Monthly Review

FEDERAL RESERVE BANK OF SAN FRANCISCO

JANUARY 1, 1943

Wartime Financial Policies of the Twelfth District Aircraft Industry

SPURRED by military necessity, the aircraft industry on the Pacific Coast has undergone a spectacular expansion since 1939. The financial requirements of this vast growth have been met from sources markedly different from those customarily drawn upon by industry, particularly in times of peace. The Federal Government has participated directly in financing part of the expansion of plant and facilities while advance payments and contract deposits by customers have provided firms with a substantial proportion of their working capital requirements. In contrast, capital stock issues and bank loans have played only a relatively minor role.

The following paragraphs review the wartime financial policies of Twelfth District aircraft manufacturers as revealed by their financial statements. The sources from which the companies have obtained funds are indicated by increases in various liability and net worth items, and uses made of funds obtained are shown by increases in asset items of the balance sheets. Profit and loss and surplus statements published by the companies provide information on the trend of sales, earnings, and dividends. The study is based upon the financial statements of six companies for the years 1935-39, and upon the statements of the same six and two other companies for the years 1940-41. These companies account for virtually the entire district output of finished planes.

Sources Drawn upon for Funds

Between 1935 and 1941, total assets of the Pacific Coast firms included in the study increased by 525 million dollars. During this period, however, capital stock and paid-in surplus increased by only 37 million dollars. In other words, funds obtained from stockholders accounted for only 7 percent of the increase in financial requirements of the six-year period. The decline in the relative importance of equity capital resulting from this situation is shown by the fact that in 1935 stock and paid-in surplus were equivalent to 72 percent of total assets, but by the end of 1941 the proportion had fallen to 9 percent.

Contract deposits and advances made by customers have recently become the most important single source of funds received by Pacific Coast aircraft manufacturers. Such payments have customarily been made in the industry for a number of years, but at no time prior to 1939 did they account for as much as 8 percent of total assets. At the present time, both the War and Navy Departments are authorized to make advance payments in amounts up to 30 percent of the contract price of the planes ordered. Under this authority they have advanced a large part of the 204 million dollars in customers' deposits and advances, or the equivalent of 38 percent of total assets, reported by Pacific Coast manufacturers at the end of 1941.

More recently, the use of cost-plus contracts, under which the customer is billed for costs as they are incurred, has increased. This development has led to a decline in the relative importance of customers' deposits and advances as a source of working capital and at the same time has also reduced the working capital requirements of the industry.

Bank loans were never an important source of funds until recently. At no time before 1941 did bank loans reported by the major Pacific Coast airplane manufacturers exceed 7 million dollars. By the end of that year, however, bank loans outstanding had advanced to 49 million dollars. Of this amount, 13 million represented loans se-

WAR FINANCE

$9,000,000,000 was asked for in December. $13,000,000,000 in purchases of United States securities was the response. That is an outstanding accomplishment in which every person who did his fair share may well take pride. We cannot stop now. $25,000,000,000 more must be borrowed before June 30, 1943. Keep on buying. Do your full part in cooperation with the Victory Fund Committee.

★ ★ ★ ★ **SUPPORT YOUR GOVERNMENT—THE TWELFTH DISTRICT MUST DO ITS SHARE** ★ ★ ★ ★

cured by accounts receivable from the United States Government for plant construction costs incurred, while the remainder represented amounts borrowed by two firms which contracted for Government business almost entirely on a fixed-price rather than a cost-plus basis. The use of bank credit has increased recently as a result of loans made under the provisions of Regulation V of the Board of Governors of the Federal Reserve System. Regulation V was issued April 10, 1942 pursuant to the authority contained in an Executive Order dated March 26, 1942. According to this Regulation, either the War Department, the Navy Department, or the Maritime Commission, acting through the Federal Reserve banks, may guarantee loans made to firms engaged in essential war work.

Other sources of funds which have been drawn upon by the aircraft manufacturing industry to finance the recent expansion in assets are shown in the accompanying tables. In large part, the rapid increase in accrued liabilities during 1941 reflects the increase in funds which companies have set aside out of profits for the payment of Federal income taxes. It may be noted that provision for payment of 1941 income taxes, amounting to 90 million dollars, exceeded total sales for any year prior to 1940. Profits retained in the business have been an additional source of funds, amounting to 11 percent of all assets in 1941.

Distribution of Assets

The most striking difference revealed by a comparison between 1935 and 1941 balance sheet asset items is the increased proportion of funds tied up in inventories. Inventories comprised 26 percent of assets in 1935 and 48 percent in 1941. During the six years, inventories accounted for 48 percent of the increase in total assets. This percentage would be considerably larger were it not for the fact that purchasing and accounting practices followed by the industry result in an understatement of the

BALANCE SHEET AND SELECTED PROFIT AND LOSS ITEMS
PACIFIC COAST AIRCRAFT MANUFACTURING INDUSTRY, 1935-41
(amounts in thousands of dollars)

	1935		1936		1937		1938		1939		1940		1941	
	Amt.	Percent	Amt.	Percent	Amt.	Percent	Amt.	Percent	Amt.	Percent	Amt.	Percent	Amt.	Percent
Assets														
Cash and cash items	3,325	16.7	4,501	13.6	5,269	11.6	11,012	22.1	25,834	30.5	130,477	39.8	91,238	16.7
Marketable securities	2,281	11.5	1,374	4.2	151	0.3	1,499	3.0	1,300	1.5	2,048	0.6	19,554	3.6
Trade receivables	1,619	8.1	4,206	12.7	3,818	8.4	3,580	7.2	5,945	7.0	18,289	5.6	77,236	14.2
Inventories	5,181	26.1	11,710	35.5	21,719	47.7	18,771	37.6	31,078	36.7	102,957	31.4	259,274	47.5
Advances on inventory purchases	2	*	0	0.0	0	0.0	0	0.0	1,036	1.2	8,306	2.6	4,729	0.9
Other current assets	61	0.3	53	0.2	54	0.1	41	0.1	83	0.1	10,964	3.4	8,988	1.6
Total current assets	12,469	62.7	21,845	66.2	31,011	68.1	34,903	69.9	65,276	77.1	273,041	83.4	461,019	84.5
Investment in affiliates	378	1.9	1,304	3.9	43	0.1	207	0.4	848	1.0	4,584	1.4	1,825	0.3
Other investments	210	1.1	320	1.0	334	0.7	153	0.3	146	0.2	119	*	419	0.1
Land, buildings and equipment	5,366	27.0	7,611	23.1	10,506	23.1	10,045	20.1	14,434	17.0	43,129	13.2	69,255	12.7
Patents	†	*	5	*	6	*	8	*	29	*	45	*	102	*
Goodwill	156	0.8	156	0.5	156	0.3	†	*	†	*	†	*	†	*
Development expense	646	3.2	927	2.8	1,933	4.3	3,227	6.5	2,370	2.8	3,263	1.0	5,062	0.9
Other deferred charges	475	2.4	592	1.8	1,141	2.5	1,087	2.2	227	0.3	2,879	0.9	6,783	1.3
Other assets	181	0.9	226	0.7	409	0.9	298	0.6	376	0.4	481	0.1	862	0.2
Total assets	19,883	100.0	32,986	100.0	45,539	100.0	49,928	100.0	84,706	100.0	327,541	100.0	545,327	100.0
Liabilities and Net Worth														
Notes payable	155	0.8	2,116	6.4	6,442	14.0	2,787	5.6	3,636	4.3	4,402	1.3	15,053	2.6
Accounts payable	1,109	5.6	2,288	7.0	3,443	7.5	3,130	6.3	7,008	8.3	23,532	7.2	55,753	10.2
Accrued liabilities	713	3.6	1,296	3.9	2.656	5.8	3,209	6.4	7,433	8.8	16,705	5.1	110,645	20.3
Customers' contract deposits and advances	153	0.8	1,027	3.1	2,335	5.1	3,632	7.3	20,717	24.4	190,896	58.3	204,286	37.6
Other current liabilities	5	*	†	*	†	*	648	1.3	801	0.9	11,425	3.5	4,266	0.8
Total current liabilities	2,135	10.8	6,727	20.4	14,876	32.4	13,406	26.9	39,595	46.7	246,960	75.4	390,003	71.5
Long term debt	17	0.1	64	0.2	†	*	1,250	2.5	1,098	1.3	3,560	1.1	34,180	6.3
Deferred income	0	0.0	46	0.1	49	0.1	40	0.1	108	0.1	119	*	62	*
Contingent reserves	373	1.9	438	1.3	489	1.1	1,760	3.5	890	1.1	1,425	0.4	10,921	2.0
Other reserves	67	0.3	81	0.3	125	0.3	119	0.2	117	0.1	169	0.1	229	*
Preferred stock	0	0.0	1,149	3.5	1,185	2.6	1,191	2.4	1,191	1.4	1,191	0.4	0	0.0
Common stock	10,145	51.0	11,390	34.5	12,767	27.8	12,941	25.9	15,414	18.2	18,957	5.8	19,055	3.5
Total stock	10,145	51.0	12,539	38.0	13,952	30.4	14,132	28.3	16,605	19.6	20,148	6.2	19,055	3.5
Paid-in surplus	4,187	21.1	8,587	26.0	11,204	24.4	12,970	26.0	12,929	15.3	28,310	8.6	31,936	5.9
Earned surplus	2,960	14.9	4,498	13.7	5,203	11.3	6,251	12.5	13,362	15.8	26,845	8.2	58,937	10.8
Total surplus	7,147	35.9	13,085	39.7	16,407	35.7	19,220	38.5	26,291	31.1	55,155	16.8	90,873	16.7
Total net worth	17,292	87.0	25,624	77.7	30,359	66.1	33,352	66.8	42,896	50.6	75,301	23.0	109,925	20.2
Total liabilities and net worth	19,883	100.0	32,982	100.0	45,898	100.0	49,928	100.0	84,705	100.0	327,537	100.0	545,323	100.0
Profit and Loss Items														
Sales	17,323		21,835		52,259		64,974		107,893		184,134		625,573	
Net profit from operations	1,778		1,908		4,194		8,795		17,102		34,841		149,071	
Provision for income tax	349		411		999		1,286		3,363		9,195		90,482	
Net profit after all charges	1,490		1,443		2,507		5,497		11,102		23,668		48,730	
Dividends	351		26		1,078		3,732		7,528		10,023		14,295	

†Less than $500.
*Less than one-tenth of 1 percent.

Note: Basic data obtained from financial statements of companies covering fiscal years ending in years indicated at top of columns. Six companies are included for the period 1935-39 and eight companies for 1940-41, accounting for virtually the entire output of Twelfth District finished airplanes. Plants of Pacific Coast companies located outside the Twelfth District are included, but their operations were relatively unimportant prior to 1942. Apparent slight discrepancies in some totals arise from the fact that all dollar amounts have been rounded off to the nearest thousand and all percentages to the nearest tenth of 1 percent.

actual amount of goods-in-process on hand. First, inventories are understated because funds received from customers are often set off directly against the goods in process to which they apply. In 1935, this type of offset accounting understated the amount of inventories on hand by $159,000; in 1941 inventory understatement resulting from this practice totaled 69 million dollars. Second, the amount of inventories actually on hand is also larger than appears on the balance sheet because of the accounting practices usually followed in the treatment of cost-plus contracts. Expenditures under cost-plus contracts are often shown as a trade receivable from the United States Government rather than in the inventory account.

SOURCES OF FUNDS—PACIFIC COAST AIRCRAFT MANUFACTURING INDUSTRY

CHANGES IN LIABILITY AND NET WORTH ITEMS, 1935-41

	Thousands of Dollars	Percent of Total
Increase in:		
Common stock	8,910	1.7
Paid-in surplus	27,749	5.3
Earned surplus	55,977	10.7
Total increase in net worth	92,633	17.6
Increase in:		
Customers' contract deposits and advances	204,133	38.8
Notes payable	14,898	2.8
Accounts payable	54,644	10.4
Accrued liabilities	109,932	20.9
Other current liabilities	4,261	0.8
Total increase in current liabilities	387,868	73.8
Increase in:		
Long term debt	34,163	6.5
Deferred income	62	*
Contingent reserves	10,548	2.0
Other reserves	162	*
Total increase long term debt, deferred income and reserves	44,935	8.6
Total increase in net worth and liabilities	525,440	100.0

*Less than one-tenth of 1 percent.

At the end of 1941, the eight firms had 69 million dollars, representing 13 percent of their total assets, invested in fixed assets. The actual amount of land, building, and equipment in use, however, was considerably greater than that shown on the balance sheets. Plant facilities built under Emergency Plant Facilities Contracts costing 24 million dollars were completed by the end of 1941, of which only about one-half are included in the above figures. Much more important are facilities built and owned by the Defense Plant Corporation for use by private companies producing war goods, and they are entirely excluded from the latter's balance sheets.

Under an Emergency Plant Facilities Contract arrangement, private funds are used in the construction of a plant, the cost of which is directly reimbursed by the Government in 60 equal monthly payments. The Government's promise to reimburse the manufacturer for the plant may be used as security for a bank loan covering the cost of the project. After the Government has completely repaid the manufacturer for the plant, title passes from the company to the Government unless the company exercises its option to purchase the property at either original cost less depreciation, or at a fair value arrived at by negotiation. The private management of a plant owned by the Defense Plant Corporation is also given an option to purchase the plant upon termination of the lease.

Other changes which have occurred in capital usage and its distribution among assets are shown in the accompanying tables. A word may be said about the item "development expense," which in 1941 amounted to 5 million dollars. Although this amount is fairly large, it by no means represents the real importance of developmental and research work to the aircraft manufacturing industry. Leading aircraft companies have long realized the necessity of spending large sums in the development of new airplane models that are not immediately offered for sale, yet according to the conservative accounting practices usually followed, most development costs are written off as rapidly as feasible and are capitalized only in part on the balance sheets. Further evidence of conservative accounting practices followed by the industry is the fact that goodwill is either entirely omitted or shown as one dollar, while the stated value of patents held by coast companies totaled only $102,000 at the end of 1941.

Sales, Earnings, and Dividend Record

Essentially, the period through 1941 must be viewed as one in which the aircraft industry was preparing for a later period of enlarged production, yet even during this period the dollar volume of sales increased substantially. Between 1935 and 1940, annual sales, identical with the value of deliveries in this industry, increased from 17 million dollars to 184 million. During 1941 several new plants were brought into production, and their output, together with technological progress in methods of production, accounted for a threefold increase in sales during the year. The current rate of production for the seven major aircraft manufacturing companies located in southern California is reported at more than 2 billion dollars annually, an amount over two-thirds as large as the total

USES OF FUNDS—PACIFIC COAST AIRCRAFT MANUFACTURING INDUSTRY

CHANGES IN ASSET ITEMS, 1935-41

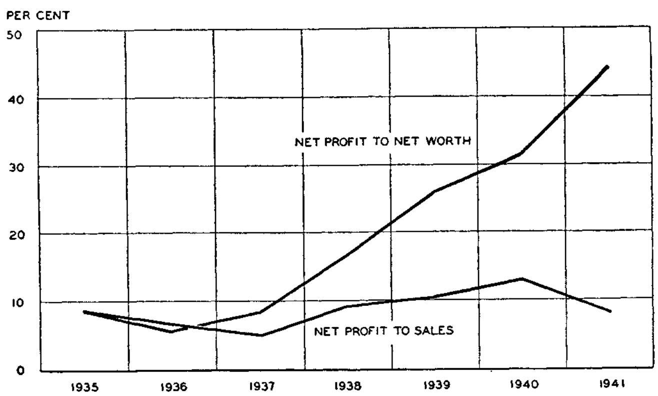
	Thousands of Dollars	Percent of Total
Increase in:		
Inventories	254,093	48.3
Trade receivables	75,617	14.4
Cash and cash items	87,913	16.7
Marketable securities	17,273	3.3
Advances on inventory purchases	4,727	0.9
Other current assets	8,927	1.7
Total increase in current assets	448,550	85.4
Increase in:		
Investment in affiliates	1,447	0.3
Other investments	209	*
Total increase in investments	1,656	0.3
Increase in land, buildings and equipment	63,889	12.1
Increase in patents	102	*
Decrease in goodwill	156	*
Increase in:		
Development expense	4,416	0.8
Other deferred charges	6,308	1.2
Total increase in deferred charges	10,724	2.0
Increase in other assets	681	0.1
Total increase in all assets	525,444	100.0

*Less than one-tenth of 1 percent.

value of all manufactured products produced in all California during 1939.

Although profits available to stockholders have increased substantially, earnings have not kept pace with the recent increases in sales. As is shown in the accompanying chart, the ratio of net profit to sales declined from 13 percent in 1940 to 8 percent in 1941, and will undoubtedly be lower for subsequent years. Profit margins on Federal Government work, which now accounts for virtually all sales, are considerably smaller than those previously obtained on foreign and commercial sales. An increasingly larger proportion of Government contracts is being let on a cost-plus-fixed-fee basis carrying margins of 6 percent and in some cases 5 percent, considerably below the 10 to 12 percent margins commonly obtained under fixed-price contracts.

In contrast to the declining ratio of net profit to *sales*, the ratio of net profit to *net worth* has increased substantially each year since 1936, reaching a new high of 44 percent in 1941. Explanation of this seemingly paradoxical



RATIOS OF NET PROFIT TO NET WORTH AND TO SALES PACIFIC COAST AIRCRAFT MANUFACTURING INDUSTRY, 1935-41

situation lies in the fact that net worth has constituted a steadily declining proportion of total assets, since, as has already been explained, funds to finance the recent expansion have been drawn primarily from customers' deposits and advances and other liability items. This increase in the ratio of total liabilities to net worth has thus provided a "leverage" by means of which it has been possible during a period of rapidly rising sales to increase the ratio of profits to net worth, even though the ratio of profit to sales has declined.

Although the Pacific Coast industry as a whole has shown some profit each year since 1935 (an aggregate loss was suffered in 1934), one large company incurred losses during three years out of the last seven, while two other firms have each reported losses for one year.

Aircraft manufacturers have traditionally followed a conservative policy with regard to dividend declarations. During the past seven years, the proportion of earnings paid out to shareholders as dividends has amounted to 39 percent. Retention of a large proportion of earnings is characteristic of young industries in need of capital for expansion purposes, and the exceptional hazards which normally confront the aircraft industry present an additional incentive.

Appraisal of Wartime Financial Policies

Methods currently followed in financing both plant expansions and working capital needs are aimed at protecting the industry from entering the post-war period with heavy fixed financial charges and an inflated capital structure. A large proportion of new plant facilities is either already Government-owned or can be turned over to the Government upon the termination of hostilities. On the other hand, should the post-war demand for airplanes be greater than the quantity which can be produced in privately-owned plants, individual companies may exercise their options to purchase Government-financed facilities or may lease them. With regard to financing working capital requirements, advance payments and cost-plus contracts represent arrangements under which the amount of funds received by aircraft producers adjusts itself almost automatically to working capital requirements. Unlike other forms of financing, such as issuing securities and borrowing from banks, the receipt of funds by the manufacturer under cost-plus contracts and advance payments is directly related to particular contract awards, and delivery of the product eliminates the liability.

Capitalization of Pacific Coast companies, consisting entirely of common stock at the end of 1941, did not quite double during the preceding six years, a period during which total assets increased over twenty-six fold. The future position of some aircraft manufacturing companies is being buttressed by the setting up of large reserves for post-war readjustment purposes. From the manufacturers' point of view, therefore, financial policies being followed are aimed at leaving the companies in a strong financial position after the war, but it is unlikely that anything the companies themselves can do will protect them completely should the post-war demand for airplanes fall to very low levels.

In the broader sense, the test of the industry's wartime financial policies is the extent to which they have facilitated the maximum output of military planes. There have been some production delays, to be sure, but apart from those which originally occurred in getting the expansion program under way in 1940, most of them have been of the type associated with the inevitable problems of frequent changes in design and shortages of men and materials. The over-all effectiveness of the program is clearly indicated by the fact that United States production increased from less than 5,000 planes in 1939 to 48,000 in 1942. Furthermore, production is expected to be more than double the 1942 figure during the current year, and this expansion appears even more remarkable when it is remembered that the average size of planes has increased considerably during the past year.

The aircraft industry has not achieved this tremendous increase in output without considerable change in financial procedure. Unusual risks attached to investment in new and growing war industries tend to make private capital hesitant unless that investment is accompanied by unusual protection on the part of the Government. As a result the Government has emerged as the most important party in the assumption of those financial risks attached to the development of new plant facilities or fixed investment for aircraft production. This is equally true for most of the war industries. As for the provision of working capital, not only aircraft but other war goods producers have made considerable use of contract deposits or advance payments. Although this device is no recent innovation in the aircraft industry, it is only with the current expansion of military production and its sale to a single customer, the Government, that such advances have grown to account for a substantial proportion of the funds employed. In aircraft manufacturing, as in other war industries, the requirements of total war appear to demand provision by the Government of a large part of the necessary funds in order to insure that the only limits upon output shall be those set by the availability of manpower and physical resources.

Review of Business Conditions—Twelfth District

War Production, Labor Shortages, and Trade

Huge strides have been taken during the past year in mobilizing production resources in the war effort. In the Twelfth District, most spectacular results have been achieved in aircraft fabrication and in shipbuilding. Late in the year, aircraft industry production was at an annual rate exceeding 2 billion dollars, more than double that of two years earlier. Deliveries of Liberty cargo vessels in November by Pacific Coast yards attained a rate of 540 ships per year. Industrial expansion has been accompanied by full employment, and labor shortages have developed in many areas. Under these conditions, trade has reached high levels, but the year closed with indications of important shortages of consumers' goods in many categories.

War Supply and Facility Contracts

Indicative of the demands being made upon district resources is the value of war supply and facility contracts awarded in the area. The most recent release on the subject by the WPB reveals that from June 1940 through September 1942 firms in the seven western states comprising the Twelfth District received contracts of approximately 13 billion dollars, excluding awards having a value of less than 50 thousand dollars and all contracts for foodstuffs. This represents 13 percent of the total awarded in the country as a whole during the period, and assumes added meaning when related to the fact that in 1939 the district accounted for but 7 percent of the value of all products manufactured in the United States.

Almost two-thirds of the awards in the district (8.8 billion dollars) were made in California, and that state ranked second only to New York. Within the district, California was followed by Washington with 2.7 billion, and by Oregon with .6 billion, while the remaining four states together received only .8 billion dollars. The prominence of California and Washington is accounted for by awards for aircraft and ships, totaling 9 billion dollars, placed with firms in those states. Oregon shipyards received orders valued at 362 million dollars.

Additional Labor Shortage Areas

As stated previously in this Review, the vast increase in war production over the past two years in the Twelfth District has taken place to a marked extent through expansion rather than conversion of industrial facilities. The result has been a sharp increase in overall expansion of industrial production during the past two years and an accompanying increase in factory employment. This large increase in employment has been fed by the migration of workers to district war production centers from other areas, both within the district and from other parts of the country. In November 1942, the seasonally adjusted

Production and Employment—

Index numbers, 1923-25 average=100	With Seasonal Adjustment				Without Seasonal Adjustment			
	1942			1941	1942			1941
Industrial Production[1]	Nov.	Oct.	Sept.	Nov.	Nov.	Oct.	Sept.	Nov.
Lumber[2]	p149	145	139	144	p142	157	162	137
Refined oils	—	—	—	—	196	196	194	176
Cement	197	182	214	177	197	210	226	177
Wheat flour	114	97	99	94	125	116	118	103
Petroleum	—	—	—	—	110	110	110	99
Electric power	p353	359	329	284	p334	338	344	269
Factory Employment and Payrolls[3]								
Employment								
Pacific Coast	p318	p298	p289	204	p322	p311	p302	207
California	354	332	326	246	361	348	338	252
Oregon	p291	p260	p260	155	p288	p270	p281	153
Washington	p261	p248	p230	145	p261	p258	p242	145
Payrolls								
Pacific Coast	p568	p496	p486	266	p569	p524	p505	267
California	598	539	535	321	604	566	544	324
Oregon	p586	p440	p426	203	p574	p471	p473	198
Washington	p497	p434	p413	183	p492	p464	p438	181

[1] Daily average.
[2] Converted to 1935-39 base. Back figures will be supplied on request.
[3] Excludes fish, fruit, and vegetable canning.
p Preliminary.

Distribution and Trade—

Index numbers, 1935-39 daily average=100	With Seasonal Adjustment				Without Seasonal Adjustment			
	1942			1941	1942			1941
Retail Trade	Nov.	Oct.	Sept.	Nov.	Nov.	Oct.	Sept.	Nov.
Department store sales (value)								
Twelfth District	p209	182	176	151	p219	191	184	158
Southern California	p200	178	171	157	p204	180	176	160
Northern California	p183	167	165	133	p200	172	164	145
Portland	p228	199	180	150	p237	210	204	156
Western Washington	p282	229	213	183	p291	240	238	190
Eastern Washington and Northern Idaho	p208	145	171	125	p217	198	193	132
Southern Idaho and Utah	p216	193	177	146	p242	224	193	164
Phoenix	p201	196	206	137	p230	213	180	156
Carloadings (number)[1]								
Total	p104	p107	112	110	p105	p126	129	111
Merchandise and misc.	p118	p113	118	128	p118	p137	140	128
Other	p 87	p100	104	89	p 89	p113	116	91

[1] 1923-25 daily average = 100. p Preliminary.

index of factory employment in the three Pacific Coast states had risen to 318 percent of the 1923-25 average, compared with 204 a year earlier and 138 in November 1940. Despite additions to the labor force from migration and from local groups not customarily employed in factories, acute labor shortages have developed in many localities. The War Manpower Commission found labor shortages in 17 areas in the Twelfth District in December, compared with nine during October. In two other areas, shortages are anticipated. Of the 91 localities in the United States reported as having labor surpluses, none were in the Twelfth District.

Areas in the Twelfth District Reporting Labor Shortages in December 1942

Everett	Portland-Vancouver[1]	San Diego[1]
Las Vegas[1]	Provo	San Francisco
Los Angeles	Sacramento	Seattle-Bremerton[1]
Ogden[1]	Salt Lake City[1]	Spokane[1]
Phoenix[1]	San Bernardino	Stockton
Pocatello		Tacoma[1]

[1] Areas reporting labor shortages in October.

In further recognition of the serious labor situation in the district, the War Manpower Commission on November 22 announced "a management-labor manpower plan for the mobilization and utilization of labor in California, Washington, Oregon, Nevada, and Arizona." The plan is designed to facilitate orderly withdrawal of employees by Selective Service, to further the recruitment and training of new workers, and to reduce labor piracy and the present excessive migration, absenteeism and turnover.

Department Store Trade in November and December

Department store trade in November and December broke all previous records. A larger proportion than usual of Christmas purchases was made in November this year, and this bank's seasonally adjusted index advanced 25 points to 209 percent of the 1935-39 level. In December the index receded to about the October level, which, itself, had marked a new high.

Inventories of district department stores declined moderately from July through November. Estimated on the basis of a substantial sample, total inventories of all district department stores reached a peak of approximately 155 million dollars on July 31. They had declined to about 131 million by the end of November but were substantially larger than the 123 million estimated for a year earlier and the 94 million estimated for November 30, 1940. In relation to demand, however, stocks of a number of items, particularly of goods made in whole or in part of metal, were scarcer in November than at any time in recent years.

Food Shortages and Farm Production

In no phase of the economy has the transition from surplus to shortage been more striking than in foods. The list of commodities in short supply has grown rapidly and now extends beyond items which are largely imported, such as sugar, coffee, and olive oil, and which were expected to become deficient. Included are many staples, such as butter, eggs, and meats, some of which were considered as "surplus" commodities less than a year ago.

1942 Farm Production and 1943 Farm Goals—Twelfth District

		Idaho Oregon Washington		Utah Nevada		California Arizona		Total Twelfth District	
Livestock Products	Unit	1942	1943	1942	1943	1942	1943	1942	1943
Cattle marketings	Thous. head	1,014	1,167	338	346	1,954	1,916	3,306	3,429
Sheep marketings	Thous. head	3,004	2,820	1,496	1,450	2,711	2,696	7,211	6,966
Hogs to farrow	Thous. head	281	339	42	52	192	212	515	603
Milk production	Mill. lbs.	4,989	5,070	722	740	5,489	5,480	11,200	11,290
Chicken production	Thous. lbs.	54,727	62,397	8,805	10,020	60,307	70,366	123,839	142,783
Turkey production	Thous. lbs.	55,877	64,521	18,089	21,746	55,986	67,316	129,952	153,583
Eggs	Thous. doz.	136,619	138,957	28,243	30,739	166,383	170,478	331,245	340,174
Field Crops									
Beans, dry	Thous. acres	165	209	14	14	446	536	625	759
Corn	Thous. acres	147	159	30	32	110	116	287	307
Cotton, all	Thous. acres	..	..	..	..	642	630	642	630
Cotton, long staple	Thous. acres	..	..	..	..	47	49	47	49
Flaxseed	Thous. acres	8	9	..	..	223	368	231	377
Hay	Thous. acres	2,722	2,732	696	698	1,899	1,905	5,317	5,335
Oats	Thous. acres	741	722	50	49	173	149	964	920
Peas, dry	Thous. acres	450	553	..	..	..	..	450	553
Potatoes, Irish	Thous. acres	212	232	15	18	74	81	301	331
Rice	Thous. acres	..	..	..	..	168	164	168	164
Rye	Thous. acres	78	80	4	4	11	10	93	94
Sugar beets	Thous. acres	112	112	49	46	190	180	351	338
Wheat	Thous. acres	3,392	3,282	257	214	739	682	4,388	4,178
Vegetable crops									
Artichokes	Acres	..	..	..	..	9,600	8,800	9,600	8,800
Asparagus	Acres	9,800	9,800	..	..	35,820	35,000	45,620	44,800
Beans, snap	Acres	..	..	..	..	10,250	12,500	10,250	12,500
Cabbage	Acres	3,720	3,770	450	500	8,930	9,000	13,100	13,270
Carrots	Acres	1,710	2,200	300	500	26,450	32,000	28,460	34,700
Cauliflower	Acres	980	950	..	..	16,920	13,000	17,900	13,950
Celery	Acres	950	700	600	500	13,230	11,250	14,780	12,450
Cucumbers	Acres	..	..	..	..	1,500	1,300	1,500	1,300
Lettuce	Acres	6,390	5,600	..	..	134,300	112,500	140,690	118,100
Melons	Acres	3,900	4,150	400	350	61,350	47,200	65,650	51,700
Onions	Acres	8,950	9,750	1,400	1,500	10,000	10,400	20,350	21,650
Peas	Acres	4,300	4,400	300	300	34,250	32,900	38,850	37,600
Spinach	Acres	1,150	1,200	..	..	2,950	3,000	4,100	4,200
Tomatoes	Acres	2,300	2,700	350	400	28,504	28,350	31,000	31,600

Source: United States Department of Agriculture.

Farm production in the United States was large in 1942, output or marketings of a number of crops and livestock products attaining record proportions. The source of current shortages, consequently, has been the expansion in demand, which has arisen from military and lend-lease requirements and from the increased civilian consumption. Three related Government programs have now evolved to cope with the problem of food shortages. Their objectives are to increase production of foods considered most essential, to assure adequate supplies for the armed forces and for lend-lease purposes, and to provide for an equitable distribution of supplies available to the civilian population.

Allocation of Essential Foods for Non-civilian Use

In order to assure an adequate supply of foods for the armed forces and for lend-lease, producers have been ordered to set aside stated proportions of their output. In 1942, almost the entire dried fruit crop was taken by the Government. Deliveries of meat for civilian consumption have now been limited by WPB order for several months. During the first quarter of 1943, meat packers will be permitted to deliver only 70 percent of the beef, veal, and pork, and 75 percent of the lamb and mutton delivered during the like period of 1941. One-half the butter in cold storage was recently ordered "frozen" for Government purchase. Canners have been asked to set aside for Government use approximately one-half of the canned vegetable pack and somewhat more than half of the canned fruit pack in 1943.

Rationing of Scarce Foods Among Civilians

The large and growing demands for food for the armed forces and for lend-lease necessitate reduced civilian consumption of some foods. It is estimated, for instance, that a maximum of 33 pounds of canned food per capita will be available for civilians in 1944, as compared with an annual per capita consumption of about 46 pounds in the 1935-39 period. In order to provide for a more equitable distribution of restricted supplies available to the civilian population, rationing programs at the consumer level have been instituted. The most recent development in this field was the announcement on December 27 of a program of "point" rationing, to become effective in February, of most canned, dried, and frozen fruits, vegetables, and soups available to civilians. Secretary of Agriculture Wickard has announced that meat will soon be rationed and it is expected that rationing of milk products will follow shortly thereafter.

Production Goals For 1943

The encouragement of agricultural production to meet expanding food requirements is embraced in the program of production goals, supported by price guarantees, initiated by the United States Department of Agriculture for the 1942 crop year. Goals for Twelfth District agriculture in 1943, together with production during the past year, of major district field and truck crops, and of livestock products, are shown in the accompanying table. They aim generally toward encouraging the maintenance of production at the high levels of 1942, but at the same time stress the need for expanding output of the more essential products, even at the expense of curtailing output of others. Major emphasis is again placed upon expansion of high protein yielding products, such as meat, milk products, dry peas, and beans. To supplement the meat supply, increased poultry production, and marketings of meat animals, particularly of hogs, at heavier weights is urged. A prominent feature of the 1943 goals is the emphasis upon further conversion of lands, where practicable, to the production of certain crops considered more essential than others. Particularly in the case of vegetables, goal crops such as tomatoes for processing and cabbage for dehydration are favored to replace such crops as melons and lettuce. It is urged that more wheat land in the Pacific Northwest be used for producing dry peas, and in California for raising flaxseed.

Government Finance and Bank Credit

The success of the Treasury's December loan drive is evidenced by the fact that total sales for the month amounted to 12.9 billion dollars, and exceeded the unprecedented goal of 9 billion dollars set by Secretary Morgenthau at the outset by 3.9 billion. Although these results were most favorable and no further borrowing, except for the continued sale of Treasury bills, war savings bonds, and tax savings notes, is contemplated before early April, it should be remembered that a substantial volume of Treasury financing remains for the future. Of the 60 billion that it is anticipated the Treasury will borrow in the fiscal year ending June 30, 1943 about 25 billion remains to be raised.

Several types of securities were offered by the Treasury in December. These included the regular weekly issues of 91-day Treasury bills, ⅞ percent certificates of indebtedness of 1943, 1¾ percent bonds of 1948, and 2½ percent bonds of 1963-68, in addition to war savings bonds and tax savings notes which are available at all

Banking and Credit—

Averages of Wednesday figures (millions of dollars)	1942 Dec.	Change From 1942 Nov.	Change From 1942 Oct.	Change From 1941 Dec.
Condition Items of Weekly Reporting Member Banks				
Total loans	1,017	−14	−16	−147
Commercial, industrial, and agricultural loans	465	−9	−4	−40
Open market paper	13	0	+1	−13
Loans to finance securities transactions	40	+1	+2	−9
Real estate loans	361	−3	−7	−27
All other loans	138	−3	−8	−58
Total investments	2,347	+157	+249	+868
United States Government securities	2,044	+157	+253	+900
All other securities	303	0	−4	−32
Adjusted demand deposits	2,071	+86	+199	+583
Time deposits	1,105	−3	−2	0
Coin and Currency in Circulation				
Total (changes only)	—	+60	+127	+596
Federal Reserve notes of F. R. B. of S. F.	1,248	+61	+126	+570
Member Bank Reserves	1,270	+53	+126	+312

times. The approximate amount of each type of security sold, both in the United States as a whole and in the Twelfth District, is shown in the accompanying table. The division of sales between commercial banks (i.e., banks which accept demand deposits) and other purchasers is also indicated.

SALES OF GOVERNMENT SECURITIES IN THE UNITED STATES AND THE TWELFTH DISTRICT—DECEMBER 1942
(millions of dollars)

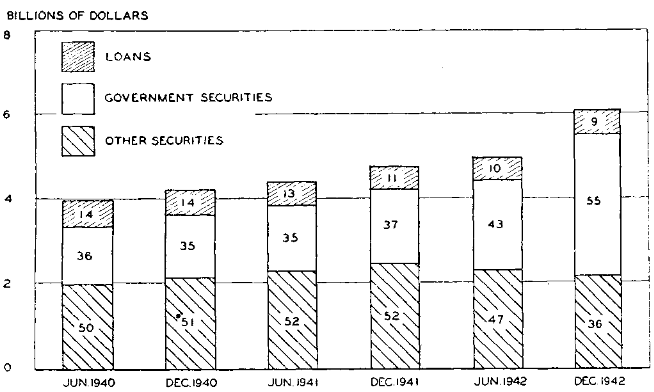
	United States			Twelfth District		Total	
Security	Com'l Banks	Other	Total	Com'l Banks	Other	Amt.	% of U. S. Tot.
Treasury bills (net)	897*	0	897	107*	0	107	11.9
⅞% C. I. of 1943	2,117	1,678	3,795	184	38	222	5.8
1¼% Treas. bonds of 1948	2,058	1,003	3,061	198	39	236	7.7
2½% Treas. bonds of 1963-68	0	2,827	2,827	0	58	58	2.1
War savings bonds	0	1,014†	1,014†	0	112	112	11.0
Tax notes	0	1,312‡	1,312‡	0	41	41	3.1
Total	5,072	7,834	12,906	489	288	776	6.0

*Includes small amount of sales to others.
†Redemptions of war savings bonds during December totaled 55 million dollars.
‡Tax notes turned in or redeemed during December totaled 631 million dollars.

Securities of primary interest to banks included Treasury bills, certificates of indebtedness, and Treasury bonds of 1948. Commercial banks are not eligible to hold the 2½ percent bonds of 1963-68 until ten years after the date of issue. All sales of Series E, F, and G War Savings Bonds and most of the sales of tax notes were made to non-bank purchasers.

Bank Holdings of Governments in the Twelfth District

As a result of this financing, Twelfth District member bank holdings of Government securities increased sharply in December. Banks which reported 90 percent of all Governments held by district member banks on June 30, 1942 increased their investments in these securities from 2,622 million dollars on November 25 to 3,040 million on December 23. Treasury borrowing and, of late, restricted opportunities for industrial, commercial, and consumer loans are reflected in the sharp increase in relative importance of Government security holdings of member banks since June 30, 1940. As shown in the accompanying chart, earning assets of district member banks have increased by more than 50 percent in the two and one-half years since that date, with almost all of the increase accounted for by the expansion in holdings of obligations of the United States. Holdings of these securities amounted to 55 percent of all earning assets of member banks in late December compared with 36 percent in mid-1940.



LOANS AND INVESTMENTS OF TWELFTH DISTRICT MEMBER BANKS
Selected call dates, 1940-42.
(December 1942 figures estimated)

These data indicate a marked change in the credit function of the commercial banks. Many usual avenues of bank credit extension to industry are closed by allocation and limitation orders relating to the uses of materials by producers, and to consumers by restrictions on construction of homes and on the purchase of durable goods. The only new loans being made by banks in significant proportions are made to essential industries. At the same time, however, the financial needs of the United States Treasury have increased enormously and the banking system is now lending more money to the Treasury than to all other borrowers combined.

Maturities of Government Securities Held by Banks

As banks have expanded their holdings of Government securities, there has been a distinct shift toward shorter term securities. It will be noted from the following table

DISTRIBUTION OF TWELFTH DISTRICT MEMBER BANK HOLDINGS OF GOVERNMENT SECURITIES
(amounts in millions of dollars)

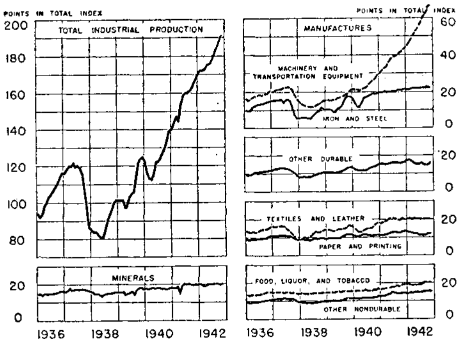
	June 29, 1940		June 30, 1942		Dec. 23, 1942[1]	
	Amount	Percent	Amount	Percent	Amount	Percent
Treasury bills (maturity 91 days or less)	6	[2]	106	5	470	14
Certif. of indebted. (maturity 1 yr. or less)	—	—	114	5	320	10
Treas. notes (maturity 5 yrs. or less)	109	8	185	9	420	12
Bonds maturing in 5 yrs. or less	31	2	84	4		
Bonds maturing in 5-10 yrs.	439	31	455[3]	21	1,950	58
Bonds maturing in 10-20 yrs.	433	31	831	39		
Bonds maturing after 20 yrs.	71	5	149	7		
Guaranteed obligations						
Maturing in 5 yrs. or less	126	9	160	8	200	6
Maturing after 5 yrs.	190	14	39	2		
Total	1,405	100	2,122	100	3,360	100

[1] Estimated from holdings of a group of reporting member banks which held 90 percent of the Governments held by all member banks on June 30, 1942.
[2] Less than 0.5 percent.
[3] Includes all holdings of U. S. savings bonds (5 million dollars).

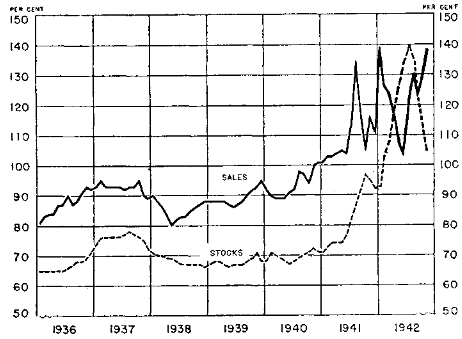
that in the two years from June 1940 to June 1942, securities maturing in five years or less increased from 20 to 31 percent of the total held by district member banks. Although a classification of bonds by maturities is not available, holdings of bills, certificates of indebtedness, and notes rose from 19 to 36 percent of the total between June 1942 and the end of the year. The increase in the amount of weekly offerings of the 91-day Treasury bills, resumption of the use of certificates of indebtedness, and the announced policy of limiting the maturity of new bond issues which commercial banks may purchase to ten years or less are important factors in this tendency toward greater relative holdings by banks of shorter term securities.

Monthly Review

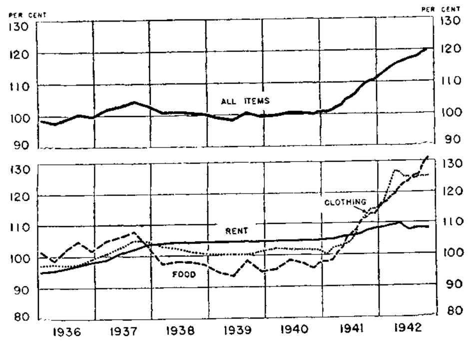
SUPPLEMENT FEDERAL RESERVE BANK OF SAN FRANCISCO JANUARY 1, 1943



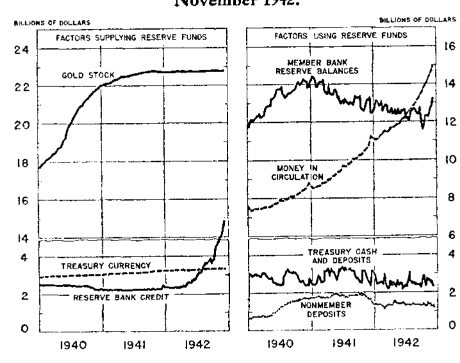
INDUSTRIAL PRODUCTION
Federal Reserve monthly index of physical volume of production, adjusted for seasonal variation, 1935-39 average=100. Subgroups shown are expressed in terms of points in the total index. Latest figures shown are for November 1942.



DEPARTMENT STORE SALES AND STOCKS
Federal Reserve monthly indexes of value of sales and stocks, adjusted for seasonal variation, 1923-25 average=100. Latest figures shown are for November 1942.



COST OF LIVING
Bureau of Labor Statistics indexes, 1935-39 average=100. Fifteenth of month figures. Last month in each calendar quarter through September 1940, monthly thereafter. Latest figures shown are for November 1942.



MEMBER BANK RESERVES AND RELATED ITEMS
Wednesday figures. Latest figures shown are for December 9, 1942.

Summary of National Business Conditions

Released December 22, 1942—Board of Governors of the Federal Reserve System

Aggregate industrial production in November was maintained close to the October level, reflecting a continued growth of output in war industries and a seasonal decline in production of civilian goods. Distribution of commodities to consumers rose further in November and the first half of December, reducing somewhat the large volume of stocks on hand. Retail food prices continued to advance.

Production

Maintenance of industrial production in November when the seasonal tendency is downward was reflected in a rise of the Board's seasonally adjusted index from 189 to 191 percent of the 1935-39 average. This rise was largely accounted for by a further advance in output of durable manufactures. Nondurable manufactures declined seasonally, while output of minerals showed less than the usual seasonal decrease. In all groups of products the proportion of output for war purposes was considerably larger than a year ago.

The increase reported for durable manufactures from October to November was in finished munitions and industrial equipment for new plants which will be completed in large number over the next few months. Steel production, at 98 percent of capacity in November and the first three weeks of December, was down slightly from the October peak, but the reduction appeared temporary as the scrap supply situation had been relieved and as further progress was being made on construction of additional iron and steel capacity. Supplies of iron ore on hand are regarded as sufficient for operations at capacity until movement of ore down the lakes is resumed in the spring. Shipments from Upper Lake ports this year totaled 92 million tons, and were 15 percent above the record established in 1941.

Construction contract awards in November were 10 percent below the level of the three preceding months, according to data of the F. W. Dodge Corporation, but were still about 40 percent higher than in November of last year. As in other recent months, publicly-financed work accounted for over 90 percent of all awards.

Distribution

Distribution of commodities to consumers increased further in November and December with active Christmas buying. At department stores, variety stores, and mail-order houses serving rural areas, sales in November expanded more than seasonally. In the first half of December department store sales continued to rise sharply and were considerably larger than a year ago.

Freight-car loadings in November declined about 7 percent from their peak levels in September and October but on a seasonally adjusted basis rose slightly over the October level. Coal loadings rose somewhat although a decline is usual in November. Shipments of other commodities declined seasonally.

Commodity Prices

Grain prices advanced from the middle of November to the middle of December, while most other wholesale commodity prices showed little change.

Retail food prices increased further by 1 percent in the five weeks ending November 17 to a level 16 percent higher than in November 1941. Prices of such fresh foods as are uncontrolled—fruits, vegetables, and fish—showed the largest advances from October to November, but price increases in controlled items contributed about two-fifths of the total rise.

Bank Credit and Government Security Markets

During the period of large-scale Treasury financing in December, total excess reserves of member banks were generally above 2.5 billion dollars. Substantial purchases of Government securities for the Federal Reserve System offset the effect of drains on reserves by the continued heavy currency outflow and further increases in required reserves resulting from a rapid growth in bank deposits.

Reserve Bank holdings of Government securities showed an increase of 850 million dollars in the four weeks and reached a total of 5.5 billion on December 16.

At reporting member banks in 101 leading cities holdings of United States Government securities increased by 800 million dollars in the four weeks ending December 9. Treasury bills accounted for practically the entire increase, with almost two-thirds of the amount going to New York City banks. In the week ending December 16, bond holdings rose sharply as banks received their allotments of the new 1¾ percent bonds subscribed on November 30-December 2; allotments of this issue to all banks totaled 2 billion dollars, representing 85 percent of subscriptions.

Total loans showed little change over the four weeks ending December 9. Commercial loans declined by 200 million dollars, with about half the decline at New York City banks, while loans to brokers and dealers increased over the period, reflecting largely advances made to security dealers in New York in connection with the Victory Fund drive.

Payments by bank depositors for new Government security issues resulted in a decline of adjusted demand deposits and a rise of U. S. Government deposits to 5.8 billion dollars in mid-December, the largest total on record.

Prices of United States Government securities have been steady in the past three weeks following an adjustment in the latter part of November when the Treasury announced the drive to sell 9 billion dollars of securities in December. Long-term taxable bonds are selling on a 2.36 percent yield basis on the average and long partially tax-exempt bonds on a 2.09 percent basis.

UNITED STATES GOVERNMENT SECURITIES COMMAND INVESTMENT INTEREST

☆ Savings Bonds Series F and G are Always on Sale ☆

☆ Tax Notes Series A and C are Continuously Available ☆

☆ Other issues will be available when Victory Loan Drive Number 2 is announced ☆

Victory Fund Committee
Twelfth Federal Reserve District

EVEN THE SMALLEST INVESTOR CAN BUY
WAR SAVINGS BONDS SERIES E AND SAVINGS STAMPS