

MONTHLY REVIEW



**Fifth District 1965: . . more investment. . . more workers. . . more hours. . .
more production. . . more income. . . but a few problems.**

FIFTH DISTRICT



1965

Fifth District business has just completed its fifth successive year of expansion. Business in the District, as in the nation generally, maintained a strong uptrend in 1965, setting new records in many areas. Spearheaded by increasing outlays for industrial plant and equipment and by heavy spending for highways and urban redevelopment, the faster rate of business growth raised employment in the Fifth District to the highest level in history.

Unemployment dropped to the lowest level in more than a decade. Labor shortages, noted selectively and intermittently during 1964, became quite general in 1965 and were acute enough in some instances to limit production gains and to exert upward pressure on wage rates. Reports of wage and price increases cropped up more and more frequently as the year progressed.

New industrial construction proceeded on an unprecedented scale. The renovation of old plants and installation of new equipment raised productive capacity by an unknown but probably substantial amount. Distributive facilities also grew as more shopping centers opened for business, and service enterprises continued to expand, especially in and near new suburban areas. Municipal governments and civic organizations hastened the transformation of downtown areas with new public service facilities, art centers, and theaters, and private developers added high-rise office buildings, luxury apartments, and parking complexes. The additional parking space gave visitors easier access to centrally located stores, offices, and recreation facilities. Travelers' accommodations were increased and improved as new, centrally located motor inns opened for business in the District's larger cities.

Highways and Growth New highways rank high among the many factors working concurrently to shape the District economy. By the middle of 1965, over 1,500 miles of limited access interstate highways were in service in the District, and if work continues on schedule, highspeed road mileage will more than double in the next few years to a total of nearly 3,400 miles. Considerable progress was made during 1965. By the fall of the year more

than seven eighths of the District interstate highway system was either complete or in process. Only four fifths of the system was as far ahead as this a year earlier.

The new highways have important implications for the mobility of labor, as workers are now able to travel farther and faster than ever before. Long distance commuting is now commonplace in many parts of the District, particularly in the burgeoning Washington, D. C. area and in the Carolinas where rapidly growing industries must attract workers from wider and wider areas.

Increased labor mobility is playing a major role in shaping changes in economic patterns in the District. Many new businesses located near new highways during 1965 to simplify commuting as well as the distribution of goods and services. Interstate 495 circling Washington, D. C. proved especially attractive. The Washington area has continued to grow at an unusually rapid pace, primarily under the stimulus of expanding activities of the Federal Government. As a result, the area possesses both a labor supply capable of acquiring more of the skills needed to sustain growth and enough market potential to foster optimistic planning.

New highways are also influential in the choice of locations for residential and commercial projects. Residential and commercial facilities combined in the same project for the mutual convenience of both businessman and customer are not new in the District, but were larger and more numerous during 1965 than ever before. Plans were announced late in 1965 for a combination high-rise apartment and shopping center development to be located on the western rim of Route 495. A joint project of three firms, it is expected to cost around \$100 million, accommodate some 100 commercial tenants, and include some 4,500 apartment units in 20 fifteen-story buildings. This would be the largest such project in the Washington Metropolitan Area.

Statistics Show Strength Most barometers of District business registered strong and steady gains during 1965. Bank debits rose one eighth above year-earlier levels, a larger gain than in the nation

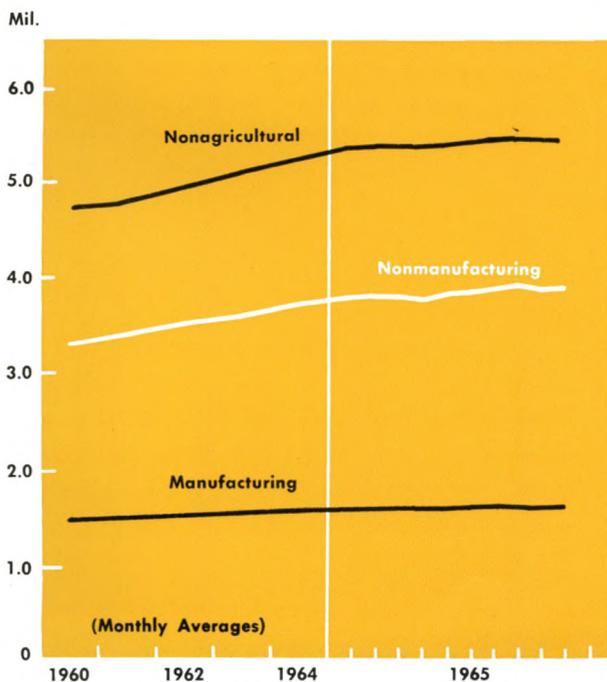
as a whole and the most that District debits have risen in any year of the current upswing. The number of new passenger cars registered in the District reached an all-time high, 14% above 1964 and two thirds ahead of 1961, the recent low year. The number of business failures averaged 10% under the 1964 rate and was the lowest in a decade. New businesses incorporated during 1965 averaged around 1,200 per month, 10% higher than in 1964 and a new record high. Nonagricultural employment grew faster than in earlier years of the current expansion. The number of nonfarm jobs, seasonally adjusted, approached 5.5 million toward the end of 1965 after rising nearly 200,000 in the course of the year. The average annual increase between 1960 and 1964 was about 130,000.

Charts Tell Story The accompanying charts have been prepared for two purposes. The first is to show the extent of progress made in 1965, and the second is to show these changes in perspective by comparison with earlier rates of growth. The left-hand side of each chart shows averages of monthly figures for the years 1960 through 1964 and the right-hand panel shows monthly data for 1965. In observing each chart, it should be noted that the time scale used in the left-hand panel to show four years of

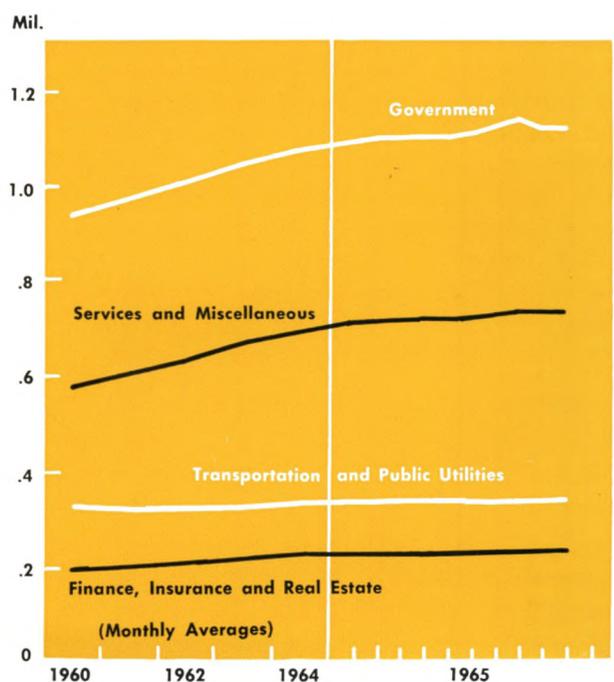
growth covers just about the same horizontal distance as the right-hand scale, which represents one year. For an accurate visual comparison, the entire increase in the right-hand panel, or the rise from 1964 on the left to an approximate 1965 average on the right, should be compared with typical annual gains shown on the left. Since 1965 data were incomplete when the charts were prepared, some of the series end with October, some with November, and the rest represent estimates carried to the end of the year.

The first two charts include total nonagricultural employment and some of its major components. Growth in 1965 was strongest in nonmanufacturing categories, although manufacturing employment also increased at a faster pace than in other recent years. Despite somewhat different growth rates among the components, the composition of District nonfarm employment changed little in 1965. About 30% was manufacturing and 70% nonmanufacturing. Government was the biggest single source of nonfarm jobs except for manufacturing and was the fastest growing. Government employment in the Fifth District, including state and local as well as Federal, averaged about 1.1 million during 1965. Government workers held 29% of all nonfarm, nonmanufacturing jobs in the District compared to 24% nationally, and 20% of all nonfarm jobs compared to 16% nationally.

NONAGRICULTURAL EMPLOYMENT FIFTH DISTRICT



Sources: State Departments of Labor.



Employment in trade, charted on page 5, is the second largest component in the nonmanufacturing sector and averaged about 1 million during the year. Trade employment grew about 2% per year between 1960 and 1964 then rose more than 3% during 1965.

The services provided employment for more than 700,000 workers during the average month in 1965 and made up, except for government, the fastest growing source of jobs. Annual increases averaging about 29,000 between 1960 and 1964 were followed by a slightly larger rise in 1965, equivalent to about 5%. Growth in services has been consistently faster in the District than in the nation.

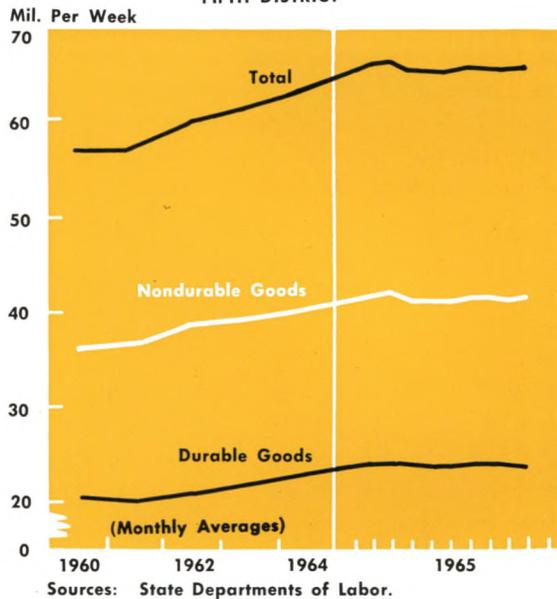
The other employment categories charted in the right-hand panel on page 3 are the public service enterprises which include transportation, communications, and public utilities, and the group comprised of finance, insurance, and real estate firms. The number of jobs in transportation and associated activities rose 2% during 1965, averaging about 330,000. This was a sharp gain when compared to the rise of little more than 1% that occurred in the four previous years combined. Jobs in finance, insurance, and real estate enterprises, on the other hand, rose more slowly than before: less than 3% in the latest year compared to an average annual growth of about 4% in the earlier years. Jobs in this group averaged nearly 230,000 during 1965.

The average growth rate in manufacturing employment between 1960 and 1964 was about 2% per year in both durables and nondurables. During 1965, however, jobs increased more rapidly in the durable goods sector, nearly 3% compared to less than 2% in nondurables.

Employment Summary District developments have been arrayed beside those of the nation in the following table:

	% Change			
	Annual Averages 1960-1964		Dec. 1964- Dec. 1965 (est.)	
	5th District	U. S.	5th District	U. S.
Total Nonfarm Employment	3	2	3	3
Manufacturing	2	1	2	4
Durables	2	1	3	5
Nondurables	2	0	2	2
Nonmanufacturing	3	2	4	3
Government	4	3	5	4
Trade	2	2	3	4
Services & Misc.	5	4	5	4
Construction	5	2	1	-1
Transportation, Com- munications & Public Utilities	0	0	2	2
Finance, Insurance, and Real Estate	4	2	3	2
Mining	-3	-2	1	-2

FACTORY MAN-HOURS FIFTH DISTRICT



Except for durable goods manufacturing and trade, more new jobs were created, relatively speaking, in the District during 1965 than in the nation. National growth in durables last year was quite extraordinary, with more jobs added in one year than in all of the previous four combined. Employment in durables grew twice as fast in the District as in the nation between 1960 and 1964, but unusual strength in steel, automobiles, and machinery and equipment revised this relationship in 1965.

Manufacturing Factory man-hours are better than employment for measuring labor use but still do not take account of differences in labor productivity. As a production indicator, therefore, man-hours imperfectly reflect both trends over time and inter-industry comparisons. Before comparing growth rates it should be noted that the structure of Fifth District manufacturing, with two thirds of all man-hours in nondurables, differs markedly from the national, where nondurables comprise only two fifths of the total.

District factory man-hours are charted at the top of this page. In the first four years man-hours rose about one tenth, a little more in durables and a little less in nondurables. Because of greater sensitivity to cyclical factors, durables would be expected to rise faster; and nationally they did. U. S. factory man-hours in durables rose 7% between 1960 and 1964 compared to 3% in nondurables, and rose 5% in 1965 while the comparable District series hardly increased

at all. The rise in nondurables last year was about 1% in both the District and the nation.

Man-hours rose between 1960 and 1964 in all of the District's principal manufacturing industries except lumber and tobacco manufacturing. Gains exceeded 25% in the apparel, machinery, and furniture industries and were over 10% in printing and publishing, chemicals, and the yarn sector of textiles.

Crosscurrents Present During 1965, the availability and use of labor responded with mixed results to crosscurrents of social and political as well as of economic origin. Despite new equipment which required fewer workers for a given amount of production, there were more jobs than workers in many parts of the District. Behind the demand for labor lay a strongly rising demand for goods and services, part and parcel of the general economic expansion. Some important factors, however, such as increased inductions into the armed forces and various Government training and aid programs, tended to reduce the ranks of potential job-seekers.

Simultaneously pushed and pulled during 1965, total man-hours remained within quite a narrow range. The high for the first ten months of the year was reached in March, and the spring peak was more pronounced in nondurables. Man-hours in nondurables, furthermore, resumed an uptrend in the fall while durable goods man-hours continued to point slightly downward.

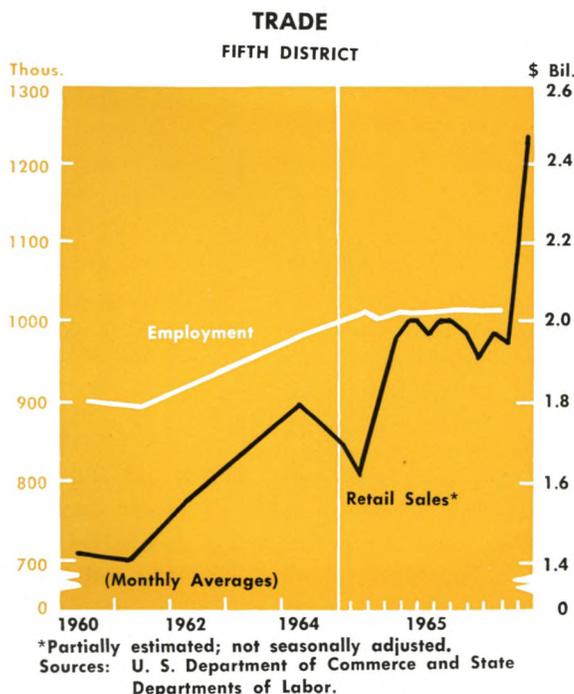
Trends for the year as a whole varied considerably among types of industry. Furniture, machinery, and electric equipment provided the only gains in the durable goods group. Declines were greatest in primary metals and lumber. Among nondurables, man-hours declined sharply in tobacco manufacturing, moderately in paper products, and slightly in foods. Among the gainers, the apparel industry set the pace with a rise of 7% in the first ten months. Strong increases also occurred in textiles, printing, and chemicals.

Textiles Changes in the textile industry are especially significant for two reasons: because it is particularly important to the District economy and because events occurring in 1965 substantially improved its outlook. With roughly half of the nation's textile output emerging from Fifth District mills, national statistics reflect with reasonable accuracy the experience of District firms. Textile manufacturers nationally invested more than \$1 billion in new plant and equipment during 1965, one third more than in 1964 and nearly three times the amount spent annually a decade earlier. Employment in textiles, reversing a prolonged downtrend, rose 1% in 1964 and 3% in 1965. Reflecting both the capacity and the efficiency of new equipment, textile production rose more than 3% in 1964 and more than 8% in 1965.

Improved conditions in the textile industry began to a considerable extent with a 1964 change in the Federal law governing cotton production and marketing. Before the change, domestic textile mills bought cotton at a supported price about one third above the world price, which foreign competitors were paying. The change in the law provided a reimbursement to domestic mills for most of the difference until July 1, 1966. Further revisions made in 1965 eliminated direct payments to mills after the middle of 1966 but extended for four years the period in which they would be assured an opportunity to buy at the world price. Revised depreciation schedules for tax purposes and negotiated limitations on imports, already in effect for several years, also contributed to the generally favorable conditions existing in 1965.

With textile products in unusually strong demand, due to rising levels of personal income and to increasing military needs, the current period of textile mill expansion and prosperity appears to be set for at least one more record-breaking year. New plant and equipment expenditures are expected to continue rising, though perhaps not as fast as in 1965 when

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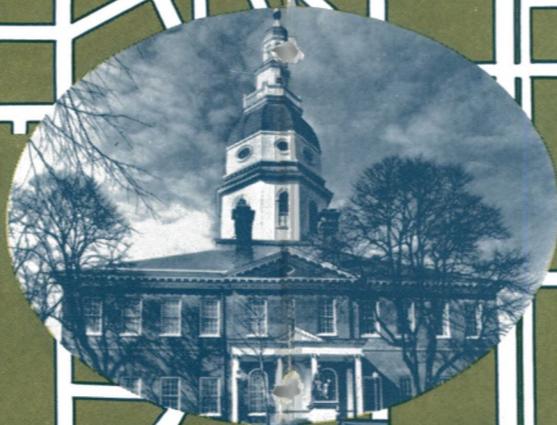


Historic ANNAPOLIS

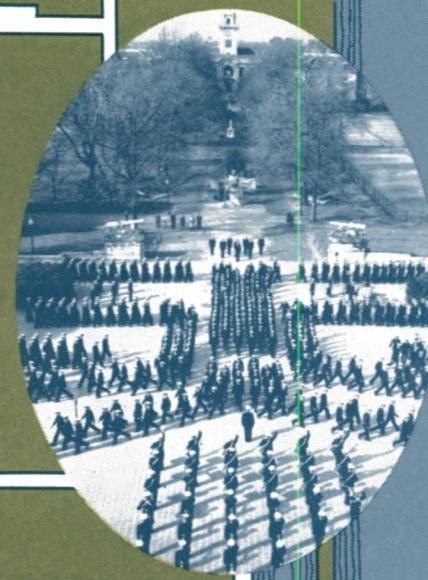
Capital of the State of Maryland



The Annapolis Convention, a preliminary to the writing of the Constitution of the United States, met in the Old Senate Chamber on September 11, 1786.



The Maryland State House is the third on this site. The first was built in 1691; the second in 1706, and the present structure was begun in 1772.



The noon meal formation is a daily event at the U. S. Naval Academy.



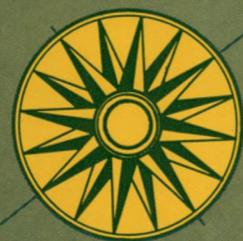
McDowell Hall was named for the first principal of St. John's College, Dr. McDowell.

EASTPORT

CREEK

COLLEGE CREEK

SEVERN RIVER



A tiny community at the mouth of the Severn River, first known as Providence, and later as Anne Arundel Town, was eventually named Annapolis and in 1695 became the capital of Maryland. The town was located in Anne Arundel County, named for the wife of the second Lord Baltimore. Annapolis took its name, however, not from the county but from Princess Anne, later Queen Anne, the last of the Stuart line to rule England.

Annapolis is one of several important Colonial centers whose charm has not been defaced by time. Non-profit organizations such as Historic Annapolis, Inc. have taken steps to preserve the outstanding examples of colonial architecture. Planned by Sir Francis Nicholson, a colonial governor of Maryland, Annapolis is a picturesque town with colonial homes and beautiful gardens lining streets which radiate out from circles like spokes from the hub of a wheel. High on a hill commanding a view of Annapolis and the harbor stands the oldest State House in continuous use in the United States. The first stone of the foundation for the present structure was laid by the colonial Governor, Sir Robert Eden, on March 28, 1772. The old Senate Chamber of this building has been the scene of many historical events. The Continental Congress met here from Novem-

ber 16, 1783 to June 3, 1784. In this room on December 23, 1783, George Washington resigned as commander-in-chief of the Revolutionary Army; and it was here on January 14, 1784, that the Treaty of Paris which ended the Revolutionary War was ratified.

Almost from the beginning Annapolis has been a center of education. In 1696 King William's School was chartered by Colonial Maryland; and in 1784 St. John's College, which absorbed King William's School, was chartered by the State of Maryland. The Honorable George Bancroft, Secretary of the Navy during the Polk Administration, founded the Naval School, later reorganized as the U. S. Naval Academy, on the site of Fort Severn in 1845.

Although over a million tourists flock to Annapolis each year, the town is not a museum. Tourism is only one of four main industries. As the capital of Maryland, Annapolis is the center of many government activities, and the town's location on the Chesapeake Bay also makes it an ideal place for a flourishing boating and yachting industry. The fastest growing industry, however, is electronics research and development. Many such firms are now in the area and others are planned.

FIFTH DISTRICT 1965

(Continued from page 5)

spending increased from an annual rate of \$850 million in the first quarter to \$1,150 million in the fourth. Profits have improved substantially and now compare quite favorably with returns earned in other nondurable goods industries.

Retail Trade Retail sales rose 8% in 1965, continuing the rapid growth that began in 1962. The chart at the foot of page 5 shows this rise and the attendant increase in total trade employment, which is about three fourths retail and one fourth wholesale. In 1961, the first year charted, employment declined slightly as did sales, but beginning in 1962 employment rose at an average rate of about 3% per year, and the pace continued throughout 1965. Seasonally adjusted employment in District trade establishments passed the one million mark for the first time in January 1965.

Retailers, like other employers, noted a shortage of workers at various times during the year. They are handling the rising volume of trade with steadily increasing efficiency, but the changing relationship between sales and employment in 1965 suggests that more workers might have been employed had they been available. The chart clearly shows that retail sales rose much faster than retail employment. The extent of the increase in efficiency can be seen in the rising volume of sales per employee in retailing, which amounted to \$24,000 in 1960 and increased to \$30,000 in 1965. Total retail volume rose concurrently from \$17 billion to \$23 billion.

Construction Construction continued to strengthen the District economy during 1965. In addition to highways, bridges, and other public projects, construction in progress included hospitals and medical centers, new buildings for schools and colleges, residential facilities from private homes to large apartment projects, hydroelectric and thermoelectric generating plants, power lines, pipelines, dock facilities, motels, recreational structures, and many industrial projects.

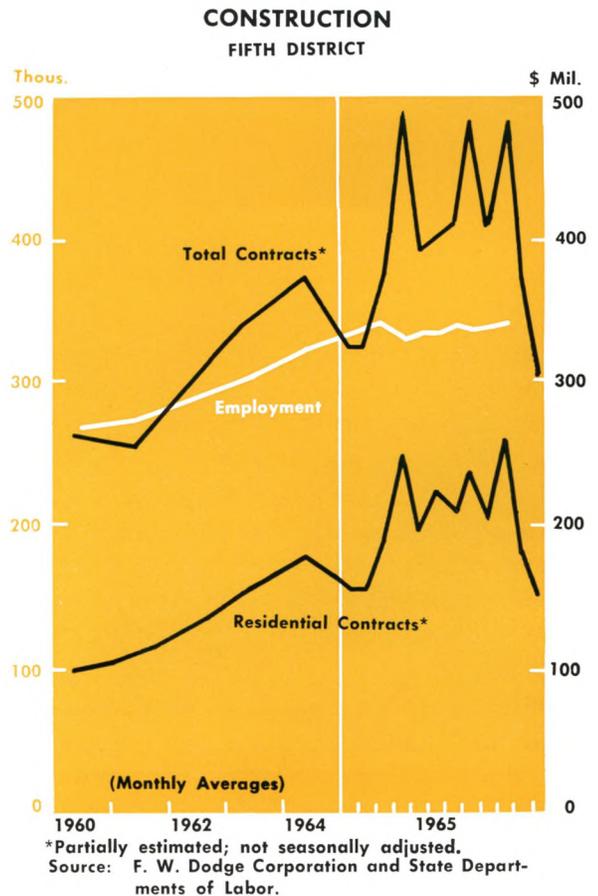
Contract award values compiled by F. W. Dodge Corporation probably provide the most comprehensive picture of trends in construction. The chart in the opposite column shows averages of monthly figures for total and residential contract values, 1960 through 1964, and monthly data for the year 1965. The figures for the last two months of 1965 have been estimated, following typical seasonal changes observed in the past few years.

In residential construction, the District and the

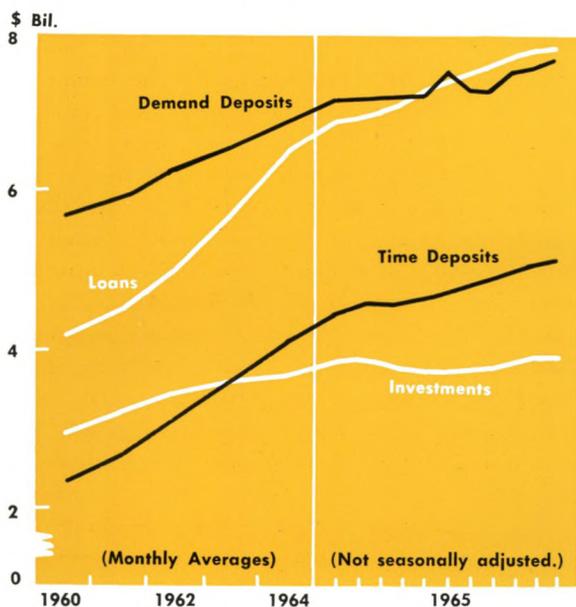
nation continued on decidedly different trends in 1965. Residential award values for the nation were practically unchanged between 1963 and 1964 and rose 5% in 1965. In the District, however, a 15% gain in 1964 was followed by a 13% rise in 1965. District housing awards were relatively low during the fall of 1964 and did not really pick up again until last April, but a strong average was maintained thereafter. The October figure, the latest available, was a new all-time high, two thirds above the previous October and one fourth higher than the previous record for October set in 1963.

Nonresidential construction awards, mainly business and institutional building, also showed considerable strength in the fall, but public works and utility awards, which began 1965 well above year-earlier levels, fell below the 1964 pace in June and continued to lose ground through the rest of the year.

Until new vigor appeared in the late summer and fall, total contract values had been drifting downward relative to year-earlier levels and were actually below



BANKING TRENDS
FIFTH DISTRICT MEMBER BANKS



1964 on an accumulative basis after the first seven months of the year. As a result of the revival, however, total award values on average rose 6% in 1965 compared to 10% in 1964.

Employment in contract construction increased rapidly between 1960 and 1964 but, as the chart shows, leveled out somewhat during 1965. A shortage of labor was a limiting factor. The average annual increase in contract construction jobs was a little more than 13,000 between 1960 and 1964, representing a 5% annual gain. The rise during the first ten months of 1965, however, amounted to little more than 3,000, an increase of about 1%.

Banking Fifth District bankers had another busy year in 1965 as demand for their services continued to grow at a rapid pace. At the end of November, as the chart above shows, loans of member banks stood at \$7.8 billion, up \$846 million since the beginning of the year compared to gains of \$642 million in 1964 and \$588 million in 1963.

Total bank credit at Fifth District member banks rose considerably faster during 1965 than in either of the two previous years, due primarily to the unusually rapid growth of business and consumer loans. Except for seasonal variations, total investments changed little during the year as acquisitions of tax exempt bonds about matched liquidation of Government securities.

Demand deposits generally followed seasonal pat-

terns, reflecting moderate growth. Time deposits, on the other hand rose sharply to a level in excess of \$5 billion, a growth of 17% in eleven months compared to 13% in each of the two prior years. Fifth District member banks greatly expanded their use of time certificates of deposit after the middle of the year, which partly explains the extraordinary rate of growth, the highest for any comparable period in the past ten years.

Agriculture Widely varying weather conditions, changes in Federal regulations dealing with cotton and tobacco, and better prices for some products turned out to be the principal factors affecting District agriculture in 1965. Location and type of enterprise determined which factor played the leading role.

Growing conditions were excellent in some areas, and peanut, soybean, corn, fruit, pecan, and potato farmers reaped exceptionally good harvests. In other regions, however, drought plagued farmers for the third consecutive year, but not as extensively as in 1964 or 1963. In the same season, parts of North Carolina and Virginia received so much rain that boll weevils thrived and sharply reduced some local cotton crops.

Flue-cured tobacco growers, operating under acreage-poundage controls for the first time, produced a 22% smaller crop than in 1964 but with marked improvement in quality. Prices were significantly higher but because of the sharply reduced marketings, the value of gross sales was down some \$128 million, or 17%, from a year ago. Livestock farmers were able to get generally higher prices for hogs, cattle, and poultry, and improved their incomes accordingly.

Reflecting mixed influences, cash receipts from farm marketings through October were 1% higher than a year ago, but it appears quite possible that final figures for the year will show 1965 gross income below the 1964 level because of sharply reduced returns from flue-cured tobacco and cotton. On the basis of ten months' data, District receipts from livestock and products were nearly 6% higher than in the previous year, while receipts from crops were down more than 2%.

With the exceptions noted, conditions continued to improve during 1965 for individual Fifth District farmers. There were fewer sharing the farm income pie as the number of workers on farms continued to decline, dropping some 10% during 1965 compared to 9% nationally. Farm real estate values continued to advance during the year, adding strength to farmers' asset and equity positions.

TREASURY TAX AND LOAN ACCOUNTS

“There is no known mechanism for achieving the balancing effect on the money market now achieved by the Tax and Loan Account System. It is the object of study and, indeed, of envy, by the government of virtually every other large country today.” So said Robert Roosa, Undersecretary of the Treasury, in 1962.

The bulk of the U. S. Government’s cash operating balance is held in demand deposits, known as Tax and Loan Accounts, in about 12,000 commercial banks. While virtually all Government payments are made by checks drawn on its account with the Federal Reserve Banks, the supplementary depository system enables the Treasury to maintain a minimum balance with the Federal Reserve, sufficient to cover its daily needs, and simultaneously to minimize the impact of its financial operations on the economic stability of the country.

Relation to the Money Market The Tax and Loan Account System is the means used for maintaining a smooth flow of funds from the general public to the Treasury and back again without causing seriously disruptive effects on the banking system and the money market. Government expenditures, tax collections and debt operations involve huge and irregular transfers of funds, many of which fall in certain months, and on certain days in the month. Because receipts and expenditures cannot be synchronized in offsetting amounts, Government financial operations would have an enormous impact on aggregate bank reserves if all funds flowed directly and immediately from the public to the Treasury’s Federal Reserve account. This would occur because the Federal Reserve transfers funds by crediting the Treasury’s account and debiting the member banks’ reserve balances, or vice versa. Thus, Government receipts would drain reserves from the banking system, forcing banks to restrict credit without economic justification or to liquidate securities or short-term paper, thereby depressing security prices and raising yields. Conversely, a large outflow of Government expenditures would provide banks with an excess of reserves, and money market conditions would be suddenly, but temporarily, easy.

In the absence of Tax and Loan Accounts, the Federal Reserve could take action to offset the wide swings in reserves, but this arrangement would be less desirable than the present system for at least two reasons. First, it would be necessary for the System to increase significantly its role as a buyer

and seller of Government securities, which it would prefer not to do. The smaller the System’s role, the more accurately the market provides useful information about the demand and supply of funds emerging out of the nation’s economic processes. In general, the System tries to hold its participation to a minimum consistent with its objectives of economic stabilization and orderly markets. Second, the absence of Tax and Loan Accounts would probably result in more massive shifts in reserves among banks than is presently the case. For example, large purchases of Government securities necessitated by an excess of tax receipts over disbursements would not restore reserves to their original location. Initially they would tend to be concentrated in the banks in the financial centers and would only gradually filter out to banks in other areas.

Development The Special Depository system was devised during World War I to facilitate the sale of bonds necessary to finance the war. Under the terms of the First Liberty Loan Act of 1917, banks which purchased securities issued under the terms of the Act, for their own or their customers’ accounts, could deposit the proceeds into special “War Loan Accounts.” By leaving the proceeds from the sales on deposit in commercial banks until they were needed, the Treasury was able to insulate the money market, at least partially, from large inflows and outflows of cash, while providing banks with an incentive to sell bonds. While these deposits were not subject to reserve requirements, banks were required to pay 2% interest on them. Interest payments on all demand deposits, including the War Loan Accounts, were abolished by the Banking Act of 1933 and, in 1935, these accounts were made subject to reserve requirements.

Little use was made of War Loan Accounts during the 1930’s, but with the advent of World War II they again became very active. To encourage banks to open these accounts reserve requirements against them were suspended between 1943 and 1947. In recognition of the high postwar levels of Government financing, Congress subsequently broadened the use of War Loan Accounts to include deposits of withheld income taxes in addition to proceeds from savings bond sales. In 1950 the Treasury provided for the payment of Social Security taxes through this mechanism, and changed the name to “Tax and Loan Accounts.” Since that time other taxes have been made eligible for deposit in these accounts, such as

ERRATUM

In the January 1966 issue of the *Monthly Review*, the article titled "Treasury Tax and Loan Accounts" reported incorrectly the current basis for classifying banks that hold Treasury Tax and Loan deposits. The error is contained in the first two sentences of the second full paragraph of the right-hand column on page 11. These two sentences, corrected, should read:

For administrative purposes Special Depositary banks are classified in three groups, according to the total deposits credited to the individual Tax and Loan Accounts during the period September 1-November 30, 1964. Group A includes all banks which in this period received Tax and Loan deposits in amounts of \$600,000 or less, Group B those which received more than \$600,000 but less than \$32,500,000, and Group C those which received \$32,500,000 or more. In the calculation of deposit totals, however, deposits resulting from new Treasury financing or from Treasury adjustments of balances held with C banks are not counted.

Railroad Retirement taxes, and corporate and personal income taxes under certain circumstances. (The latter taxes are eligible when checks total \$10,000 or more and the Treasury grants permission.) Also, to the extent authorized by the Treasury, banks continue to be permitted to pay for their own and their customers' subscriptions to Government marketable securities by crediting their Tax and Loan Accounts.

Mechanics of Operation Although all incorporated banks and trust companies have been designated as Special Depositories by the Secretary of the Treasury, banks must qualify individually to hold Tax and Loan Accounts by filing an application with the District Federal Reserve Bank. In the application, a bank must specify the amount for which it wishes to qualify, within the ceiling established by Treasury regulations. This ceiling is either 30% of the bank's total deposits, exclusive of Treasury Tax and Loan deposits, or 100% of its capital and surplus, whichever is greater. The 30% guideline is used most frequently.

One of the most important requirements for qualification is the pledging of collateral at least equal to that part of the Treasury deposit in excess of the \$10,000 limit insured by the Federal Deposit Insurance Corporation. Although U. S. Government securities constitute the principal collateral for these deposits, a wide variety of other types of securities and paper have been pronounced "eligible" by the Treasury, such as obligations of U. S. Government Agencies, State bonds and high-grade corporate and municipal bonds, certain commercial and agricultural

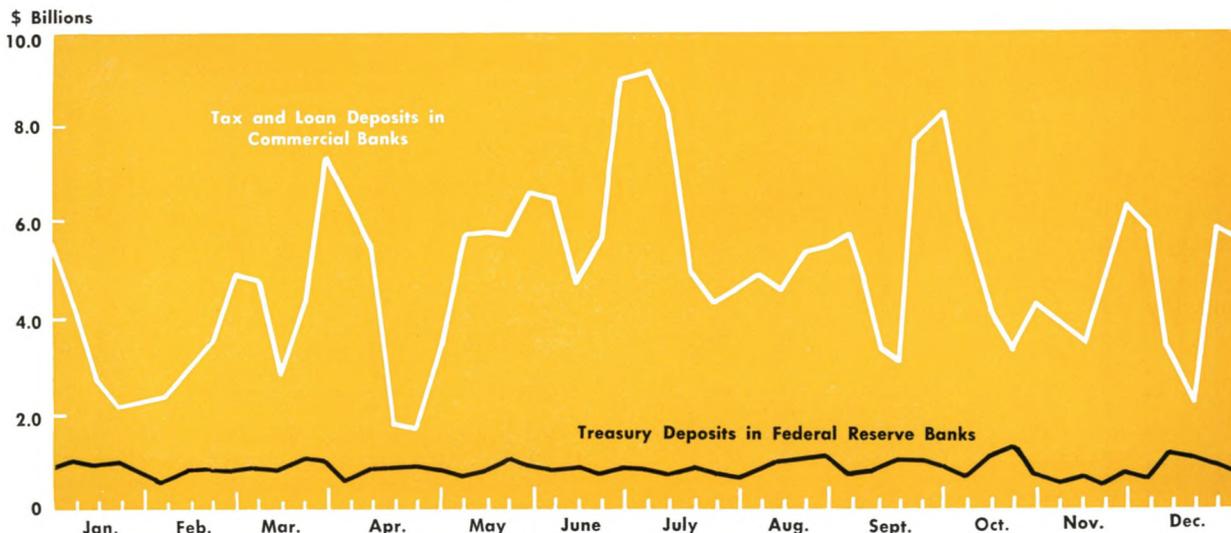
paper, bankers' acceptances, and notes representing loans guaranteed by certain U. S. Government departments and bureaus.

Once a bank has qualified to hold a Tax and Loan Account it may deposit proceeds from purchases of new Government securities in the Treasury account, when permitted by the Treasury. In order to receive deposits of Federal taxes, however, a second application must be made to the Federal Reserve.

For administrative purposes Tax and Loan Accounts are classified in three groups. Group A includes banks with Tax and Loan balances of \$600,000 or less; Group B includes those with Tax and Loan balances over \$600,000, but less than \$32,500,000; and C banks are those with balances of \$32,500,000 and over. C banks, which number less than 100, hold about half of all Tax and Loan deposits. The Treasury withdraws funds from these banks by "calling" a certain percentage of the aggregate balance in each group, so that the same per cent is withdrawn from each bank within a group. Calls from A banks are generally made once a month, with partial payment required in a week and the balance in three weeks from the date of call; B calls are usually on Mondays and Thursdays with payment due in four or five days; and C calls are the same as B, except that "special" calls, redeposits, or cancellations of calls may be made at any time. "Special" calls must be paid the day of the call, and usually consist of a certain per cent of the previous day's balance.

In order to minimize fluctuations in total bank reserves, the Treasury endeavors to maintain its

TREASURY OPERATING BALANCES, 1964



Source: U. S. Treasury Department.

balance in the Federal Reserve Banks within a certain range. In fiscal 1965 it averaged about \$850 million. Special C bank action is the principal means of adjusting for unexpected changes in this level. Thus, while all Treasury deposits are technically payable on demand, a large number of small banks actually hold relatively predictable balances, balances in larger banks are subject to wider swings on shorter notice, and a small number of very large banks may find their Treasury balances fluctuating sharply on a few minutes notice.

The volume of Tax and Loan Account receipts and disbursements has risen steeply since World War II. Receipts totaled \$60.1 billion in fiscal 1965, up from only \$8.6 billion in fiscal 1948. During the year balances in these accounts fluctuate sharply with a strong seasonal pattern. The low point is usually reached in January and the high in June, when total budget receipts are the greatest. In the past two fiscal years this spread has varied from \$2.5 billion to \$10 billion. The balances also peak in March and September, due primarily to heavy corporate tax payments. Of the approximately \$120 billion total cash budget receipts in fiscal 1965, about 48% were channeled into the Treasury through Tax and Loan Accounts. Most of the other receipts were deposited directly with Federal Reserve Banks.

Commercial Banks as Fiscal Agents and Underwriters Most banks perform a wide variety of services for the Treasury, regardless of whether or not they have a Tax and Loan Account. The most commonly performed services are:

1. Issuing and redeeming U. S. savings bonds.
 2. Promoting new offerings of and handling subscriptions to U. S. securities.
 3. Handling matured Government obligations.
 4. Cashing Government checks.
 5. Handling "Depositary receipts" relating to withheld income and other Internal Revenue taxes.
 6. Reporting large or unusual currency transactions to the Treasury.
 7. Submitting information returns to the Internal Revenue Service.
 8. Submitting reports relating to certain financial activities of foreigners.
 9. Processing letters of credit under programs sponsored by Government agencies.
 10. Keeping records and filing reports in connection with the Treasury's Foreign Funds Control Operations.
 11. Counseling the general public in regard to savings bonds and marketable Government securities.
- All of these services are performed without direct

compensation from the Treasury except the redemption of savings bonds, for which banks (per qualified paying agent) are reimbursed 15 cents each for the first 1,000 bonds, and 10 cents each thereafter, during the calendar quarter. While a bank may receive indirect compensation through the increased customer traffic which some of these services might generate, a Tax and Loan Account is profitable only if the bank works hard to build it up. By endeavoring to maintain a flow of funds through its Tax and Loan Account, a bank automatically increases its effectiveness as a fiscal agent for the Treasury while earning profits in connection with certain services which, for the most part, it would be rendering anyway.

In the absence of formal underwriting arrangements, the Treasury depends to a large extent on the commercial banking system for the efficient and successful marketing of Government securities. In the particular instances when the Treasury allows partial or complete payment for a debt offering through credit to Tax and Loan Accounts, however, banks become similar to "underwriters" in that their eagerness to acquire the securities assures the success of the offering. The best example is the sale of tax anticipation bills when Tax and Loan privileges are extended. Banks bid aggressively for these issues, for their own and their customers' accounts, and the resulting rates are much lower than on comparable outstanding issues. Thus, the Treasury incurs a lower interest cost than would otherwise have been possible. This is particularly true when banks are strapped for funds and would not ordinarily be interested in purchasing short-term Government issues.

Tax and Loan Accounts are not maintained to compensate commercial banks for their services to the Treasury, but rather to avoid the reserve fluctuations which would otherwise result from the Treasury's taxing, borrowing, and spending activities. They do, however, provide at least some offset to the cost of performing fiscal agency functions. According to the findings of two recent studies by the Treasury, the cost to the banking system of the services provided for the Government is slightly greater than the potential earning power of the Tax and Loan deposits.

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