Other.....	+3	+2	-1	+3	+7	+1						
Check payments.....	+9†	+4†	+4†	+8	+6	+7						
PRICES												
Wholesale.....				0	+2	+3						
Consumer.....	0‡	+3‡	+3‡	0	+3	+3						

LOCAL CHANGES	Factory*		Department Store		Check Payments					
	Employment	Payrolls	Sales	Stocks	Check Payments					
	Per cent change October 1957 from		Per cent change October 1957 from		Per cent change October 1957 from					
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago				
Allentown...	-1	-3	-5	-6		+11	+7			
Harrisburg...	-2	-1	-2	+2		+9	+3			
Lancaster...	0	-1	0	+1	+7	-2	+13	+7	+6	-2
Philadelphia...	-1	-1	-2	-2	0	-2	+5	+5	+10	+3
Reading.....	+3	-2	+2	-2	-10	+5	+13	+4	+10	-3
Scranton.....	-1	-6	-1	-7	+6	0	+7	+1	+13	+2
Trenton.....	+1	-3	-4	-3	-5	-5	+4	-2	+9	+28
Wilkes-Barre...	-1	-1	-1	0	-10	-4	+12	+2	+9	+9
Wilmington...	0	+5	+6	+11	0	+6	+7	+5	+3	-2
York.....	0	-7	0	-6	+4	0	+8	-8	+6	+6

*Adjusted for seasonal variation. †20 Cities ‡Philadelphia

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