

FEDERAL RESERVE BANK
of MINNEAPOLIS
ANNUAL REPORT 1974



On the cover:

An effective energy conservation program is needed to reduce the flow of dollars to oil producing countries. Moreover, consumption cannot continue to expand as rapidly as during the past decade.

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The Limping Giant: The American Economy 1974-75

As we close out the accounts on 1974 and try to peer ahead into 1975 and beyond, the economic barometer is giving out strong signals of unsettled conditions, with a possibility of rough seas. The sources of our malaise are well known, yet difficult to understand, and still more difficult to deal with.

At least four factors are contributing to our troubled situation: 1) inflation, 2) recession, 3) "the energy crisis," and 4) questions of financial stability. Each of these problem areas in turn has several dimensions — domestic and international; long-term and short-term — and they are all interconnected. It's small wonder that the public is confused, and policy makers find it difficult to devise a comprehensive, yet comprehensible program.

Inflation

There is not much profit in debating whether inflation or recession is America's number one economic problem. There's little doubt that we are suffering from both, and that the virulence of price increases in 1974 had much to do with the recession we are now experiencing.

Nor is there much doubt that "stagflation" (i.e., a combination of stagnation and inflation) is a worldwide phenomenon. Many of the other developed countries experienced even faster price increases last year than did the United States, and are now in a similar downturn in economic activity.

The causes of inflation are many, and the importance of each factor varies over time. We could leave such complexities to economic theorists, were it not necessary to untangle them in order to prescribe appropriate remedies. Some observers, noting the unusual persistence of inflationary pressures in the postwar period, point to apparently fundamental institutional changes in society as a root cause of our inflation. They cite, for example, 1) the strong political commitment in most developed countries after World War II to "full employment," 2) the downward rigidity of wages in an era of labor unions and unemployment insurance, 3) a similar downward rigidity of prices in key industries where a few large firms can exercise market power, 4) the phenomenon of rising expectations worldwide, promoted by advertising, transmitted by example, and financed by credit, 5) the allocation of a part of business

capital financing to non-output-producing investments in environmental cleanup and employee safety. (Some might add, as a fundamental change, a growing scarcity of resources to meet these rising demands, but this point is much more controversial.)

On top of these secular trends that, it can be argued, now impart an inflationary bias to the world economy, one must add a number of cyclical and special factors that in 1974 drove the price indexes to record readings. The worldwide boom of 1972-73, partly the result of excessive monetary expansion, carried economic activity around the globe to unprecedented — and unsustainable — levels. In the process, bottlenecks were created in basic industries and in raw material supplies that caused commodity prices to skyrocket. The exchange rate realignments of 1971, and especially the second dollar devaluation in 1973, added price and output pressures in the U.S. and elsewhere that echoed throughout the international trading world. Crop failures in 1972, and disappointing grain harvests again in 1974, against a background of rapidly rising demand for feedgrains, resulted in sharply rising food prices at home and abroad. Compounding the food price increase was the roughly four-fold jump in world petroleum prices levied by oil-producing countries following last winter's embargo. And to round out the picture, in the United States, prices in several sectors probably rose unusually rapidly this past year following the end of Phase IV controls last spring, and perhaps in anticipation of possible new price/wage guidelines in the coming year.

These myriad factors all contributed to upward price movements, and we usually lump their effects together under the catch-all term "inflation." Yet it's clearly inappropriate, if not impossible, to respond to a multi-faceted problem with a single policy prescription, especially when "inflation" is only one of our afflictions. Indeed, to the extent that last year's price increases were exaggerated by non-recurring events, a policy response — apart from an attempt to lessen the extent to which such increases are institutionalized in 1975 wage settlements — should concentrate primarily on the sources of continuing price pressures.

Reduced harvests, combined with rising world food demands and increasing costs of production, have pushed up food prices.

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Recession

Given the boom conditions that characterized 1973, one could argue that the world was poised for a cyclical slowdown in any case. But the timing and extent of the slowdown were virtually impossible to predict because of the extraordinary shock to the world's economic system caused by first the oil embargo and then the increase in petroleum prices.

In retrospect, it appears that in this country at least, and perhaps elsewhere, the onset of recession was delayed — and the downturn made potentially more severe — by the shortage mentality that gripped businessmen. Not only were there real shortages of grains, raw materials, and outputs of key basic industries in a boom economy, but there were artificial shortages of petroleum and petroleum products, and continued rounds of price increases that gave the appearance of shortages. Order backlogs grew at misleadingly rapid rates; inventory accumulation was stimulated not only by "shortages," but by inflation hedging; dollar sales appeared to hold up despite declining real incomes; and nominal profits continued to rise, largely reflecting the effects of inflation.

Because consumers in the United States had not previously faced double digit inflation, they were probably unprepared for the rapid inroads that price increases of that magnitude make on real incomes. Only gradually, as bills accumulated, did it become clear that family spending would have to be curbed — and big ticket items like cars and color TV sets were the first to feel the jolt.

Thus inflation in its many manifestations was a key ingredient in the present recession. Not only was real purchasing power siphoned off by the oil producers, but disposable income was further eroded — for both businesses and individuals — by higher taxes on fictitious profits and misleading increases in nominal incomes.

If one could be sure that the present sharp downturn in business activity would be equally sharply reversed in coming months, then it might be possible to dismiss this cycle as an unavoidable correction. But because at least one element in the picture — the "energy crisis" — is unprecedented (and unpredictable), one can have no such confidence.

"The Energy Crisis"

Like inflation and recession, the energy crisis is a worldwide phenomenon with worldwide repercussions. Unlike inflation and recession, it is essentially a political problem, but with profound economic (and social) consequences.

As with inflation, it is important to be specific about the nature of the energy crisis. Obviously, if the major foreign oil producers decide for political reasons to cut back production sharply once again, then the developed countries dependent on their output are in a crisis by any definition. And given the persistent tensions in the Middle East, that kind of crisis can by no means be ruled out. By the same token, that kind of crisis cannot be dealt with by economic policy responses alone.

The vulnerability of the developed countries to an oil embargo has been increasing over time. In the United States, for example, consumption of petroleum grew at a 4½ percent annual rate since the mid-1960s, while domestic production ceased expanding in 1970. At the moment, therefore, we are dependent on foreign supplies for 100 percent of any increase in our petroleum consumption. Moreover, it seems fairly clear that world demand and supply of energy in general, and petroleum in particular, could be kept in equilibrium in the years ahead only at rising energy prices. Were it not for the political vulnerability of dependence on unreliable supplies, however, it's far from clear that the prospect of gradually increasing energy costs could be characterized as an "energy crisis," despite the adjustments that would have to be made. The fact is, at today's artificially high petroleum prices, there is surplus of productive capacity and supplies, not a shortage.

What has turned the present situation into a "crisis" — apart from the threat of another embargo — is not an energy shortage as such, but the income, balance of payments, and financial consequences of the four-fold increase in the world price of petroleum. It is estimated, for example, that foreign oil producing countries will accumulate some \$50 billion of trade surpluses, the rest of the world will "accumulate" equal trade deficits — imbalances that dwarf any previous experience. Theo-

Personal income tax cuts should be targeted toward low and middle income groups, whose incomes have been eroded particularly rapidly by food and fuel price increases.



The Limping Giant: The American Economy 1974-75

retically, if the surplus countries were willing to lend or invest their surpluses in the deficit countries, the overall accounts could be brought into balance. As a practical matter, such automatic recycling is not in the cards. As a result, an urgent search is under way for new institutions to assist private financial markets in rechanneling these huge balances. Even if such institutions can be found, there remains a real question — how long the rest of the world can afford to go on borrowing or selling off assets to sustain economic activity on the basis of artificially high-priced imported oil. And in the meantime, there will be increasing temptations among deficit countries to solve their own problems at their neighbor's expense.

A further aspect of "the energy crisis" is the distortion, or perhaps more accurately, distension, of financial markets and institutions that accompanied the massive rechanneling of financial flows from oil consumers to producers and back. Actually, the private markets have absorbed these shocks surprisingly well. Those financial institutions that did get into well-publicized difficulties during the past year seem to have been the victims of poor management and/or unwarranted foreign exchange exposure in a world of floating exchange rates, not innocent victims of forces beyond their control.

Nevertheless, it seems inevitable that the task of transforming billions of dollars of oil revenues into productive, repayable loans and investments will continue to place severe strains on existing financial institutions. Not only is the rapid growth of assets and liabilities likely to stretch further the banks' already reduced capital ratios, but it will also be difficult to resist the temptation to widen further the maturity gap between deposits and investments. As has been pointed out elsewhere, recycling, while sounding easy, really comes down to piling debt upon debt, with the institutions in the middle between petro-lenders and consumer-borrowers — whether private, national, or international — taking on substantial added credit risks.

Financial Stability

Questions of financial stability are not confined to the new pressures associated with petro-dollars. As with the

other problems we now face, some of our present difficulties are the result of trends in progress for many years. From a peak at the end of World War II, the liquidity of our business and financial institutions has been gradually eroding, and with it, their flexibility to cope with adverse economic circumstances. While attention has more often focused on government deficits and the corresponding increases in federal debt, a much more rapid increase has taken place in corporate debt, in absolute terms and in relation both to business income and invested equity. This increased leveraging has not only reduced the capability of firms to withstand variations in income (i.e., made them less stable), but has used up borrowing capacity that might see them through economic reverses.

Several factors contributed to this trend: 1) declining rates of return on equity (i.e., profits), 2) tax laws that induce firms to raise capital in the form of debt rather than equity shares, 3) investor preoccupation with "performance" as indexed by price/earnings multiples, and 4) a generalized emphasis on rising standards of living now (i.e., consumption) at the expense of more output in the future (i.e., savings and investment).

Businesses in general, and financial institutions in particular, have gone through an especially severe wringer this past year. Monetary restraint tightened in the face of inflation-amplified credit demands, and nearly brought new-issue credit and equity markets to a halt in the early fall. Thrift institutions were hit hard by rapidly rising interest rates, and housing suffered disproportionately as a result. Capital values in the form of equities and fixed-income securities eroded rapidly with rising interest rates, and business ventures built on expectations of continuing inflationary boom began to look much less attractive, both to investors and lenders.

These financial symptoms of an economy moving from boom to recession are not different in kind from those experienced in previous business cycles. But the unprecedented severity of the present inflation, the distortions in the economy resulting from the energy crisis, the reduced flexibility of less liquid, more leveraged firms to cope with adversity, and the untested ability of

international financial markets to handle the wrenching transfer of financial wealth, all raise new questions as to the ability of existing institutional arrangements to withstand these pressures.

A program for 1975

If our current problems are as many-sided, interconnected, and as long in accumulating as the foregoing discussion indicates, then it would be holding out false hope to suggest that there are any easy, simple, or fast-acting remedies. At the same time, we are already late in getting started on a program to deal with our problems, and an integrated approach must begin now.

Perhaps the greatest temptation (and the most dangerous trap) would be to single out inflation or recession as "the" problem, and then apply the standard treatment. There is a particular risk, given the biases of our political system, that we will concentrate on short-run "cures" for recession, to the detriment of our ability to correct more fundamental weaknesses in our economy.

If the present recession were simply one more cyclical downturn along an essentially stable economic growth path, then it might be appropriate to try another dose of the medicine we've used in the past — an expansion of federal spending and further easing of monetary policy. But our problems today are intractable partly because: 1) we have tried to raise living standards faster than investments in productive facilities could keep pace; 2) investments, particularly those financed by equity capital, have lagged as a result of inadequate rates of return on capital; and 3) we have substituted credit expansion for savings as the means to finance the growth of consumer and business spending. Another dose of the old medicine would only worsen the disease, in the longer run if not immediately.

Instead, if this analysis is correct, we are going to have to accept as fact that we cannot continue to expand consumption (i.e., living standards) as rapidly in the next few years as we have during the past decade. It is

important to understand that this conclusion rests basically on the argument that credit-financed expansion, beyond a certain point, leads to instability rather than further expansion. The conclusion does not rest on the dubious premise that the world is running out of resources. It is strongly reinforced, however, by the current drag on potential rates of growth in consumption among developed countries imposed by the transfer of wealth from oil consumers to oil producers.

In the past, widespread increases in standards of living in developed countries eased social tensions that otherwise might have been associated with disparities of income and wealth, both within and between countries. If long-nourished expectations of "a better life" (i.e., more goods, services, leisure, etc.) are now going to be frustrated, or at least postponed, as seems inevitable, then there is going to have to be an equitable sharing of the burden of this adjustment. This is particularly true in the short run, given the disparate effects of past price increases and the anticipated rise in unemployment.

The thrust of a program for 1975, then, should be: 1) to ease the harsher impacts of the current recession without worsening inflation; 2) to do so in ways that are at least consistent with, and hopefully, make a positive contribution to, a shift in the use of resources from current consumption toward future consumption, i.e., investment; and 3) to mitigate the financial effects of the energy crisis, and possibly turn them to advantage as a means of financing needed investment. This is no small order. Too often, however, we despair of finding policies that can usefully attack inflation and recession simultaneously. If there's a lesson in the above approach, it's that we can indeed structure a program that takes advantage of the current recession to get a start on our longer-run problem of inflation.*

The federal budget is a key element in any economic program. Like other budgets, it has two sides, revenues and expenditures, that can be adjusted to a considerable

*This same point was made by Robert V. Roosa, in a talk prepared for the Atlantic Institute for International Affairs, Munich, Nov. 11, 1974, entitled "Controlling Inflation During Recession."





extent independently. Both tax and expenditure changes, however, should be targeted toward achieving each of the above objectives. To help ease the harsher impacts of the current recession, for example, it makes sense that unemployment benefits be expanded and that the public service employment program be enlarged. This has already been done, and the adequacy of the program will need to be reassessed in the months ahead. For the same reason, the largest part of any cut in personal income taxes should be targeted toward low and middle income groups whose incomes have been eroded particularly rapidly by food and fuel price increases.

Other adjustments to the budget should be designed to stimulate investment. Specifically, liabilities for corporate taxes should be adjusted to compensate for the effects of inflation on nominal profits and depreciation schedules. In addition, the investment tax credit should be enlarged to, say, 10 percent. In the same vein, dividends on new equity capital issues should be deductible as a business expense (as interest payments on borrowings now are) to reduce the bias favoring debt financing over equity. And capital gains taxes should be prorated with length of holding period.

On the expenditure side, increases, except to ease hardship or stimulate *selected* investments, should be severely restricted. So far as investment priorities are concerned, a systematic process for identifying high priority areas is needed. In the meantime, energy research and development and mass transit (financed from the highway trust fund, and designed to ease transition problems in the auto industry) seem two reasonable candidates. Housing, though technically an investment, would qualify for assistance primarily to ease the severe slump in that industry.

To reduce the flow of dollars to oil producing countries, an effective energy conservation program is needed. Voluntarism is not enough. A sizable tax on imported and domestically produced petroleum is essential, even though the effect will be to further raise consumer prices. The substantial revenues generated by such a tax (together with such "tax reform" measures as capital gains liability at death, elimination of depletion allowances, and higher tax rates on preference income) could

Consumers, faced with double digit inflation, have curbed spending on big ticket items.

A Program for 1975

be used to finance investment incentives and other tax reductions in order to reduce the size of budget deficits.

There will be substantial budget deficits in the next couple of years, however, and given the expected sluggishness of the economy, deficits are appropriate. In the short run, with the economy expected to operate so far below potential, reasonable deficits should not add significantly to inflationary pressures. But in the longer run, as the economy moves back toward its potential, deficits should be eliminated since they represent, in themselves, dis-saving rather than needed savings. Even in the short run, it is important that the deficits be financed to as great an extent as possible from savings rather than credit creation.

In this connection, there is an opportunity to tap the forced "savings" extracted from this economy and from other developed countries in the form of unspent revenues of oil-producing countries. Indeed, it is essential that these huge "savings" be placed back into income streams quickly if a world recession is not to feed on itself. Again, in the short run, it is appropriate that such funds finance government deficits. In the longer run, they must be channeled into productive investments (rather than used to finance unsustainable levels of consumption in the developed countries) if the credits and equity holdings acquired by the oil producers in this process are to be serviced.

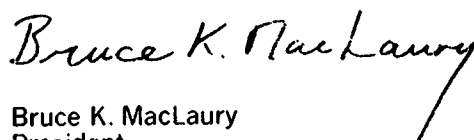
Whether recycling of petro-dollars in this fashion can be accomplished is an open question. Indeed, if there is an Achilles' heel in the prospect for recovery from the current recession, it will probably stem from an inability of the world's economic and financial institutions to adapt quickly enough to the financial consequences of the oil price increase.

For this reason, among others, it is important to see that our own financial institutions are in as strong a condition as possible. Among the measures needed to reinforce confidence in those institutions are the following: 1) supervisory insistence on gradually strengthened equity bases, and an asset/liability mix less sensitive to interest rate changes; 2) improved examination procedures, and reserve requirements, for banks'

Eurocurrency and foreign exchange positions; 3) standby authority for a government institution analogous to the Reconstruction Finance Corporation; 4) consolidation of bank supervisory authority; 5) passage of the Financial Institutions bill, which, among other things, would gradually remove interest ceilings on consumer time deposits; and 6) curbs on further relaxation of consumer credit terms, and eventually, some tightening of these terms.

On the price/wage front, the key risk now is that previous price increases will become institutionalized through large wage settlements in 1975. For this reason, among others, the Council on Price and Wage Stability should be given subpoena powers, as well as the power to delay wage settlements and price increases for up to ninety days in key industries. The Council, if given sufficient prominence, is also the logical body to publicize the direct link between restrictive practices, productivity, and incomes. Wage restraint should also be emphasized as a *quid pro quo* in connection with the tax reductions mentioned earlier.

There are undoubtedly other measures that could help see us through the difficult months that lie ahead. In fact, none of the policy actions suggested above are novel, though some are controversial. Too often, however, proposals are put forward that deal with only one facet of our current problems, overlooking the consequences for our problems taken as a whole. If there is a need at the moment, it is to try to understand our present difficulties in their broadest context, and to devise remedies that contribute not only to short-run solutions, but longer-run solutions as well.



Bruce K. MacLaury
President

The adequacy of expanded unemployment benefits and the public service employment program will need to be reassessed in the months ahead.

CLAIMS



Looking back at 1974

The Federal Reserve Bank of Minneapolis began five years ago to commit to writing a statement of the important, long-term, continuing purposes of the Bank. These have taken the form, in keeping with contemporary business theory and practice, of a set of seven **Goals**. Although these goals (which are stated in summary form at the end of this report) have been revised and refined since their initial promulgation, they remain essentially unchanged as being both a statement of the reasons for our existence and the credo under which we intend to operate.

Objectives, on the other hand, are in our definition, shorter-term, specific, program-related ends, which can be accomplished within set periods of time. For each of the past several years we have developed sets of specific objectives which we hope to achieve during the following calendar year. The broadest and most important of these aims become the Bankwide objectives for the year; in addition, each officer, each department, and, in some cases, even smaller units, develop their own annual objectives which may be either ancillary or complementary to those which are Bankwide.

For 1974 Bank management developed six principal purposes it hoped to accomplish during the year, together with approximately 75 subobjectives which were directly supportive of the primary objectives. These principal objectives and an evaluation of the extent to which they have been accomplished are set forth below:

■ **Achieve a fully integrated PACS (Planning and Control System) process within the Bank.**

The PACS process contemplates a Systemwide as well as Bankwide procedure for planning, objective setting, budgeting, results reporting, results analysis, and feedback.

During 1974 the Bank made significant progress on PACS. The 1975 budget was put together in the suggested PACS format; we developed monthly and quarterly salary-to-budget comparisons by departments and cost-to-budget comparisons by function; an internal system of performance measures and standards, mentioned under Objective II below, was adopted; we made further progress in the development of performance reviews at

all staff levels, and for the first time officer and department objectives were integrated into an expanded statement of Bankwide objectives. We are also in process of forming an internal PACS group to develop the PACS process in the Bank insofar as we can do so while awaiting the recommendations of the System Task Force.

Full integration of the PACS system in the Bank depends upon the progress made in establishing it Systemwide. Although a System Task Force has completed Phase I of a PACS project, Phase II is just getting under way, and the start of actual implementation is still at least six months in the future.

■ **Improve efficiency and effectiveness of Bank operations.**

This objective is one that is repeated year after year, but with different annual subobjectives. In 1974 our emphasis was on the subobjective of developing performance measures and standards, a process begun in 1973. Our first effort to develop such measures and standards, plus other statistical information, is now complete and the first quarterly report encompassing this information has been issued. The format is still tentative.

Another subobjective was to identify operations in our Bank which seem to be high cost compared with similar operations in other Reserve Banks and analyze the reasons therefor. This was accomplished in part. High cost operations were identified but analysis and study of methods used by other Banks were accomplished only in part.

In some functions where cost and production comparisons with other Reserve Banks are possible on the basis of quarterly reports issued by the Board of Governors, improvements in efficiency and costs were achieved. Specifically, productivity in coin sorting and counting, currency sorting and counting, coin wrapping, unfit currency verification, money order processing, and food stamp processing all increased. Productivity in conventional check processing, on the other hand, is not as high as the 1973 average because of combining the conventional check figures with those for the regional processing center this year. Because regional processing center checks require fewer item passes (the basis

on which productivity is calculated) our productivity appears to be poorer, although in terms of items handled it may actually be better. Nevertheless, Minneapolis ranks fifth among the Reserve Banks head offices in check processing productivity and is 15 percent above the head office average.

A specific subobjective in 1974 was to keep check holdover and difference accounts within stated System maximums. This objective has been achieved consistently throughout the year.

Probably the single most cost-effective measure taken in 1974 — one that avoided a budgeted cost increase of more than \$125,000 annually — was a policy decision to go to fourth class on all mail shipments of coin. Batch processing of penny and nickel deposits, absorption of differences up to \$1.00 on incoming currency shipments, reduction in the number of checks drawn on other districts which we will accept for inclusion in our cash letters, changing of deposit deadlines, adoption of a new method for verifying five-dollar bills, elimination of sorter observation of the currency cancellation process, discontinuance of guard escort for money movements in secured areas of the Bank, and a reorganization of the Fiscal Agency, Safekeeping, and Collections departments to reduce staff numbers and provide a more efficient work flow, were all examples of a cost and productivity-conscious attitude on the part of Bank personnel in 1974. Two cost-reducing projects, one to reduce the use of computer paper at an estimated annual cost avoidance of \$37,000 and one to reduce copymaking costs by an estimated \$27,000 annually, were implemented by this Bank and submitted in summary form to the System's Operations Improvement Clearinghouse.

Projects such as these, along with substantial cut-backs in travel expense, use of part-time in lieu of full-time tour guides, elimination of drug testing for new hires, and other numerous, and therefore significant, cost reductions, combined with less-than-anticipated increases in operations volume to keep actual controllable expense approximately 2.7 percent below the original budget.

■ Work with and through District banks to insure prudent banking standards and improved services to the community.

Bank Examinations, in fulfillment of one of the subobjectives under this objective, developed a "liability management" measure, as one means of assessing whether any District banks may develop liquidity problems. Utilizing this and other information, Bank management is able to stay abreast of the District banking situation, should any foreign, national or local financial crisis ever develop. Twice yearly, a summary of the condition of District banking is reported to the directors. Examinations also prepared a position paper on liability management for consideration by the directors and management.

In response to another subobjective, the Research Department developed a service output profile for commercial banks. Although it was decided that its usefulness to the Bank was limited, it was offered to those who attended our commercial bank directors' meetings, cited below, as a tool to help in measuring bank performance.

A third subobjective, to use data from the Bank's Functional Cost Analysis program to prepare an analytic report on the relationship of Bank size and structure to costs and profitability, is now virtually complete with the report now in draft form.

The final subobjective in this category was to develop and put on seminars for commercial bank directors. Four such seminars were held in various cities in Minnesota during the week of September 30 with a total attendance of approximately 650. Functional Cost Analysis workshops were also held in Minneapolis and Helena in November for member banks.

Incidentally, this District had a net gain for the year of three state banks and one national bank as members of the Federal Reserve System.

■ Increase measurably the impact of research capabilities.

The emphasis in research in 1974 was shifted somewhat toward regional projects. The Research Department is developing a conceptual framework for such projects and is currently carrying on a specific program of project

Looking back at 1974

research in three areas: commercial bank portfolio management, market structure and bank performance, and regional development and public policy.

Research projects supportive of this objective and the resulting reports completed during the year include:

Implementing the Rural Development Act — J. Rosine

Minnesota's Economic Environment: 1985 — D. Dahl, J. Rosine, T. Supel

Cattle Cycles — Past and Present — J. Rosine

Financing Rural Economic Development: Implications for the Ninth Federal Reserve District — D. Dahl

Rural Banking Alternatives: Spatial Framework and Evidence — P. Jessup, R. Stolz

Minnesota's Exceptional Banking Structure: Research and Policy Perspectives — P. Jessup

Nonbank Financial Intermediaries — D. Paxton

Measures of Wholesale and Retail Banking in Minnesota — R. Stolz

Acquisitions by Bank Holding Companies: Promise, Performance, Potential — P. Jessup

Usury Laws and the Minnesota Statute — A. Rolnick

How Free is Free Checking? — P. Jessup

In process is a paper dealing with the decision-making process of the Federal Open Market Committee and the contribution of monetary policy research to that process. This paper should be ready for publication early in 1975.

The Bank's program to help promote economic development of reservation Indian people, another sub-objective, has begun to evolve with the development of working guidelines to reflect the program's mission and rationale. In November the Bank helped plan and was host to a national organizational conference of Indian businessmen, attended by representatives of Indian business and financial interests and of Government from all parts of the nation. The Bank has joined the University of Minnesota and other institutions in a pilot-project

to help assure that recently developed, Indian-owned recreational facilities on reservations can deliver a full range of quality, competitive services. The Public Information Department, in coordinating the Indian economic development program, has maintained an active membership in the Minority Business Opportunity Committee of the Federal Executive Board during the year.

■ Develop and apply an energy conservation program.

The Bank set this objective as one specific to the year 1974, but obviously it will be continued in 1975 and beyond. A target of fuel consumption 20 percent below what normally would be used by the Bank was set for 1974 operation of the building. This target included a 35 percent reduction in lighting, lowered temperatures in winter and raised temperatures in summer, and the changing of humidity standards. The target very likely has been achieved although variances from normal in outside temperatures and a lack of historical data on fuel use in the new building have made target achievement difficult to measure.

We are also developing plans for expanded fuel storage space and are in process of studying the establishment of operating priorities in the event of an emergency caused by fuel shortage or other factors.

■ Develop a more structured plan for management development.

The Personnel Department at the beginning of the year formulated a staff development plan which emphasized in-Bank supervisory training courses, seminars on minority group dynamics, and job enrichment. This plan was successfully implemented during the year and will be continued and expanded in 1975. We have continued our participation in the A.I.B. Consortium which provides training for minorities and disadvantaged, have expanded our program for training of the deaf, and offer participation to staff in a great variety of banking schools, seminars, and conferences, as well as continuing our educational assistance program of A.I.B. and college tuition reimbursement. A Council of Staff Representatives, organized primarily to provide better communications between management and staff, offers as a

byproduct good potential for management development of those who participate. Nevertheless, more must be done to provide opportunities for individualized management development, particularly at the middle-management level, and for women and minorities, and this will be a continuing objective for 1975.

Goals

To be an innovative component of the Federal Reserve System.

To make a significant contribution to the formulation and conduct of monetary policy.

To foster the growth and development of the Ninth District.

To improve services to government, banking and the public.

To promote the strength and viability of the nation's financial institutions.

To develop a more effective work force and to provide leadership in the corporate community.

To improve the efficiency of Bank operations.

Federal Reserve Bank of Minneapolis Financial Statement

Statement of Condition

December 31

Assets	<u>1974</u>	<u>1973</u>
Gold Certificate Account	\$ 309,300,000	\$ 114,240,000
Special Drawing Rights Certificate Account	7,000,000	7,000,000
Federal Reserve Notes of Other Federal Reserve Banks	27,249,000	26,688,000
Other Cash	9,340,000	10,455,000
Loans to Member Banks	1,550,000	9,900,000
Securities		
Federal Agency Obligations	104,877,000	40,284,000
U.S. Government Securities	1,785,563,000	1,631,304,000
Total Securities	<u>1,890,440,000</u>	<u>1,671,588,000</u>
Cash Items in Process of Collection	424,918,000	399,797,000
Bank Premises — Net	33,965,000	35,547,000
Other Assets	24,791,000	49,977,000
Total Assets	<u>\$2,728,553,000</u>	<u>\$2,325,192,000</u>
 Liabilities		
Federal Reserve Notes in Circulation	\$1,412,036,000	\$1,171,138,000
Deposits		
Member Bank Reserve Accounts	682,133,000	618,713,000
U.S. Treasury-General Account	128,634,000	89,442,000
Foreign	6,670,000	5,980,000
Other Deposits	11,246,000	8,519,000
Total Deposits	<u>828,683,000</u>	<u>722,654,000</u>
Deferred Availability Cash Items	418,687,000	368,441,000
Other Liabilities	25,685,000	23,663,000
Total Liabilities	<u>2,685,091,000</u>	<u>2,285,896,000</u>
 Capital Accounts		
Capital Paid In	21,731,000	19,648,000
Surplus	21,731,000	19,648,000
Total Capital	<u>43,462,000</u>	<u>39,296,000</u>
Total Liabilities and Capital Accounts	<u>\$2,728,553,000</u>	<u>\$2,325,192,000</u>
Ratio of Gold Certificate Reserves to Federal Reserve Note Liabilities	21.9%	9.8%

Earnings and Expenses

For the Year Ended December 31

	1974	1973
Current Earnings		
Interest on Loans to Member Banks	\$ 2,773,000	\$ 1,792,000
Interest on U.S. Government Securities and Federal Agency Obligations	125,727,000	97,100,000
All Other Earnings	428,000	248,000
Total Current Earnings	<u>128,928,000</u>	<u>99,140,000</u>
Current Expenses		
Salaries and Other Benefits	12,161,000	10,652,000
Postage and Expressage	2,610,000	2,390,000
Real Estate Taxes	1,564,000	1,467,000
Furniture and Equipment Purchases and Rentals	1,858,000	1,784,000
Depreciation -- Bank Premises	1,566,000	362,000
Other Operating Expenses	2,821,000	2,626,000
Assessment for Expenses of Board of Governors	967,000	1,024,000
Federal Reserve Currency	1,076,000	842,000
Total Current Expenses	<u>24,623,000</u>	<u>21,147,000</u>
Expenses Reimbursable or Recoverable	<u>(1,183,000)</u>	<u>(893,000)</u>
Net Expenses	23,440,000	20,254,000
Current Net Earnings	105,488,000	78,886,000
Payments to U.S. Treasury	(100,438,000)	(74,485,000)
Dividends Paid	(1,262,000)	(1,148,000)
Net Profit or (Loss)	<u>(1,705,000)</u>	<u>(1,738,000)</u>
Transferred to Surplus	2,083,000	1,515,000
Surplus, January 1	19,648,000	18,133,000
Surplus, December 31	<u>\$ 21,731,000</u>	<u>\$ 19,648,000</u>

Volume of Operations*

	Number		Dollar Amount	
	1974	1973	1974	1973
Loans to Member Banks	1,386	995	\$2.0 billion	\$2.4 billion
Currency Received and Verified	115 million	109 million	871 million	777 million
Coin Received and Counted	376 million	320 million	56 million	39 million
Checks Handled, Total	558 million	529 million	152 billion	136 billion
Collection Items Handled	.7 million	.7 million	2.6 billion	2.3 billion
Issues, Redemptions, Exchanges of U.S. Government Securities	7.3 million	6.8 million	18.7 billion	22.7 billion
Securities Held in Safekeeping	405,824	383,962	6.3 billion	4.1 billion
Transfers of Funds	529,423	440,063	455 billion	404 billion

*All figures are for Minneapolis and Helena combined.

Federal Reserve Bank of Minneapolis

Directors

Bruce B. Dayton, Chairman and Federal Reserve Agent
James P. McFarland, Deputy Chairman

Class A — Elected by Member Banks

David M. Smith, President (1975)
First National Bank, River Falls, Wisconsin

Charles T. Undlin, President (1976)
First National Bank of the Black Hills
Rapid City, South Dakota

William E. Ryan, President (1977)
Citizens State Bank, Ontonagon, Michigan

Class B — Elected by Member Banks

David M. Heskett, President (1975)
Montana-Dakota Utilities Company
Bismarck, North Dakota

Warren B. Jones, Secretary-Treasurer (1976)
Two Dot Land & Livestock Company, Harlowton, Montana

Donald P. Helgeson, Secretary-Treasurer (1977)
Jack Frost, Inc., St. Cloud, Minnesota

Class C — Appointed by Board of Governors

James P. McFarland, Chairman (1975)
General Mills, Inc., Minneapolis, Minnesota

Howard R. Swearer, President (1976)
Carleton College, Northfield, Minnesota

Bruce B. Dayton, Chairman (1977)
Executive Committee, Dayton Hudson Corporation
Minneapolis, Minnesota

Member of Federal Advisory Council

George H. Dixon, Chairman and President
First National Bank, Minneapolis, Minnesota

Helena Branch Directors

William A. Cordingley, Chairman
James C. Garlington, Vice Chairman

Appointed by Board of Directors Federal Reserve Bank of Minneapolis

Donald E. Olsson, President (1975)
Ronan State Bank, Ronan, Montana

John Reichel, President (1976)
First National Bank, Great Falls, Montana

George H. Selover, President and General Manager (1976)
Selover Buick-Jeep, Inc., Billings, Montana

Appointed by Board of Governors

William A. Cordingley, President and Publisher (1975)
Great Falls Tribune, Great Falls, Montana

James C. Garlington, Partner (1976)
Garlington, Lohn & Robinson, Missoula, Montana

Term expires December 31 of indicated year

Officers

Bruce K. MacLaury, President
Clement A. Van Nice, First Vice President

Sheldon L. Azine, Assistant Counsel
and Assistant Secretary
Earl O. Beeth, Assistant Vice President
James U. Brooks, Building Officer
Melvin L. Burstein, Vice President
and General Counsel

Frederick J. Cramer, Vice President
Ralph J. Dreitzler, Vice President
Leonard W. Fernelius, Vice President
Lester G. Gable, Vice President

Thomas E. Gainor, Senior Vice President
Roland D. Graham, Senior Vice President
Albert R. Hamilton, General Auditor
Richard C. Heiber, Assistant General Auditor
Douglas R. Hellweg, Vice President

William B. Holm, Assistant Vice President
Ronald O. Hostad, Assistant Vice President
John D. Johnson, Assistant Vice President
Ronald E. Kaatz, Research Officer

Arthur I. Lee, Assistant Vice President
John A. MacDonald, Senior Vice President
David R. McDonald, Vice President
Clarence W. Nelson, Vice President
and Director of Research

John P. Olin, Vice President and Secretary
Michael J. Pint, Assistant Vice President
Ruth A. Reister, Assistant Vice President
and Assistant Counsel

Charles L. Shromoff, Assistant Vice President
Richard B. Thomas, Assistant Vice President
Joseph R. Vogel, Chief Examiner
Robert W. Worcester, Vice President

Helena Branch Officers

Howard L. Knous, Vice President
Bruce J. Hedblom, Assistant Vice President
Betty J. Lindstrom, Assistant Vice President