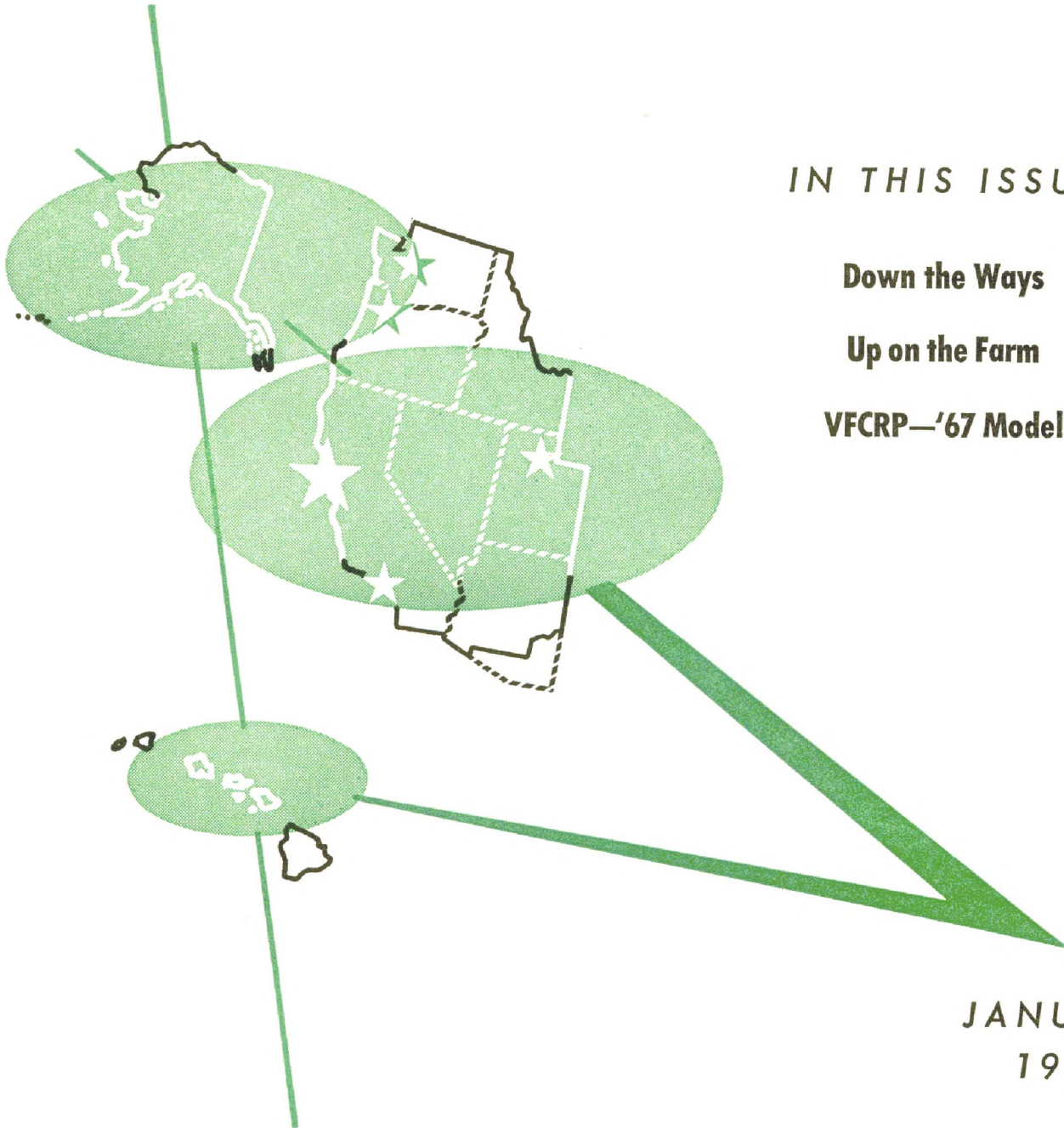


FEDERAL RESERVE BANK OF SAN FRANCISCO

# MONTHLY REVIEW



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JANUARY  
1967

## **Down the Ways**

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## **Up on the Farm**

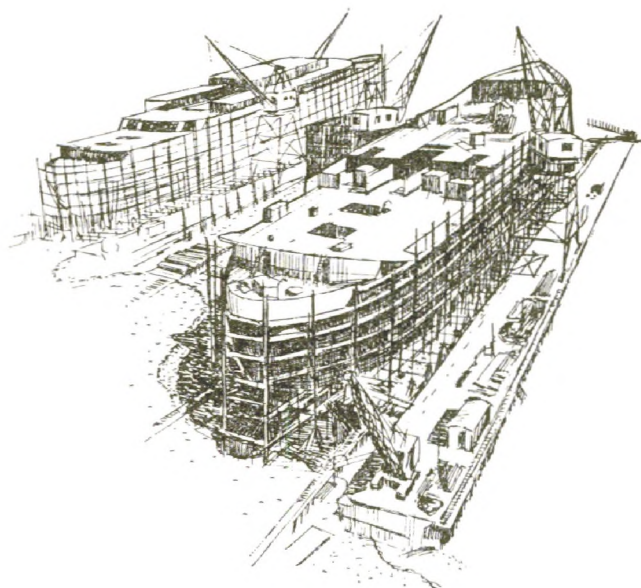
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**Editor: William Burke**





## Down the Ways

**I**N the world's shipbuilding competition Japan stands alone at the head of the list, with almost 35 percent of new merchant-ship construction. Sweden, Germany, and the U.K. follow, with about 10 percent each, and then far behind—in fourteenth place to be exact—comes the U. S., with less than 2 percent of new construction.

It wasn't always thus. In the 1942-45 period, under the pressure of heavy wartime demand, U. S. shipyards delivered over 5,000 ships to the American and Allied merchant fleets. During that period, merchant-ship construction exceeded \$12 billion and commercial shipyards employed some 4 million people. At their peak production rate, U. S. yards could have replaced the entire U. S. prewar fleet within sixteen weeks and the entire world fleet in less than three years' time.

Today, however, the situation is different. The handful of commercial shipyards left in operation, building ships slowly by time-honored methods for a small but guaranteed market, have failed to keep up with the efficient yards built abroad since the beginning of the postwar period. The Navy's \$2-3 billion annual spending for repair and maintenance work is spread around to keep commer-

cial yards operating, and the fourteen shipping lines which receive Federal operating subsidies are required by law to buy their new ships from American yards. But, despite a ship-replacement program which has produced 110 modern ships over the past decade, one Congressional critic claims that "72 percent of the existing merchant fleet is composed of obsolescent, inefficient and uneconomic ships".

All in all, U. S. yards today have only 45 merchant ships under construction or on order. In terms of tonnage, American yards build less than ½ million tons annually, compared to the 4-5 million tons produced by Japanese shipyards and the 1 million tons or so constructed each year by German, British, and Swedish yards.

This feast-or-famine situation has an historic parallel. During World War I as during World War II, the nation's shipyards produced millions of tons of merchant shipping, but those ships were unable to compete two decades later with the efficient modern ships produced in the interim by efficient modern yards abroad. And then as now, U. S.-flag ships dominated the world's sealanes in the immediate postwar period but met much



heavier going in the competitive seas of later decades.

### Who rules the waves?

The U. S. in 1945 operated 60 percent of the world's merchant-fleet tonnage and, even though it sold off a substantial part of that fleet over the next several years, it still accounted for 36 percent of the total in 1948. Since then, however, the U. S. active fleet has declined, from 4½ to 4 million tons in tankers and from 8½ to 6 million tons in dry cargo ships. Meanwhile, total world tonnage has almost quadrupled for tankers and almost doubled for dry cargo ships, so the U. S.-flag share has now dropped to less than 8 percent of the total.

On the other hand, the U. S. fleet is supplemented—perhaps almost doubled—by those “flags of convenience” which are under “effective” American control. Registration data are somewhat inexact for ships registered under Panamanian, Liberian, Honduran and other convenience flags, but perhaps one-half of such tonnage is owned by American citizens and perhaps almost as much by Greek citizens. The system permits the smaller states to gain revenue from the use of their registry, and it enables shipowners to avoid restrictive U. S. maritime laws and high U. S. taxes and

labor costs—albeit at the sacrifice of U. S. subsidy payments as well.

West European flags are the most commonly seen on the world's sealanes today, but Japan and the U.S.S.R. hope to attain dominance in coming decades. In 1965, the British merchant fleet amounted to 20 million tons, the Liberian flag-of-convenience fleet 17½ million tons, the Norwegian fleet 15 million tons, the U. S. and Japanese fleets 10 million tons each, and the Russian and Greek fleets 7 million tons each.

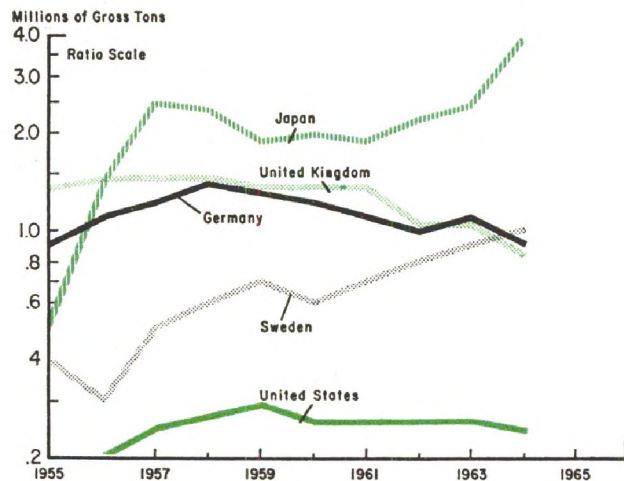
The U.S.S.R. today has 236 ships on order from foreign shipyards, and it also has a substantial shipbuilding capability itself. According to present plans, its merchant fleet may be twice the size of the American fleet by 1971. Japanese shippingmen meanwhile hope to expand their fleet eight-fold by 1980, to some 80 million tons.

### Vietnam rules the waves

American shipping and shipbuilding capabilities have come under increasing scrutiny in recent months, because of the heavy pressures on trans-Pacific supply routes generated by the conflict in Vietnam. About two-thirds of the troops and fully 98 percent of the supplies required for Vietnam have gone by sea, although the Defense Department contends that cargo planes eventually will be able to do the job of moving troops and supplies to battle. By 1970, they may well be doing so, since military air transport capacity will then be equal to about 250-350 Victory-type freighters. But this is 1967, and heavy requirements for shipping are evident right now.

Some of the 1,400 ships in the inactive merchant fleet have been de-mothballed, even though all of these are over 20 years old and cost about \$400,000 each to recondition. Moreover, some of the 950 ships in active service have been shifted from their regular trade routes to the Saigon-West Coast run, many of them under Defense Department charter. To give some idea of the magnitude

### Japan dominates shipbuilding scene, and U. S. lags far behind





of shipping involved in a somewhat similar operation, about 350 ships were needed during the Korean conflict to supply about 500,000 troops at the end of a 6,000-mile-long supply line with some 20,000 tons of dry cargo and 125,000 barrels of petroleum daily.

National emergencies of this type require today, as they did twenty years ago, a sharp increase in commercial shipbuilding and ship-repair activity. Employment in the nation's shipyards is roughly one-fourth higher than it was in the earlier part of this decade, although it is still only a fraction of what it was at the World War II peak.

**West Coast: ships and costs**

West Coast commercial-shipyard employment, which plummeted from 500,000 at its wartime peak to 9,000 in 1950, has since increased to about 22,000—roughly 9,000 in Washington, 8,000 in Southern California, and 5,000 in Northern California yards. In the rest of the country, about 150,000 workers are now employed in ship-repair and shipbuilding. (Naval shipyards, which have generally exhibited a much stabler employment pattern, now employ about 24,000 civilian workers in California and about 10,000 in Washington.)

Over the past decade, East Coast yards have built 138 merchant ships, whereas Gulf Coast yards have built 40 and West Coast yards only 26 ships. The relatively poor West Coast performance reflects cost considerations that differ between the different coasts. For example, a typical freighter that costs \$12.0 million to build on the East Coast may cost as much as \$12.6 million in West Coast yards.

According to Maritime Administration data, West Coast costs are about 5 percent higher than East Coast costs and about 9 percent higher than Gulf Coast costs. No trend is visible in the direction of cost equalization, since labor and material costs have

generally risen at the same rate in each region of the country.

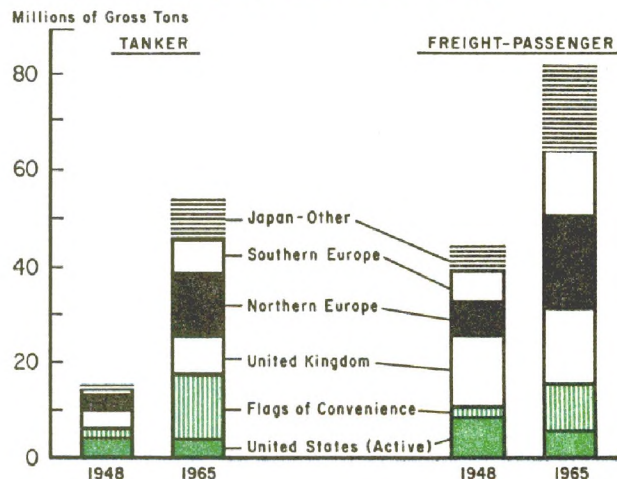
Of the 45 merchant-ship contracts awarded during the last three years, the East was low bidder 16 times, the Gulf Coast 25 times, and the West 4 times. But the Maritime Administration contends that geographical cost differences are "not sufficiently significant to justify any remedies to equalize costs between the coastal districts." West Coast yards formerly received a cost differential of this type, but the legislation permitting this differential was repealed by the 87th Congress.

**U. S.: ships and prices**

Construction work in U. S. private yards centers around the Maritime Administration's 20-year, 300-ship construction program, which got under way a decade ago. About 110 of these up-to-date merchant vessels have already been delivered to U. S. shipping lines, which in return for operating subsidies are required by law to buy their new ships from high-cost American yards.

Ship prices, both here and abroad, have roughly doubled since World War II. A standard dry-cargo ship, mass produced in World War II at \$280 per ton, cost as much as \$1,000 per ton during the shipping crisis generated by the Suez controversy. Prices

**Merchant tonnage expands rapidly, except for ships under U. S. flag**





later dropped about 25 percent below that peak, but about half of the decline has been recovered since 1961.

U. S. prices have risen gradually during the last several years. Shipbuilders have been trying to regain normal profit margins, since previous assignments were relatively profitless because of competitive pressures and because of the limited amount of work available. Moreover, they have recently encountered difficulty in holding their labor force to meet current commitments as well as growing Vietnam requirements. Then again, rising wage rates in other industries have put pressure on shipbuilding wages and on shipbuilding material costs.

But foreign prices have also been rising in recent years. Japanese price levels have increased sharply under the pressure of a massive 9-million-ton backlog of orders. European prices also have reflected rising backlogs; on the other hand, European firms are strongly price competitive, since they are contract hungry because of the increased capacity made available by recent mergers and technological improvements.

### **Japan: dominance**

In their efforts to obtain high-quality merchandise at low cost, shipping men throughout the world have turned increasingly to Japanese shipyards. Japan, which accounts for more than one-third of the world's total construction, sent more than 5 million tons of ships down the ways in 1965. Today it has 34 yards capable of building ships of 10,000 tons or over, and it is increasing its yard facilities by 20 percent annually. Two-thirds of Japanese shipyard production is exported, and this \$700 million in overseas sales accounts for one-tenth of the nation's total exports. All in all, it is a far cry from the Occupation period, when Japan was completely prohibited from replacing its destroyed merchant fleet.

A number of factors account for Japan's

domination of the world's shipbuilding industry. Added together, they lead to such testimonials as the following from one U. S. shipowner, "I build in Japan because their workmanship is excellent; they are good to do business with, they deliver faster, and their prices are the lowest in the world."

Labor costs, which account for almost one-half of the total construction costs on large ships, are an important item in this equation. The Japanese shipyard worker, with his modern equipment, maintains a high level of productivity, and yet earns only a fraction of the U. S. shipyard worker's \$3.15 average hourly wage, so Japanese yards boast a major unit-cost advantage right there.

The attractive prices made possible by such cost advantages provide a very important selling point too. Japan can offer a price as low as \$100 per ton, as against \$175 for European yards and \$270 for U. S. yards. Construction costs per ton have dropped from \$200 to \$73 over the past decade because of a number of engineering innovations—for example, prefabricated engine rooms and deck houses, along with various design changes which have cut steel requirements by almost one-third.

Speed of delivery is yet another major selling point. From time of keeling to time of launching, a Japanese 50,000-ton ship requires less than half the six-month's time required in other yards. Japanese yards have invented or refined a host of construction techniques. Their specialty is building entire ships in separate 250-ton prefabricated blocks with groups of interlocking units welded together. This technique permits work to proceed simultaneously on all parts of the ship, instead of in sequence, and thus cuts down on production delays.

### **Japan: mammoths**

Japan's most spectacular achievement is the construction of giant ships in the 200,000-



## Under Whose Flag?

A subsidiary of an American oil company recently ordered two 68,000-ton tankers from Japanese shipyards for delivery in 1968. The item is not especially newsworthy, except that it typifies the tangled skeins of the international shipping market.

The tankers will be built in Japan for Liberian registry, as they will be owned by a Liberian firm which is a subsidiary of a Swiss firm, which in turn is a subsidiary of the foreign-operations subsidiary of the U. S. oil company. Moreover, they are scheduled to haul crude oil from Persian Gulf oil fields to U. S.-owned refineries in Italy and Australia.

ton category. Earlier giants—the 17,000-ton tanker of two decades ago and the 48,000-ton tanker of a decade ago—were later outmoded by 100,000-ton giants. The latter, however, have recently been superseded in their turn through the development of new construction techniques and of larger shipbuilding docks. Four Japanese yards now contain docks with 200,000-ton ship capacity, and an even larger dock will be ready this year.

The past year has witnessed the launching of a 150,000-ton giant with a 1.2-million-barrel crude oil capacity, but this was recently followed down the ways by a 210,000-ton giant. At present, 61 ships in the 100,000-ton class or over are under construction, and a U. S. firm has recently ordered six tankers in the 276,000-ton category.

These giant tankers are an entirely new phenomenon, resulting from the spectacular increase in world petroleum demand and the spectacular economies available in moving oil in bulk from Persian Gulf fields to Western markets. The mammoth ships are of course restricted to special-purpose runs and to specially-built ports. In fact, one major firm plans to supply the European market from a million-ton tank farm on the Atlantic

Coast of Ireland, since it considers the North Sea and the English Channel to be too shallow for these Japanese dinosaurs to enter.

### Sweden: technique

Sweden, like Japan, has been a pioneer in developing ship construction techniques. As evidence of this, the U. S. recently negotiated for license rights on a number of Swedish patents after U. S. Navy Secretary Nitze investigated the mechanized yard at Arendal, Sweden.

The Arendal yard can produce a 70,000-ton tanker in twelve weeks' time with only 40 percent of the manhours required by the same firm's nearby conventional shipyard. The new yard emphasizes prefabrication, but this of course is now a standard technique. What is unique is the use of a small work force with very advanced equipment, operating under cover along a straight production line.

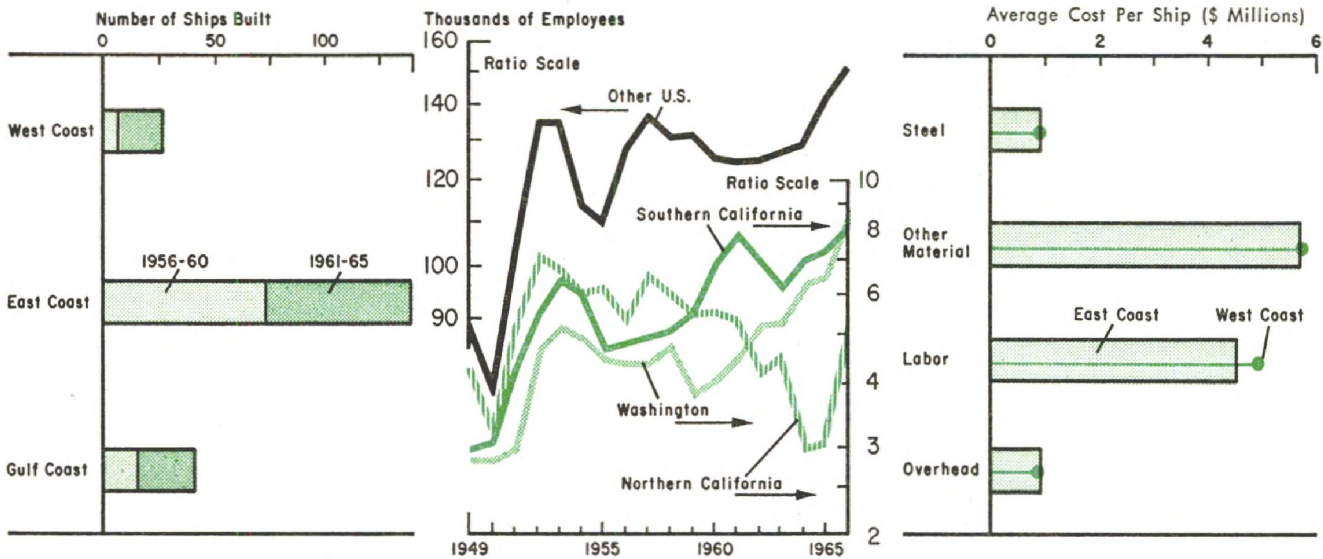
The final stage of an Arendal launching typifies the new style. The ship emerges from a covered dry-dock in sections. Hydraulic jacks push the stern into the open, and hydraulic doors close around the inner-end of the completed section; the next section is then assembled and joined to the first by a fast-moving welding machine, and so on. The ship is fitted-out with wiring, plumbing, and engines as it emerges into the open part of the dry-dock, the completed ship is then floated in the dry-dock—not launched down ways—and is then readied for sea trials within another week.

### U. S.: fast deployment

The Navy has not only turned to the Swedes for advanced techniques, but it has also enlisted the aid of several technically oriented aerospace firms in developing a large fleet of high-speed transports—FDL's, or Fast Deployment Logistic Ships. It has awarded three study contracts to aerospace firms to encourage the spin-off of technologically advanced techniques into the field of shipbuilding, and



**Shipbuilding employment increases under pressure of reconversion work  
 . . . East Coast dominates industry because of construction cost advantage**



on the basis of these studies, it plans to award a \$1-billion contract this June for up to thirty ships for delivery in the 1970-72 period.

The FDL program would be linked directly to the C5A program as part of the Defense Department's policy of rapid logistic support. The C5A could fly troops to trouble spots anywhere in the world within a matter of hours, and the FDL could bring in ammunition, C-rations, vehicles, tanks, and artillery within a very short time. (Since trouble spots do not always provide port facilities, each ship would carry two helicopters, barges, and deck cranes for unloading.) An FDL could cover the distance between San Francisco and Saigon in eight days travel—half the time required by older ships and three days less than required by modern ships now under construction.

The FDL program envisages the construction of the first new and automated private shipyard since World War II. It should increase the standardization of ships and increase the modernization of shipyards. In the \$150-million, 5000-worker shipyard now planned, work would be performed as it is on an aircraft production line—with the use of numerically controlled machines, computer control for inventory movement, and auto-

mated welding techniques. In sum, the program envisages the application of total systems planning, aerospace style, to ship construction.

**U. S.: modernization**

In another development, the Navy has awarded the largest blocks of ship procurement contracts since World War II, in the form of a \$250-million contract for 17 landing ships and another \$250-million contract for 20 destroyer escorts. The technological advances achieved through this and the FDL program should help U. S. shipyards catch up with foreign shipyards—for example, in the greater automation of steel handling (the most costly item in cargo-ship construction), the increased use of building docks rather than slip ways for more concurrent outfitting, and the prefabrication of increasingly large ship sections.

In yet another development, several Federal agencies have recently advanced plans for the construction of three or four more nuclear merchant ships. The earlier resistance to nuclear-powered ships has declined as the technological advantages of such construction have become more apparent, and also as the cost differential in favor of non-nuclear ships



has declined from 50 percent to roughly 20 percent. In fact, the operator of the first American nuclear merchant ship, the SS Savannah, is so impressed with its capabilities that it has submitted applications to the Maritime Administration for three more nuclear ships for its foreign trade routes.

In other ways too, the U. S. maritime industry has shown its recognition of the need to expand and modernize. For one example, the average general cargo ship today has one-fourth greater cargo capacity than the early postwar model. Moreover, major innovations have included the introduction of high-capacity specialized bulk carriers, the introduction of automated ship-control equipment, and the increased use of standardized cargo containers.

The 1,000 giant ships now sailing—30-knot ships in the 30-150,000 ton category—today carry one-half of the world's bulk cargo, and each such ship requires no more crew than is needed aboard an old-style 11,000-ton Liberty ship or 16,000-ton T2 tanker. Advances in the construction of mammoth ships are more obvious than advances in ship automation and containerization, but the cost advantages from operating and loading techniques are now increasingly evident to maritime industry leaders.

Yet with all these advances, the high costs and long delivery delays of American shipyards have helped prevent the development today of an up-to-date merchant fleet. Thus, in the Vietnam crisis, the Government has been forced to eke out its needs by taking some ships off their regular trade routes, by chartering foreign-flag ships, and by taking World War II ships out of mothballs. U. S. shipyards have played only a small role in this crisis—apart from their reconversion work—since they are geared to produce only a relatively few vessels every year, and are able to do this only because the Government pays more than half of each ship's construction cost

so as to equalize the differential between U. S. and foreign yards.

### How much subsidy?

The construction differential subsidy is intended to aid shipbuilding by absorbing the excess of the U. S. construction cost over the cost of comparable construction in foreign shipyards. Payment is authorized under the terms of the Merchant Marine Act of 1936—a pathbreaking piece of legislation for the nation's shipbuilders as well as the nation's shipowners.

Under the act, the Government and the ship operator contract with a U. S. shipyard, with the Government paying the construction differential (and so-called national-defense allowances) and the operator paying the balance of the domestic construction costs. The shipping line, in other words, pays what it would cost to obtain a similar ship from a low-cost foreign yard. In the postwar period over \$600 million has been paid out for subsidy payments on over 125 new ships plus a small amount of reconversion.

The law as recently extended sets a 55-percent maximum on the construction differential subsidy. (Through 1959, the statutory limit was 50 percent.) Subsidy rates in recent years have been consistently in the 50-55-percent range, and Government subsidy payments have increased 20 percent since the beginning of the present ship-construction program in 1958.

As a reflection of the growing differential between U. S. and foreign costs, an uptrend in subsidy rates has become evident since the beginning of the current construction program. In 1957 several bids implied subsidy requirements of about 45 percent, but in the 1958-62 period subsidy rates were near 50 percent. Finally, this past spring, four new shipbuilding bids implied subsidy rates of 56-57 percent—which of course exceed the statutory ceiling.



### Why subsidy?

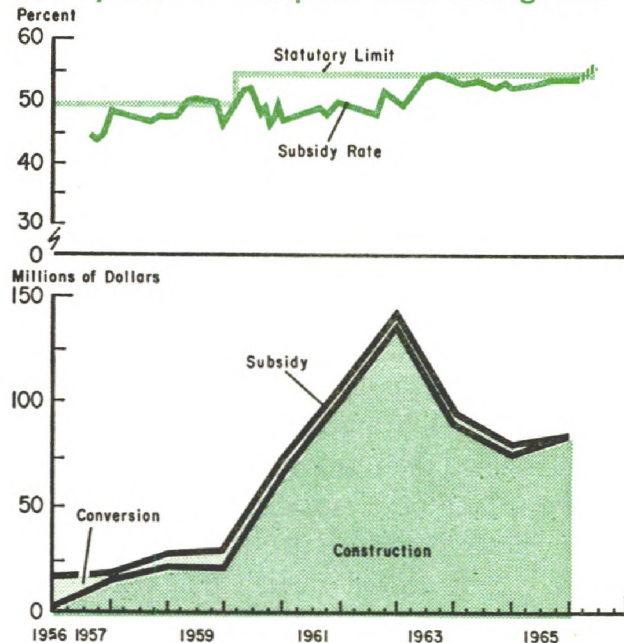
The subsidy program came under sharp attack in the report submitted by the Inter-agency Maritime Task Force in late 1965. This Administration report noted that U. S. yards have no competition, due to the legal requirement that ship operators must buy in this country in order to obtain operating subsidies. Thus, there is no realistic option to build abroad for ships of U. S. registry, and the expansion or replacement of the U. S. merchant fleet must be carried out at U. S. shipyards at double the price available elsewhere.

The task force noted that annual subsidy payments amount to roughly \$120 million for ship construction and \$32 million for ship repair—roughly five percent of total Government spending on shipyards—but it also noted that payments are limited to only about five of the twenty surviving private shipyards. And with a 57-percent subsidy rate, the Government would be forced to spend 57 cents in this country in order to conserve 43 cents in foreign exchange—“a high price for this conservation.”

The task force thus proposed that the construction subsidy be restructured to improve industry competition, and also to establish a realistic ship purchaser’s option to build abroad as an incentive to increased shipyard productivity. The proposed program would simply relate the amount of construction subsidy to the national requirement for shipyard capacity. In the Task Force’s words, “Domestic shipping is the only mode of domestic transportation required to purchase its equipment solely in the U. S.; we see American domestic airlines with British aircraft and railroads and truck operators with German equipment. This market advantage is denied to the water carrier on the basis of a law passed in 1817 to develop shipyard capacity.”

The proposed program, like the current program, envisions the continuation of shipyard employment of about 150,000 and con-

### Subsidy payments required to permit U. S. yards to compete with foreigners



struction of about 21 merchant ships each year for the next several decades. Unlike the current program, however, the proposed program envisions a 10-percent expansion in tonnage (instead of a 20-percent decline) through the construction of more giant ships. And, with an improvement in U. S. ships, it expects U. S. shipping to hold its 9-percent share of U. S. foreign trade, instead of dropping to 3 percent as it might otherwise do.

Defense Secretary McNamara previewed the Task Force recommendation in testimony before a House committee in early 1962. In his words, “From a purely military point of view the reserve fleet, plus vessels in service, plus the construction program previously outlined, appear adequate to our needs . . . I do not wish to overstate the military requirement, thereby providing an umbrella under which a huge ship construction program for the merchant marine can be justified.”

Secretary McNamara reiterated this view in early 1966. Whether the shipping requirements arising out of the present crisis in Vietnam will yet modify his view is a question which 1967 may answer.

—William Burke



## VFCRP-'67 Model

The Government's voluntary credit-restraint program will be continued in 1967, in an effort to move toward international payments equilibrium "as fast as the continued substantial costs of Vietnam will permit." According to the revised program announced in mid-December, the Commerce Department will tighten the formula governing the overseas flows of corporate direct investment, and the Federal Reserve Board will retain the 1966 ceilings on outstanding bank loans to foreigners but will simplify the rules governing loans to foreigners by nonbank financial institutions.

The new guidelines for bank lending to foreigners are substantially the same as last year's rules. Banks are requested to limit the amount of such loans outstanding to 109 percent of the roughly \$9 billion outstanding on 31 December 1964—the same ceiling and dollar base as in 1966.

Commercial banks as a group were about 13 percent under their ceiling at the end of September, so they will have some leeway for loan expansion during 1967. However, the Federal Reserve Board requested that they use up that margin at an even pace throughout late 1966 and 1967. In addition, the Board asked banks to use no more than 10 percent of their leeway in making loans not directly related to the financing of either U. S. exports or the developing countries' credit needs. At the same time, the Board afforded special consideration to banks with foreign credits of \$10 million or less, so as to encourage their export financing efforts.

In the 1967 program, the three guidelines used last year for nonbank financial institutions, such as insurance companies and private pension funds, will be replaced by a single guide permitting a 5-percent increase in foreign credits and investments by year-end. But certain types of assets previously subject to ceilings—for example, bonds of the International Bank and the Inter-American Development Bank—may be excluded under the revised guidelines.

In its 1967 program, the Commerce Department set revised investment targets for the foreign subsidiaries and affiliates of U. S. firms. Corporations were asked to limit their capital transactions for 1966 and 1967 to no more than 20 percent above the average annual rate of spending (capital outflows plus reinvested earnings) recorded in the 1962-64 period. This ruling may restrict the outflows of some firms, since the guidelines issued a year ago permitted an increase of 35 percent, instead of 20 percent, for 1966 capital outflows.

The voluntary credit-restraint program has played an important part in improving the U. S. international payments position since its initiation in February 1965. Between the near-crisis period of fourth-quarter 1964 and the first three quarters of 1966, outflows for direct investment remained close to a \$3.2-billion annual rate, but outflows in the form of portfolio investment and short-term credits dropped sharply from a \$5.6-billion to a \$0.5-billion annual rate. Much of the 1966 improvement, however, can be attributed to general monetary conditions rather than to the workings of the VFCR program.



## Up on the Farm

LAST year was the second straight year of abundant prosperity for the nation's farmers. Their net income during 1966 exceeded \$16 billion—fully one-fourth more than it was two short years ago. Production costs continued advancing, as usual, but net income jumped sharply as a consequence of an increased volume of marketings and an unexpectedly large increase in farm prices.

This performance may be difficult to repeat in 1967, according to latest Agriculture Department reports. Production expenses again are expected to advance. Gross receipts may not rise, however; direct government payments should drop, and receipts from marketings should rise only modestly (despite a continued gain in output) because of some easing in farm prices which hitherto have been sharply rising.

### Western upsurge

Western farmers recorded a substantial gain in 1966, to about \$1.7 billion in net income, but their expenditures remained high and their net income increased at only half the national pace. Over the year, growers recorded a 2-percent gain in crop marketings as against a 6-percent gain elsewhere, but stockmen, like their counterparts elsewhere, posted a sharp 15-percent increase in receipts.

Western farmers failed to match the national pace partly because they accounted for only a small share of 1966's most profitable products and partly because they encountered narrowing profit margins in certain Western specialties. Hogs and soybeans, the strongest pillars of the national farm prosperity, are only minor sources of income for Western farmers. Moreover, net returns from Western cattle-feeding operations have failed to grow as fast as gross receipts; the rising costs of feed grains and the rising costs of cattle entering feedlots are the major factors in this cost

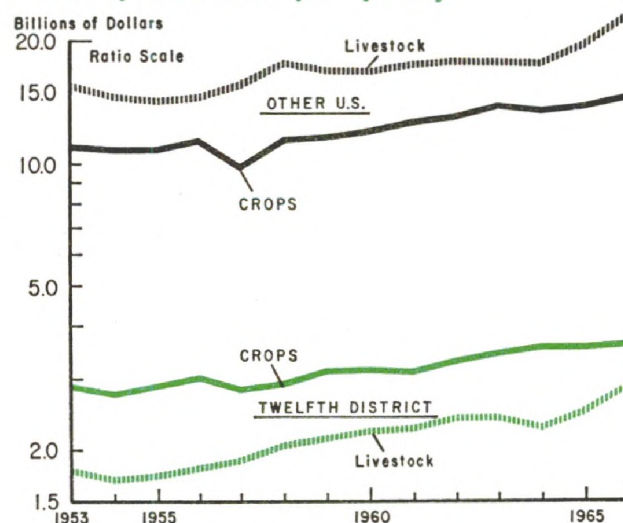
squeeze. In addition, the West's important cotton crop has suffered from reduced acreage, lower yields, and lower market prices, and these factors have been only partially offset by rising government payments.

The income situation of Western farmers continues to be beset by rising costs. Between 1961 and 1965, the last year for which detailed data are available, costs increased 20 percent in the West as against only 13 percent elsewhere, as a consequence of sharp rises for such items as pesticides, debt interest and taxes. Labor costs, which are more than twice as important in Western operating budgets than they are in other regions, increased 10 percent in this period in the West while dropping elsewhere.

### New era dawning

Nonetheless, the demands for farm products nationwide have grown by enough to more than offset these rising costs, and the prospects for further increases in demand are bright indeed. The post-Korean period of superabundant supply is coming to a close, and a new era is now dawning, characterized by a supply that is merely abundant and a worldwide demand that is accelerating rapidly.

### Cash receipts expand, as livestock boom sparks farm prosperity





In the early post-Korean period, agricultural policy emphasized the control of farm output and the expansion of foreign markets. In 1954, Congress authorized acreage allotments and marketing quotas for most crops in order to forestall an inventory buildup, and at the same time it passed Public Law 480 in a major effort to move surplus stocks into foreign markets through foreign-currency sales. For instance, the crop restriction program, along with a sharp rise in exports, was responsible for reducing U. S. cotton inventories by 4 million bales in 1966.

Now, a decade later, the concern is not about burdensome stocks but rather about adequate supplies to meet foreign and domestic demand. Demand here at home has risen along with population and income; demand abroad has skyrocketed because of gains in purchasing power in some countries, major crop failures in other countries, and sharp gains in population everywhere. As a result, the U. S. crop acreage harvested for export (including feed for livestock) has jumped from 37 to 78 million acres between 1954 and 1965, and one-fourth of the nation's total crop output has moved into export trade channels.

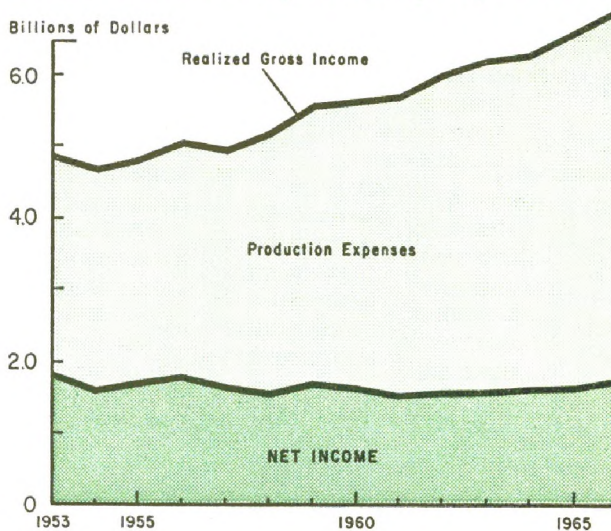
These basic demand factors have created favorable conditions for the regional as well as the national industry. The overall trend of demand for Western products—cotton, wheat, livestock, fruit, and vegetables—should be strong in 1967 and thereafter well into the foreseeable future.

### Improvement in cotton?

Cotton, the District's largest cash crop, should fare better in 1967 by virtue of higher output from higher yields, despite the continuation of recent restrictions on acreage.

Efficient California and Arizona farmers, unlike their counterparts elsewhere, relied very little last year on the government payments offered for taking more than the minimum required acreage out of production. Out of their total allotted acreage, cotton farmers

## Western farmers register gain in net income, despite rising expenses



elsewhere planted only 60 percent, whereas Arizona farmers planted 77 percent and California farmers 85 percent of total allotments. However, Western producers suffered from insect and weather damage as well as from restrictions on the practice of skip-row planting.

With roughly the same acreage as before and with more normal growing conditions, Western cotton farmers expect to increase their output in 1967. They also anticipate a gain in marketing receipts; the price-support loan level will be reduced but the market price should be about the same as in 1966. Moreover, government payments also may rise since they are geared generally to the (rising) trend of farm expenditures.

### Scarcity in wheat?

Wheat, the major crop of the Pacific Northwest, will be faced with the almost unknown problem of scarcity rather than surplus. This development is a consequence of the successful efforts of the past decade to limit production increases through acreage restrictions, to channel commercial and government shipments into the export trade, and to encourage the domestic use of wheat as animal feed. Thus, between the 1961 and the 1967 crop years, U. S. wheat inventories have declined from 1.4 to 0.4 billion bushels.



In early 1966 it became evident that additional supplies were needed to meet export and domestic requirements. Thus, acreage allotments for the 1967 crop were raised in May and again in August, by almost one-third overall, to 5.7 million acres in the District and to 62.5 million acres elsewhere.

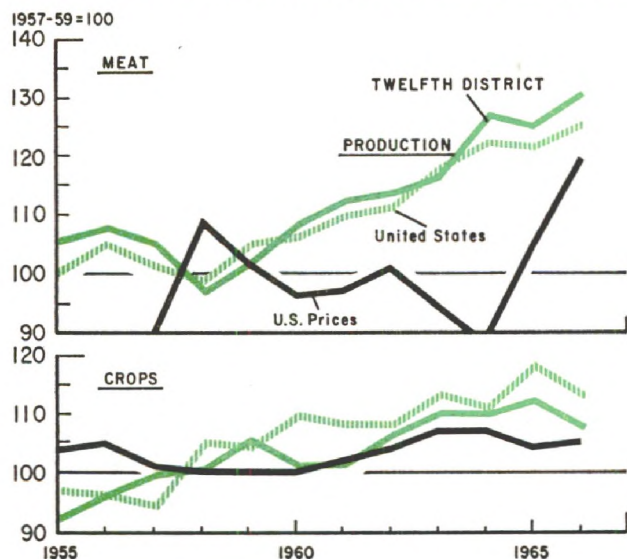
For the 1967 crop, moreover, farmers will be permitted to plant all of their allotted acreage instead of diverting one-eighth of the acreage from wheat into soil-conservation use. The new program retains the \$1.25-per-bushel price-support loan level.

**Livestock still booming?**

The nation's livestock producers hope to match their extremely favorable 1966 record in 1967. In 1966, marketing receipts soared because of increased marketings and substantially higher prices. In 1967, prices are expected to be lower than last year—although still high by historical standards—and total receipts thus may not rise so sharply as they did in the preceding year or two.

Nationally, some increase in milk output is expected after the recent sharp decline, since milk producers should respond to the rising trend of milk prices and to the decreasing attractiveness of a shift into meat production.

**Livestock bonanza sparked by rising output and sharply rising prices . . . boom centered elsewhere, since livestock play larger role outside District**



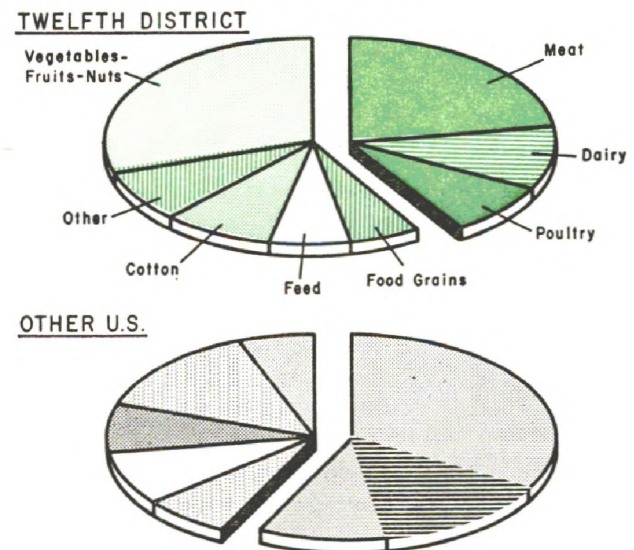
Increased production is also expected in pork, poultry, and eggs. However, beef production may decline as the marketing of cows is held down in order to build up cattle herds. If so, a supply problem may develop for Western feedlot operators, since they rely heavily on sources outside the District for cattle to be fattened in feedlots.

**Fruit-vegetable outlook**

Western fruit producers will be hard put to match their bumper 1966 crop. In the season just past, Northwest orchards rebounded sharply from their freeze damage of the preceding year, and in California the cling-peach crop was heavier and pears were much more abundant than in 1965.

A bumper citrus crop is now in prospect, but the West—which today accounts for only one-sixth of U. S. output—may not play much of a role in this market. Sharp increases are expected in Florida, which supplies over 80 percent of the total crop, and in Texas, which has sharply increased citrus acreage in recent years.

Nationally, producers of processing vegetables may encounter a heavier demand from processors in 1967, and this should redound to the benefit of Western producers as well.





The inventory of canned and frozen vegetables is no larger than a year ago, despite sharp increases in production last year.

### Food as culprit

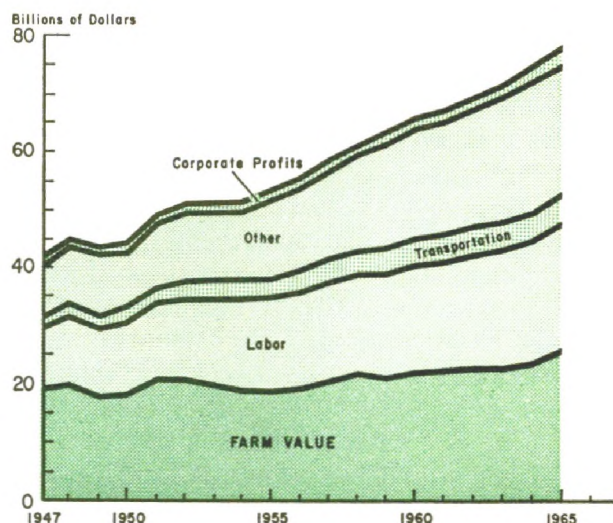
The recent and future shifts in the farm sector may not appear crucial to the business outlook; after all, the farm sector alone accounts for only 4 percent of GNP. However, the recent sharp rise in farm and food prices has affected family budgets everywhere—and in a very visible manner—and thus has given rise to pressures to obtain greater-than-guidelines wage boosts in forthcoming labor negotiations. In this respect, the farm sector may play a major role in the 1967 business situation.

Over the past 1½ years, the food component of the consumer price index has risen over 8 percent—twice as much as the increase for all other items (including sharply rising service prices). In the same period, while the industrial-commodity component of the wholesale price index was gradually rising, farm and food prices shot up 12 percent before tapering off this past summer and fall. The controversy over these increases became so sharp that when Agriculture Secretary Freeman suggested that farm prices would shortly decline, he was roundly criticized by farmers everywhere.

Yet, despite this, Secretary Freeman was eventually proven correct about the course of consumer meat prices. These have dropped about 2 percent since last spring, after rising 17 percent in the preceding twelve-month period. But other components have continued to put pressure on the consumer's food budget; after rising moderately in 1965 and early 1966, bakery prices thereafter have risen 5 percent and dairy products have jumped 8 percent.

Farmers contend, as they have for some time, that rising marketing costs are the culprit in the food price increase. Between 1951 and 1965, when the farm value of the food

### Farm value of food budget rises, but not as sharply as marketing bill



market basket was rising from \$20.5 billion to \$25.5 billion, marketing costs (labor, transportation, and other processing and selling costs) jumped from \$29 billion to \$52 billion and thereby sharply boosted the final price to consumers.

### Superabundance to abundance

In any case, farmers and consumers alike are moving into a new era—from a period of superabundance calling for supply management to a period of simple abundance calling for supply expansion to meet sharply rising worldwide demand. The market for U. S. products has been rising in this decade by about 2½ percent annually, after growing only sluggishly during the preceding decade. Thus, fully 4 percent of the food and fiber consumed last year has come out of the stocks accumulated from previous surpluses, and the one-sixth of the nation's farmland taken out of production since 1950 looks increasingly attractive as a production resource.

All in all, the future is bright for the regional as well as the national industry. The sharp increases in income of the recent past may not be repeated, but the continued strength of demand seems assured for the foreseeable future. —Donald Snodgrass



# Western Digest

## Banking Developments

Bank credit expanded by \$207 million at District weekly reporting banks during November. The November increase—which followed two months of contraction in credit—was about evenly divided between loans and investments. . . . Business borrowing was the major factor contributing to the loan increase; mortgage loans and consumer loans both registered small declines for the month. An expansion in Treasury security holdings accounted for the increase in investments, since holdings of short-term municipals sharply declined during the month. . . . Weekly reporting banks recorded an increase in demand deposits adjusted in November, but this was more than offset by a sharp reduction in U. S. Government demand deposits. Total time and savings deposits also declined. District banks paid out a record amount of Christmas Club accounts, and these withdrawals substantially exceeded a seasonal increase in state-local government time deposits.

## Employment and Unemployment

Nonfarm employment dipped slightly in California and Washington during November, mostly because of declines in construction and some manufacturing industries. Over the month, nonfarm jobs dropped from 6.18 to 6.16 million in California, and from 1.03 to 1.02 million in Washington. . . . Aerospace activity remained high in these states, as employment rose slightly to 556,000 in California and 95,000 in Washington. At those levels, California employs one-eighth more aerospace workers than a year ago, and Washington employs fully one-half more. . . . Unemployment (seasonally adjusted) dropped to 4.9 percent in California in November. Both regionally and nationally, joblessness dropped back to last spring's level after drifting upward during the summer and early fall months. But the national rate, at 3.7 percent in November, remained substantially below the California rate.

## Construction Activity

Construction activity was briefly spurred in November by the start of two particularly large projects—a water tunnel in Los Angeles County and an office building in San Francisco—but the one-month gain could not be interpreted as a reversal of the downward trend of recent months. The non-housing sectors of the construction industry have continued to post respectable gains over year-ago levels, but not enough to offset the housing slump. Residential awards were off 28 percent in the District, and 12 percent elsewhere, between the first eleven months of 1965 and the comparable period of 1966. . . . This year, reductions in awards for heavy construction are expected in the light of the Administration's recent cut in allotments for the Federal highway program. In fiscal 1967, District state allotments will be reduced 18½ percent (\$137 million). . . . Housing's satellite, the lumber industry, showed improvement in November, as increases of \$1 to \$3 per thousand-board-feet were posted for various categories of lumber. Declining production and a temporary rise in orders accounted for the modest price advance at Northwest mills, but no real improvement in consumer demand was evident, in view of the continued weakness in the residential construction sector.