

MONTHLY *Business Review*

FEDERAL RESERVE BANK of CLEVELAND

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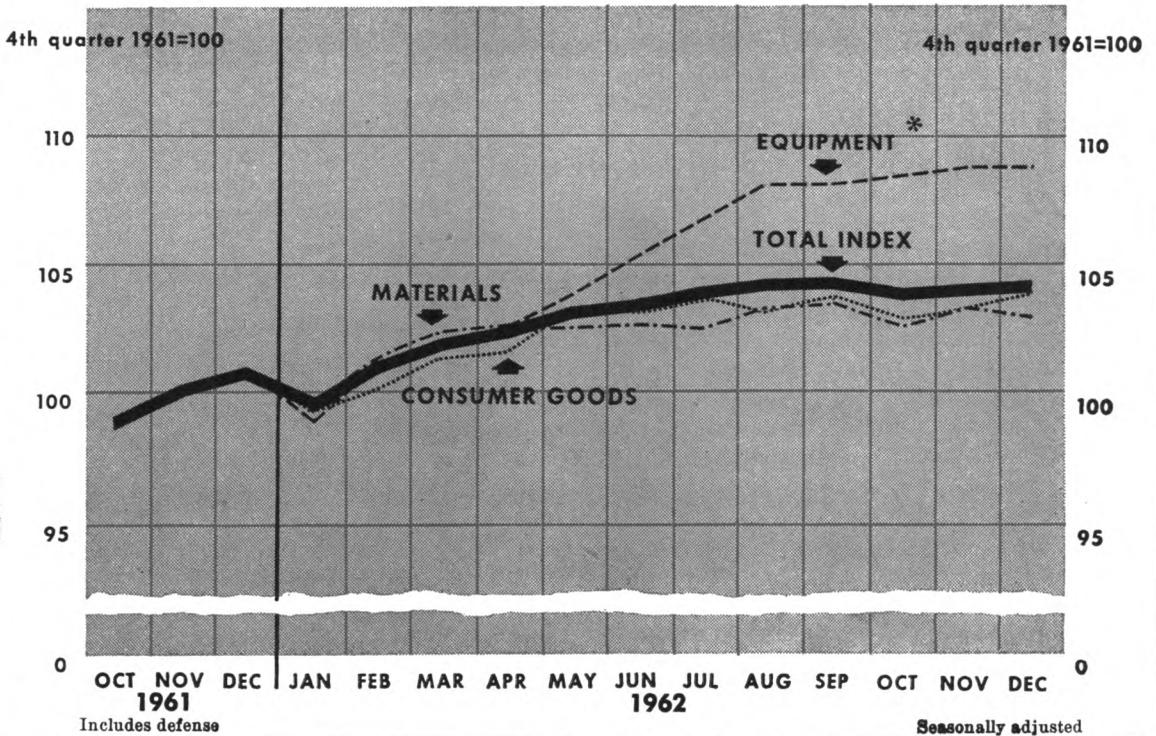
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1962 In Retrospect

THE YEAR just passed was one when great expectations for business activity were dashed early in the year. It was a year during which large and sudden changes in business sentiment were perhaps the most publicized characteristics. Yet, when all was done, 1962 proved to be a year of moderate expansion.

News that Gross National Product had increased by hardly more than one percent between the fourth quarter of 1961 and the first quarter of 1962 brought the first realization that the projected goal of \$570 billion for the year was probably not to be. Then, when the sharp break in security prices came during May and June, widespread doubts about the business outlook grew to serious proportions. The major question of that time became, "How long can the expansion last," rather than, "How high will the economy soar." The expansion nevertheless continued, albeit somewhat unsteadily until October, at which time the pace of business became noticeably firmer.

As 1962 progressed it became increasingly obvious that some of the questions of economic significance which had accompanied other postwar expansions were no longer as germane. With price stability persisting throughout the year, the question of how to combat inflation remained secondary to the question of how to stimulate economic growth. The persistent hovering of the unemployment rate between 5½ and 6 percent, and the less than full use of productive capacity identified areas of economic concern where some sort of solution needed to be found. Thus, it is not surprising that there emerged increasing attention on possible fiscal measures which might provide a stimulant to growth in the economy at large.

In this connection, depreciation schedules were liberalized by the Administration, and a new tax credit law on investment was passed by the Congress. A reduction in corporate and personal income taxes was given serious attention during the summer, although formal consideration was postponed. Increases in Federal spending were invoked during 1962 as a means of stimulating business activity. For example, spending under the federal highway program was stepped up, military obligations were increased sharply after June, and the Congress gave the President powers to obligate funds for a \$900-million public works program.

In retrospect, however, some developments in 1962 were very encouraging. For example, the economy weathered in quick succession a national debate on the issue of prices in the steel industry, and its far-reaching implications, a prolonged liquidation of steel inventories, a severe decline in equity prices, a brief but sharp decline in consumer demand, and a trip to the brink of war. While the business expansion did not attain the goals laid down by the President's Council of Economic Advisors, it was in line with the more moderate general business forecast for 1962, which had envisaged a GNP for the year of \$555-560 billion. However, it is highly unlikely that many general business forecasts for 1962 had anticipated anything like the particular chain of events which actually occurred during the year.

The ability of the economy to overcome a series of obstacles and to continue its advance was, in itself, a significant economic event of the year. It indicated a basic vitality in the economy which was to some extent overlooked in the preoccupation with the question of how

long the expansion could continue. Largely forgotten was the fact that the advance of both GNP, in constant prices, and the Federal Reserve Index of Industrial Production from previous peaks was fairly substantial when compared with previous postwar expansions.

With respect to various measures that were considered for stepping up economic growth, there developed a surprisingly widespread opinion that reductions in income tax should be in the forefront of the attack. By the end of the year, the debate was confined largely to questions of whether it should or should not be coupled with tax reform and reductions in federal spending. Another important consideration was whether reductions in taxes should have the objective of stimulating, in the first instance, consumption or investment, or both. On this account alone, the events of 1962 deserve a careful review, because to some extent they may provide evidence as to where the shortfalls in the economy occurred; they may also shed some light on the areas where official tax actions may be most needed.

Consumer Sector

The irregular rate of expansion during 1962 in the economy at large was apparent even in the consumer sector, which was alternately weak and strong during winter, spring, summer and fall. To a large extent, the irregularity reflected a particularly erratic pattern of new domestic car sales. Car sales rose from a seasonally adjusted annual rate of slightly less than six million in January to over seven million by April. During the summer, car sales declined irregularly, only to rise very sharply during the new model sales season in October and November. Total sales (including imports) of 7.1 million new cars for the year set the best record since 1955.

Personal Consumption Expenditures. Despite the strong showing of automobile sales during the year, the allocation of consumption expenditures continued to shift toward more spending on services. Consumption expenditures for services, as a percent of dis-

posable income, continued to rise during the year, while the comparative percentages for nondurable goods, durable goods, and savings continued below previous levels.

The chart on page 4 shows estimated personal consumption expenditures for 1962 and previous years by types of spending. It also shows what the dollar amount of expenditures and savings would have been in the years shown, had the actual amounts of these components been equivalent to the same percentage of disposable income as they were in 1956.⁽¹⁾

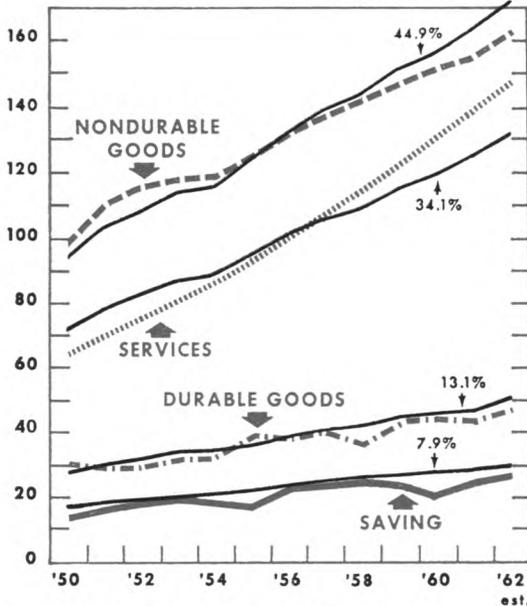
A comparison of actual 1962 allocations of consumer expenditures with what those allocations would have been at 1956 rates throws light on shifting patterns of consumer spending in recent years. The differences may be summarized as follows: expenditures for services in 1962 were \$14 billion *more* than they would have been at 1956 rates, while expenditures for durable and nondurable goods were nearly \$13 billion *less* than they would have been at 1956 rates, and savings were about \$1 billion *less*. Part of the increase in the spending for services thus represented a gain from the shift away from spending on all kinds of goods; and part of the gain of course also reflected the increased share that service spending has been taking out of advancing disposable income.

Savings. Contrary to its behavior during the recovery years of 1955 and 1959, personal savings taken as a percent of disposable personal income, declined only slightly between 1961 and 1962. As indicated by the chart, the more "normal" behavior of the savings "rate" during comparable expansion years of the last decade has been to decline *sharply* as the expansion progresses, at a time when consumer spending is picking up momentum. The failure of the savings rate to decline further than it did during 1962 may be explained by a number of things. For example, it may have reflected to a large extent the higher interest rates generally available at financial institutions; or it may have merely

(1) 1956 is used as a benchmark year because it was not distorted by recession as were 1954, 1957 and 1958, nor by abnormally high durable goods sales as was 1955.

CONSUMER SPENDING AND SAVING (in current dollars)

Billions of dollars



Note: The black lines show what the dollar amount of the individual series would have been in each year, if the individual series had been equivalent to the same percentage of disposable income as it was in 1956.

represented a return to the more normal relationship of savings to disposable income that prevailed during much of the 1950's. Savings declined from 7.9 percent of disposable income in 1956 to a low of 6.0 percent in 1960, and had moved back up to 6.9 percent by 1962. If comparably higher savings rates in earlier years—7.9 percent in 1956 and 7.6 percent in 1957—were associated with strong consumption expenditures in those years, it would not appear reasonable to argue that lagging consumer spending in 1962 was due to strong savings activity.

Spending. Increases in consumption expenditures during 1962 were less than the increases which had occurred during the earlier recovery years of 1950, 1955, and 1959. However, one reason why the increase in 1962 was comparatively slight was that the decline in spending during the immediately preceding 1960-61 downturn was also slight. In order to put all four recovery periods in

longer-range perspective, the chart on the opposite page on changes in income and spending was designed to sidestep the tracing of individual recession patterns and to concentrate instead on the net advance in consumer expenditures from the peak of one expansion to the next period of advance. Specifically, the chart compares percent changes in consumer expenditures and consumer credit from the peak quarter of each expansion period to the sixth quarter after the trough of the intervening recession. All comparisons are based on estimated constant (1954) dollars.

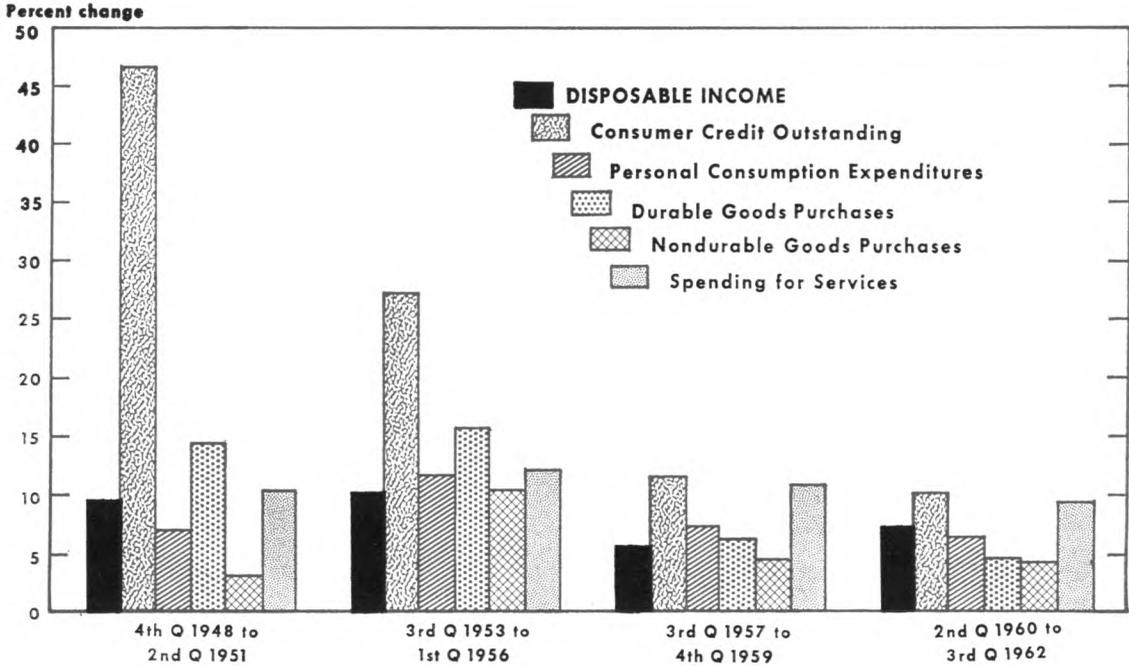
When judged on this basis, there was still a noticeably smaller upward movement in consumption expenditures in 1960-62 relative to the increases in the comparable periods of 1954-55 and 1957-59. The slowdown in the 1960-62 rate of increase occurred despite the fact that real disposable income increased more in the recent 1960-62 period than it did in the 1957-59 period. The explanation of these diverse movements lies in the fact that in 1960-62 consumers were apparently less inclined than previously to increase their total spending power by taking on debt. As the chart shows, the rate of increase in disposable income turned up in 1960-62, but the rate of increase in instalment credit outstanding continued to taper off, as it had throughout the 1950's.

Business Sector

Although consumption expenditures may have been slightly below expectations during much of 1962, it was spending by the business sector which was the more disappointing. While both physical output and consumption dollars were at record highs during 1962, business spending, particularly for investment (plant and equipment and inventories), may be judged as conservative, although some interpretations may vary, depending upon the yardsticks used for comparison.

A myriad of factors may have contributed to the sluggishness of investment in the business sector. These would include concern because of the erratic nature of the expansion,

CHANGES IN INCOME AND SPENDING



Note: Constant 1954 dollars, seasonally adjusted

a lack of firmness in industrial prices, excess capacity, declines in stock prices, and uncertainty regarding proposed changes in tax laws. While attitudes cannot be precisely measured, they were nonetheless one of the outstanding characteristics of the year.

Industrial Production. Industrial output as measured by the Federal Reserve Index of Industrial Production (1957-59 = 100) averaged 118.2 in 1962, or approximately seven and one-half percent higher than in 1961. Its rate of increase declined, however, as the year progressed so that the level of output during the fourth quarter was not quite three and one-half percent higher than it had been during the previous December.

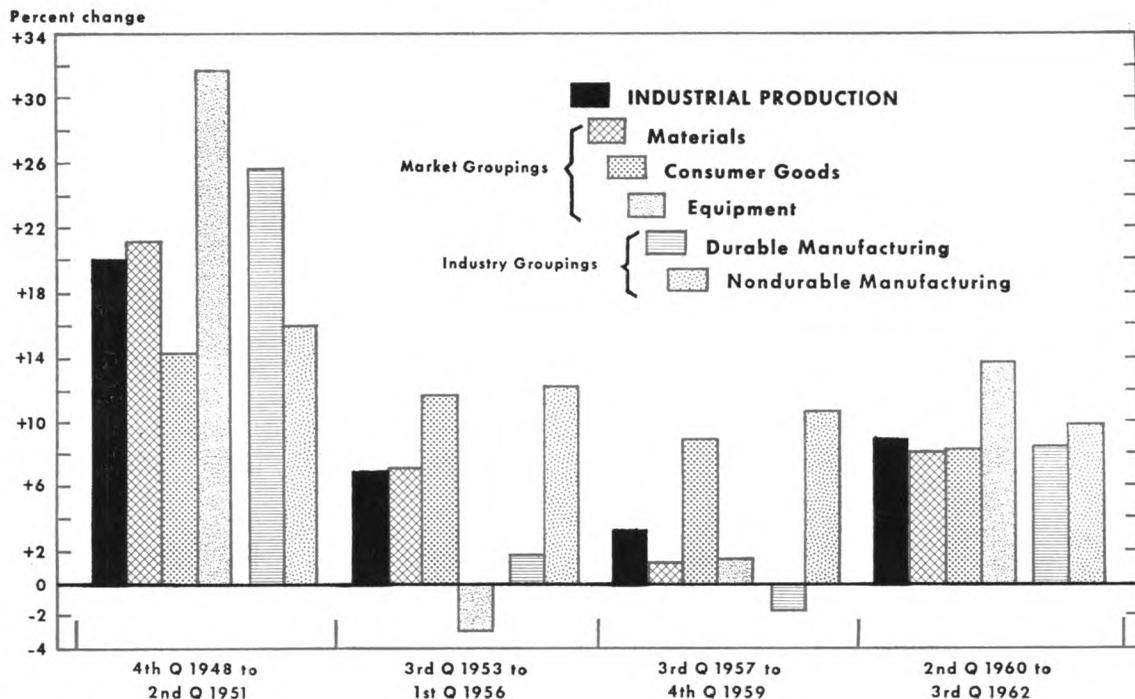
During January, industrial output suffered its only significant decline of the first half of the year, largely as a result of particularly bad weather over much of the country during

the mid-month reporting week.⁽²⁾ After January, the index of production increased at the rate of nine-tenths of one percent per month through May. After May, further increases in total output were small. Industrial production increased a total of only one percent between May and December.

The chart on the cover of this issue shows the changes in the various market groupings of industrial production during 1962 from the average levels during the fourth quarter of 1961. Between the fourth quarter 1961 and April 1962, materials production increased in step with total output, and accounted for more than one-half of the two and seven-tenths-percent increase in the total index. Production in the primary metals industries, particularly in the steel industry, increased sharply

(2) A substantial part of monthly output in the U. S. is estimated on the basis of hours worked during the week closest to the middle of the month.

CHANGES IN INDUSTRIAL PRODUCTION (Selected Groups)



Note: All figures seasonally adjusted

in response to a surge of orders placed as a hedge against a possible steel strike which never occurred.

Manufacturers' steel inventories, as reported by the Department of Commerce, rose from 9.3 million tons on November 30, 1961, to 12.4 million tons at the end of April, an increase of 33 percent. Once the threat of a strike had been averted, the liquidation of stockpiled inventories began, steel output declined abruptly, and further increases in the output of other industries barely compensated for the downward push that primary metals output exerted upon total production after April.

Although primary materials output slumped after the first quarter, the higher output of other construction materials and nondurable materials prevented any decline in total materials output until October. Moreover, consumer goods output (largely supported by

automotive production) remained at a high level, and the output of business and defense equipment continued to increase sharply during the second and third quarters.

As shown in the cover chart, the output of consumer goods also leveled off by late spring. Output of the appliance industry declined, but automotive production continued to increase until August. In the entire period from May until December, the increase in total consumer goods output was only one-half of one percent. Month - to - month changes were also very small during this period.

The increase in total industrial production which occurred after May was attributable primarily to the sustained advance in the output of business equipment and defense items which continued, almost uninterrupted, from the fourth quarter of 1961 through October 1962. Between April and October, roughly

sixty percent of the increase in total output which occurred was due to increases in equipment production, including defense. Despite the short-term divergencies in the direction taken by the various components of the index of industrial production, there was a remarkably even expansion in the major groupings, as compared with other expansions from previous peaks. The chart on the opposite page shows the changes which occurred in the total and in selected groupings of industrial output, from the peak second quarter of 1960 to the third quarter of 1962, as well as the corresponding changes between comparable quarters of previous postwar business cycles.

Total industrial production (solid bar on chart) increased further from its previous peak during the 1960-62 period than it had during either of the previous two comparable periods. The chart shows that total output increased nine percent during the 1960-62 period, compared with increases of seven percent from 1953 to 1956 and approximately three percent from 1957 to 1959. The 1957-59 comparison, however, was distorted by a steel strike during the fourth quarter of 1959.

Different industries have supplied the impetus to the expansion in industrial activity this time as compared with 1956 and 1959. Consumer goods output and nondurable goods manufacturing (one of these is a market grouping and the other a manufacturing grouping, so that double counting is involved) have fallen short of increases attained during previous expansions. But the output of equipment, including defense, has far exceeded its advance during either of the last two expansions. Not since the Korean War has the production of equipment expanded further from its previous peak during the first 18 months of a business expansion.

In November, 1962, however, the index of production of business equipment and defense items declined, its first month-to-month decrease since the preceding January. This easing of equipment production, following closely the report by the Department of Commerce that its survey showed anticipations of a de-

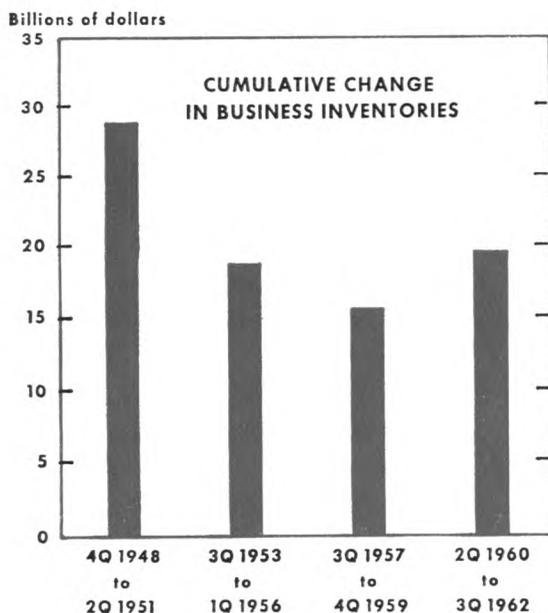
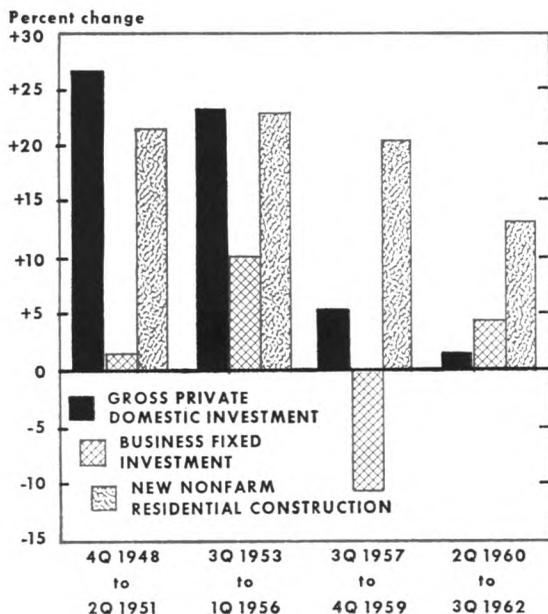
cline in total plant and equipment outlays during the first quarter of 1963, caused some doubt as to the probable course of private investment during 1963.

Investment. Gross private domestic investment accounts for approximately one-seventh of total goods and services produced each year in the economy. More importantly, *changes* in the level of private investment, particularly in inventories, have accounted for a large part of the fluctuations in business activity which have occurred in the postwar period. During 1962 as a whole, it was probably the lack of inventory building, i.e., investment in inventory, more than any other one thing, which restricted the gain in total output.

After the sharp decline in common stock prices during the second quarter of 1962, it was feared that a sudden setback in business investment might follow. Although both capital appropriations and manufacturing purchased materials inventories were cut back during the summer, fixed business investment continued upward during each of the year's first three quarters. By the third quarter of 1962, business fixed investment (measured in constant 1954 dollars) had regained, for the first time, the peak attained in 1957 during the capital spending boom. However, because of the larger increase in GNP since 1957, business fixed investment represented less than nine percent of GNP in the third quarter of 1962 as against 10 percent during the third quarter of 1957 (in 1954 dollars). In addition, there was considerable doubt that such investment would stay at the relatively high 9-percent level for long in the face of declining contract construction awards and the anticipated decline in plant and equipment spending, as indicated by the most recent Department of Commerce Survey of capital spending plans.

While increases in business fixed investment and new residential construction both added to gross private domestic investment during the year, these advances were offset

CHANGES IN GROSS PRIVATE DOMESTIC INVESTMENT AND SELECTED COMPONENTS



Note: Constant 1954 dollars, seasonally adjusted

in part by a decline in the net accumulation of inventories during the second and third quarters of the year. (In the computation of gross domestic private investment, a decline in the *rate* of inventory accumulation results in a decline in inventory investment.)

Even though private investment was at a high level during the third quarter of 1962, its percentage increase during 1960-62, as shown on the chart, was somewhat less than during previous comparable periods. Gross private domestic investment during the third quarter of 1962 was less than two percent higher than it was during the peak of business activity in 1960. That figure compares with increases of five percent in 1948-51, twenty-three percent in 1953-56, and twenty-seven percent in 1957-59, which were comparable earlier periods.

Inventories. It was inventory investment which was largely responsible for the small increase in total business investment in 1962. While inventories are technically "investment," inventory accumulation neither represents an increase in the nation's capacity to produce nor provides permanent jobs in the same way as fixed investment. Actually, a too rapid rate of inventory accumulation can result in both inflation and excesses in stocks, which lead to more prolonged downturns. Hence, even though inventory investment failed to increase during 1962, and thus on balance reduced the level of total output, this was not necessarily an adverse situation.

The easing of the rate of inventory accumulation during 1962 was largely due to the fact that inventories had not been reduced during the 1960-61 recession for as prolonged a period of time as they had, for example, in 1957-58. The shifting from inventory liquidation in the first quarter of 1961 to inventory building during the second quarter marked a difference from the more normal recovery pattern, in which inventory liquidation continues for several quarters after the upturn of general business activity.⁽³⁾

(3) For a description of inventory investment in 1961, see "Economic Recovery and Expansion"; *Monthly Review*, Federal Reserve Bank of Kansas City, January 1962.

The chart, on the opposite page which shows the cumulative changes in the GNP inventory component, in constant dollars, also indicates that inventory accumulation during 1962 may have been somewhat milder than expected because of the earlier-than-usual buildup of inventories coming out of the 1961 recession. This chart plots the cumulative dollar changes in business inventories quarter - by - quarter during recession and recovery, rather than just the percent change between the peak quarter and the sixth quarter after the trough. It indicates that, on a deflated basis, inventory accumulation during 1961 and 1962, taken together, was quite comparable to what occurred in the other postwar expansions.

Fixed Investment. The advance in business fixed investment between the second quarter of 1960 and the third quarter of 1962 contrasted markedly with the decline from the previous peak during the comparable 1957-59 period. In addition, compared with an advance of one percent in 1948-51 and a shortfall of over ten percent in 1957-59, the expansion in business fixed investment during 1960-62 suffered only in comparison with the ten-percent advance which occurred in 1953-56. Just as it is felt that the shortfall of business investment during 1959 and 1960 may have choked off that expansion prematurely, so there is concern as to whether the mild increase in fixed investment in the current recovery would sustain expansion in 1963.

Residential Construction. The advance in new residential nonfarm construction was more moderate between the second quarter of 1960 and the third quarter of 1962 than during the three earlier periods, as shown on the chart. The relatively low number of new family formations in the early 1960's is thought to have caused a reduction in the demand for new houses that might continue for several years. In addition, the sharp increase in apartment building in recent years has resulted in declining expenditures per unit of housing built.

Employment. Largely because the increase

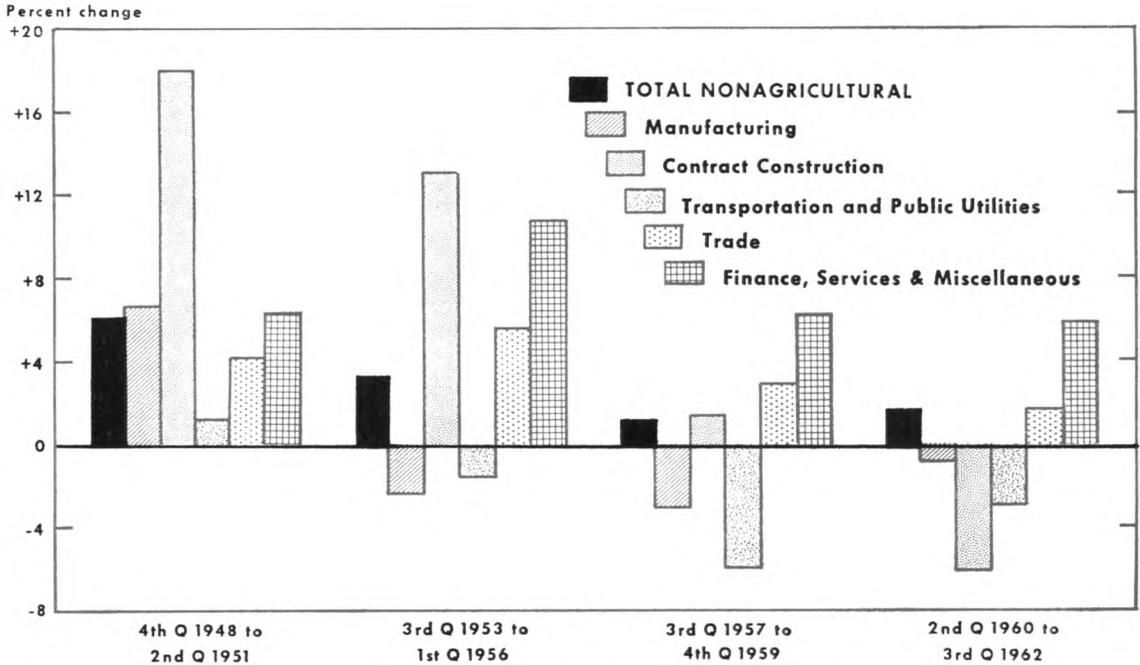
in total output during the year was relatively small, the increase in employment during the year was also small. In October and November 1962, total nonagricultural payroll employment averaged only about two percent higher than it had during the fourth quarter of 1961. More than one-fourth of the 1.1 million gain in the number of jobholders was in federal, state and local government, where employment increased by over four percent. In the private sector of the economy, changes in employment were smaller during the year and ranged from an increase of nearly two and one-half percent in finance and services to a decline of one percent in contract construction.

Following the course of output generally, nonfarm payroll employment increased during the first half of the year, but showed very little change after July. The second half of the year was marked by declining employment in the goods-producing industries, in the wholesale and retail trade categories, and in metal-working industries. These employment losses were largely offset by a substantial increase in state and local government and a lesser increase in the finance and service categories.

Nevertheless, as shown in the chart on page 10, the increase in nonfarm payroll employment during the 1960-62 period was larger than had occurred during the comparable period of 1957-59, largely because of the steel strike which affected employment during the fourth quarter of 1959. Contrary to its behavior in previous periods, contract construction employment had fallen short of previous levels by the third quarter of 1962, while employment in the trade, finance and service areas had increased almost as much as it had in the 1957-59 period.

At 71.9 million persons in November (seasonally adjusted, and after allowance for the introduction of 1960 Census data in the monthly estimation procedure) the civilian labor force was over six hundred thousand persons larger than it had been the previous November; but the increase was less than had been anticipated, based on long-term

CHANGES IN EMPLOYMENT (Selected Groups)



Note: All figures seasonally adjusted

trends in population and rates of labor force participation.

The lack of growth in the labor force during the year was due largely to dropouts from the labor force. This suggests that the persistently high unemployment rate during the year would have been still higher were it not for the fact that the official count excludes many potential workers in the population who are no longer actively seeking employment under labor force definitions.

Public Sector

A third major segment of the economy is comprised of governmental units on a Federal, state, and local level. The ways in which these units acquire and disburse funds — as well as the magnitudes involved—constitute a very important factor in total economic activity. Total government purchases of goods

and services have accounted for roughly one-fifth of the Gross National Product in recent years. In addition, government fiscal measures have a definite and diffusive effect on the income and spending of consumers and businesses. Thus, government measures may have both a primary and a secondary effect on the economy. The experience in 1962 was not an exception to the rule.

What is perhaps more significant, is the fact that government expenditures often are expected to take up slack in the economy by acting as a counter-balance to forces in the other sectors of the economy. Federal fiscal policy in particular often is aimed in the short run at offsetting inflationary or deflationary pressures in the private sectors of the economy. While the primary function of such policy is to provide and channel the funds needed for the operation of the Gov-

ernment, the secondary counter-cyclical function has become more and more important. The year 1962, as described in the preceding sections, was not characterized by spectacular gains in economic activity. There were strong points in the picture, but there were also weaknesses; both were important factors influencing fiscal policy and debt management during the period.

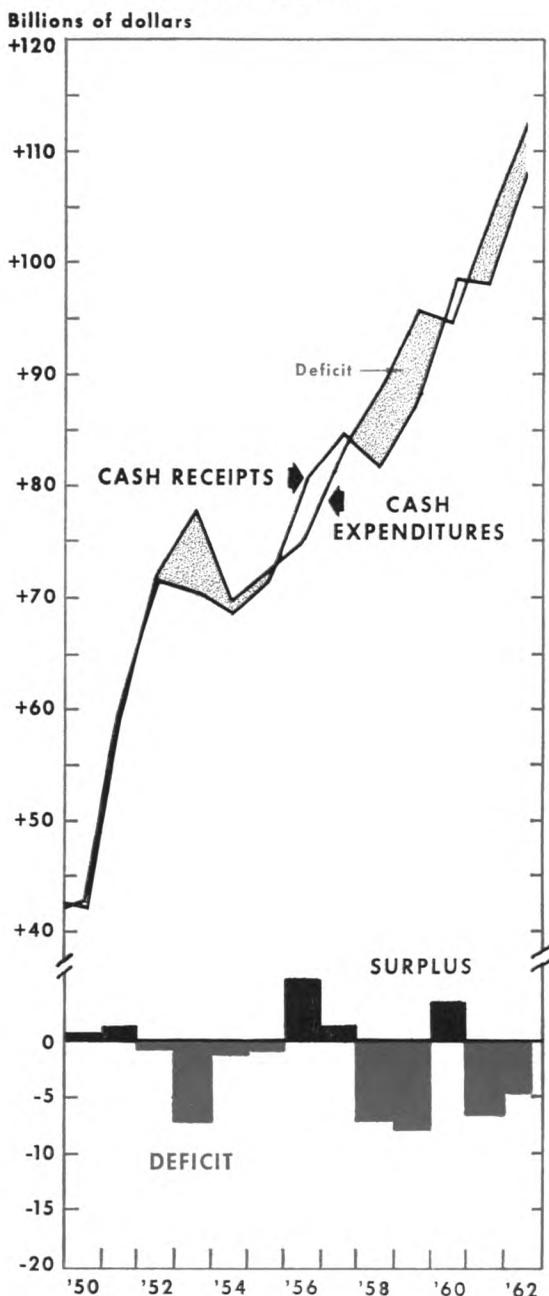
Deficit in Federal Cash Budget. Total cash receipts of the Federal Government amounted to about \$108 billion in the twelve months of calendar 1962. This was somewhat less than had been expected for the period, chiefly because of a shortfall in corporate income taxes. Tax receipts from corporations, which account for about one-fifth of Federal cash income, are sensitive to changes in business activity. While 1962 was a year of recovery in the economy, it was not accompanied by the sharp rise in corporate profits which had been associated with previous economic recoveries in the postwar years. Thus, corporate income tax receipts in 1962 were up only 3 percent from the preceding twelve months.

Cash receipts from other types of taxes and duties held up well in 1962. Income tax receipts from individuals, comprising about half of total Federal income, were 9 percent above the 1961 volume. This gain reflected the fairly steady rise in personal income during 1962. Excise taxes, which showed a 7 percent gain, and customs duties, up 17 percent, benefited from the record level of domestic retail sales and the increase in imports in 1962. The year-to-year gain in net cash receipts was about \$9 billion, or 9 percent.

Federal cash expenditures in 1962 totaled \$112 billion. The amount was slightly higher than the estimate projected in early Budget messages, because of some unexpected developments in the cold war. Large increases in spending from the previous year were reported by the Defense Department (up 8½ percent), the Atomic Energy Commission, NASA, and the Department of Health, Education, and Welfare.

FEDERAL CASH BUDGET

(Calendar Years)



Other advances in Federal spending are attributable entirely to factors on the domestic scene. For example, expenditures by the Commodity Credit Corporation in 1962 jumped 38 percent from the previous year, as both the number and size of price support payments to farmers rose. Interest on the Federal debt increased somewhat because of slightly higher rates on U. S. Government securities, particularly Treasury bills. Payouts from Federal old-age and disability insurance trust funds were also up during the year.

The net balance of Federal income and spending left a cash budget deficit of about \$5 billion for 1962 as a whole. That was less than the deficit of \$6.8 billion in the previous calendar year, but, as mentioned above, it was larger than had been anticipated.

The weakening in the cash budget is more apparent when examined on a quarterly basis and after seasonal adjustment. In the first three months of 1962, the adjusted cash deficit equaled \$3.2 billion. Only once before in the postwar period (in 1959) had the cash deficit been this large in the first calendar quarter. Ordinarily, cash receipts are heavy from January through March because of payments on corporate and individual income taxes. It is noteworthy that in the first quarter of 1962 total cash receipts were virtually the same as the level of receipts in the fourth quarter of 1960 and in the second quarter of 1961 — which were the quarters surrounding the trough of the most recent business recession.

From April through June 1962, Federal cash receipts roughly balanced expenditures so that a negligible surplus resulted, on a seasonally adjusted basis. This was somewhat better than the experience during the past decade, over which the average deficit for the second quarter was about \$700 million. In the third quarter, a small deficit of \$300 million after seasonal adjustment was recorded, or about half the size of the average deficit during the past ten years. Thus the cash budget position in the mid-quarters of 1962 was favorable when compared with pre-

vious years. A sharp increase in net cash payments was reported in the final quarter of the year, however, with the deficit rising to the second-highest level for the quarter since World War II.

If the cash budget position is measured against economic activity in 1962, it can be seen that fiscal policy provided a larger-than-usual amount of stimulus in the first and fourth quarters of the year. In view of the general sluggishness of business, such Federal action served a good purpose. It might have been preferable, however, if the net payment of funds to the public (on a seasonally adjusted basis) had been spread more evenly throughout the year. Many key business indicators showed a tendency to level off in the second and third quarters, a period when the cash deficit was smaller than the average for recent years.

This points up the persistent criticism of fiscal policy, i.e., lack of flexibility in timing. Many of the policy measures determining both receipts and expenditures are fixed long before the year in question and cannot be adjusted quickly or easily to short-run changes in business activity. A case in point arose last year in the discussion about lowering income tax rates. Many observers were of the opinion that a decrease in income taxes for both individuals and businesses would help to stimulate economic activity. It was felt that the money freed by a tax change would increase the demand for goods and services and investment in plant and equipment. If such action is not deemed urgent, it is helpful first to make studies to determine the appropriate size of the cut in rates and the effect of the reduced income on the Federal budget. In addition, the actual change in the tax laws must be discussed and approved by the Congress. All this takes time. The year 1962 ended without any amendment to the income tax rules. Proposals are likely to be discussed in 1963, but the actual decision still may take many months.

Two important changes in the tax laws affecting business spending decisions were

made in 1962, as mentioned earlier. First, liberalized depreciation rules were published by the Administration, increasing the allowances on plant and equipment that are deductible from taxable income. Second, a tax credit of 7 percent on funds that companies invest in new plant and equipment was legislated by the Congress. Both measures were designed to encourage spending on increased industrial capacity and greater efficiency in output. The effect of the measures will not be discernible for some months, because corporate plans for plant and equipment spending are made long before the funds actually work themselves into the economy.

Debt Management. In any year, the Federal government usually borrows money from the public. This may be done to refinance maturing securities that the Government does not plan to refund in cash, to raise funds during periods when receipts are temporarily insufficient, or generally to finance a deficit in the budget, if one exists. In 1962, the gross borrowing of the Treasury amounted to \$77.7 billion, a record amount for the past decade. Funds were raised in every month of the year, with the largest operations being undertaken in February, May, August, September, and November. (The Treasury attempts to schedule its borrowing on a quarterly basis, using the middle month of each calendar quarter to avoid undue pressures in the financial markets.)

Of the total borrowing in 1962, two-thirds took the form of securities to replace previously issued debt instruments that matured during the year. (There was little opportunity to repay the owners of the maturing issues in cash because of the deficit in the Federal budget.) About one-sixth of the new securities issued by the Treasury were sold to raise new cash, i.e., to finance the budget deficit. The remainder of the borrowing represented advance refunding of outstanding securities. By this process, Treasury issues that have not yet reached their maturity can be exchanged on favorable terms for new issues with longer maturities. Such an opera-

tion benefits both the Treasury and the owners of the securities. The debt managers are enabled to extend or to stabilize the maturity structure of the Federal debt, and the owners, who preferred long-term securities at the time of their original purchases, can extend once again the average length of their portfolios.

The Treasury continued the use of several recently-introduced techniques in its management of the debt in 1962. Advance refunding operations were one example. Another technique was the heavy reliance placed on short-term securities in borrowing operations. About 58 percent of the total borrowing during the year was accomplished through the sale of Government securities with maturities of one year or less. Specifically, \$5.7 billion in net new cash was raised through additions of \$100 million or more to the weekly sales of Treasury bills. In addition, about \$25 billion, gross, was borrowed through four issues of one-year certificates of indebtedness. These statistics contrast sharply with comparable data for 1961, when a substantial portion of short-term borrowing was in the 1-2 year range.

The emphasis on short-term borrowing in 1962 reflected the difficulties in the United States balance of payments. By adding to the supply of short-term securities, the Treasury was able to help hold down the prices on such issues and to maintain yields. The relatively high (and unusually stable) level of rates on such securities lessened the attractiveness of comparable foreign investments, thereby restraining an outflow of funds from the United States. Short-term borrowing had a second function of supplying liquid assets to the economy at a time when a large volume of funds was available for temporary investment.

One of the tasks of debt management, as implied above, is to offset the constant shortening of maturity structure which takes place with the passage of time. The Treasury was highly successful in this function in 1962. At the start of the year, the average maturity

of the marketable debt was 55 months. The average was boosted twice during the year by the advance refunding operations, reaching a high level of 60 months in September, the longest maturity in four years. Yet this feat was accomplished, even though the volume of securities issued with terms of more than 10 years was the smallest since 1959, and even with the large amount of short-term financing that took place. The Treasury relied on new issues falling in the 6- to 10-year range. (Four separate bond issues which will come due in 1971 or 1972 were offered.) Unlike the experience of 1961, no new issues in the 1-2 year range were sold. This will help to reduce the pressure of impending maturities that has often hampered debt management in past years.

By concentrating Federal borrowing in an intermediate maturity range, rather than a long-term range, a widely accepted practice of debt management was followed. At a time when the economy showed little sign of inflation or boom psychology, the Treasury avoided the absorption of long-term funds. Such funds could instead be placed in private investment outlets that would lead to an increase in the nation's total product. In 1962, long-term funds in record amounts were invested in mortgages and municipal securities.

One final aspect of debt management in 1962 is noteworthy, namely, that the net increase in Federal debt was absorbed primarily by the Federal Reserve System and Federal agencies and trust funds. Data on net changes in the ownership of Treasury issues are not complete for the entire year, but the partial information is worth examining because it allows some general observations to be made about 1962 as a whole. (When figures for the entire year are available, they may show some changes in the patterns described below.)

The largest single group of holders of Government securities are commercial banks. In 1962, the banking system reduced its holdings of such investments. The net reductions were most apparent in Treasury issues maturing

within one year, although the volume of over-ten-year issues also showed a decline. In addition, banks shifted a substantial amount of 1-5 year maturities into the longer 5-10 year range. These changes in bank portfolios were due in large part to the interest of banks in obtaining earning assets with higher yields, as well as the increased availability of longer-term securities.

Other financial institutions, such as mutual savings banks and insurance companies, increased slightly their holdings of Government securities in 1962. Here too, the largest net gain was in issues maturing within 5-10 years. The same pattern was also true for savings and loan associations, but the total holdings of this group are quite small.

State and local governments purchased Treasury securities, on balance, during the year. In this group, holdings of Treasury bills and very long-term issues (maturing in more than 20 years) increased, in the former case as a result of the temporary investment of the proceeds of municipal bond sales. Individuals' ownership of Federal securities showed little net change in 1962, but holdings by foreign and international organizations increased markedly as a result of the deficit in the United States' balance of payments. Non-financial corporations, in contrast, reported net liquidations of Government securities during the year. (Holdings by this ownership group are confined primarily to issues maturing within 5 years.) Thus, when all the holdings of the Federal debt are combined for 1962, only a fractional increase in public ownership is evident, with the bulk of the net increase in the Federal debt being absorbed by official agencies.

State and Local Government Finances. State and local government funds are not expected to serve as a counter-cyclical force in the economy. To round out the picture, it may be mentioned, however, that spending by states, cities, and local taxing districts has climbed steadily in recent years, and no doubt did so in 1962. (Actual data are not yet available for the year.) The rise in spending re-

flects a growing demand for public services and the increasing cost of providing those services on the state and local level. The sharp rise in construction costs has been a particular factor.

One-third of total municipal expenditures goes for the upkeep of schools and libraries, with substantial amounts also needed for highways, health and welfare, and general administration. In these areas, the increased emphasis on education, medical services, and improved administration has led to an increasing dollar total in expenditures. In addition, there is some indication that state and local spending for goods and services has increased slightly as a proportion of total government spending for such items, moving from 45 percent to 47 percent of the total in the last four years.

More than half of the income which is received by state and municipal governments

represents taxes which are collected locally; the chief sources of tax revenue are real estate levies and excise taxes on goods and materials sold. Intergovernmental receipts, such as grants in aid from the Federal government, account for a smaller share—about one-tenth of state and local income. Tax income and intergovernmental receipts are supplemented with long-term funds obtained by borrowing in the capital market.

At the end of fiscal year 1961, (which ended in June of that year), state and local indebtedness totaled \$75 billion, and was principally in the form of long-term issues. The gross amount of funds that has been raised in the capital market in recent years has averaged about \$8 billion a year. The estimated volume of new state and local issues for long-term capital in calendar 1962 is only fractionally below the \$8.5 billion that was raised in 1961.

Around the Fourth District—

As of the week ended January 17, total department store sales in the District exceeded year-ago volume for the fifth successive week. The largest year-to-year gains were recorded in Akron, Columbus, and Toledo (all in Ohio).

* * *

Burley tobacco growers grossed substantially less for their 1962 crop than they did for the 1961 crop. The decline in gross receipts, which occurred despite a 6 percent increase in volume, resulted from lower prices due to lower quality. Most of the nation's burley tobacco is grown in Kentucky, a state which lies partly in the Fourth District.



FOURTH FEDERAL RESERVE DISTRICT