

A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1961 October



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THE Trend OF BUSINESS

During the third quarter business activity continued to rise but at a slower pace than in the April-June period when the turn-around in inventory investment occurred. Expansion in recent months has been geared more closely to final demand for goods on the part of consumers, business and government.

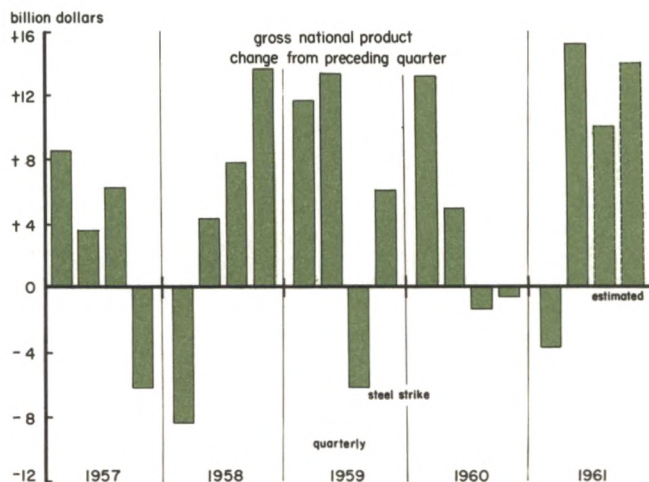
Industrial production rose about 6 per cent in the second quarter, while during the third quarter the gain was only about 4 per cent. Wage and salary employment which increased one million from March to June showed only a slight further gain in July and August. Average hours worked by factory employees, which had increased from 38.3 last December to 40.0 in June, showed very little change during the summer.

Although activity continued to increase throughout the third quarter, output in some of the industries which led the upsurge, including steel, autos, building materials and textiles, leveled off. Some industries such as farm machinery and television which had increased production substantially earlier in the year reported declines during the summer. Output increases in recent months have been centered in machinery and a variety of nondurable goods industries, including chemicals and food processing.

Despite evidence of a slowing in the rise in activity, confidence that the upswing in business will continue has become increasingly widespread. Occasional expressions of concern about possible inflation are now heard as demand for both finished goods and raw materials rises and new wage increases are negotiated.

Wholesale price indexes and prices of most individual commodities which are quoted publicly have not advanced in recent months. In September major auto companies indicated that they would hold the line on prices of 1962 models, and aluminum producers reduced prices of ingots from 26 to 24 cents

**Rise in total spending
projected for fourth quarter**



a pound. Meanwhile, spokesmen for other basic industries such as steel, farm and construction machinery, building materials and petroleum continue to emphasize the extremely competitive nature of their markets.

Any worries that prices will increase on a broad front relate to the future. Rising government expenditures at both the Federal and state and local levels and new wage agreements adding appreciably to industry costs are cited commonly as possible sources of inflationary pressures. Counter forces, however, are found in the still substantial unused capacity in manufacturing and service industries, unemployment (which remains near 7 per cent of the labor force) and the continued reluctance of consumers to increase their spending sharply despite higher incomes, increased savings and improved debt positions.

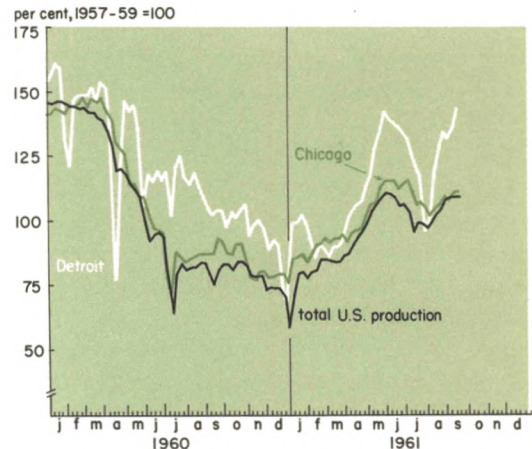
More spending on capital goods

The Government's survey of new plant and equipment expenditures by business firms released in September confirms earlier projections pointing to a decline in spending in 1961 of about 3 per cent from last year. However, there have been significant shifts in expenditure estimates of various industries. Between the second and the fourth quarters it is now estimated that the seasonally adjusted rate of capital expenditures will rise by 7 per cent—a sharper reversal of the downturn than had been indicated previously.

Most industries are increasing capital expenditures or at least maintaining them at the reduced level reached earlier in the year. Railroads stand out as an exception; their spending for capital goods continues to decline. In the fourth quarter the railroads expect to be spending only half as much as in the same period of last year.

For 1961 as a whole plant and equipment

Steel production rises after summer lull



expenditures of durable goods manufacturers are expected to be off 5 per cent from last year with steel and motor vehicles showing even larger declines. Outlays of nondurable goods manufacturers are expected to be up 3 per cent with chemicals, food processing and petroleum refining accounting for the bulk of the change. Outlays by mining, public utilities and commercial firms will be about even with 1960.

Auto production accelerates

After nearly equaling the 1960 level in July, automobile sales dropped 15 per cent in August, relative to the corresponding month last year, and were down further in early September. On the surface the auto sales picture has been very weak in recent weeks with the lowest totals of the past decade except for 1958. Nevertheless, industry spokesmen have indicated satisfaction with the pace of the cleanup of 1961 models and continue to express optimism on sales prospects for the 1962 lines. In mid-September

only about 355,000 prior-year cars were on hand, about 40 per cent less than a year earlier.

A rash of strikes at one major firm, resulting from a variety of snags in labor-management negotiations after basic agreement had been reached on economic matters, cut deeply into September production schedules originally projected at over 500,000 units for the industry. Uncertainty as to prospects for the resumption of work at all plants was partly responsible for the failure of steel output to rise further in September. Directly and indirectly, therefore, strikes in the motor industry have had a substantial dampening impact upon over-all business activity in September.

Between 1.6 and 1.8 million cars are expected to be assembled in the fourth quarter of 1961. The higher figure would be above the comparable period of 1960 and the highest on record except 1955. Inventories of domestically produced new cars may be about one million at the end of the year, about the same as a year earlier.

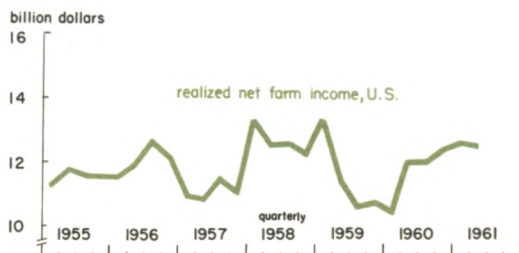
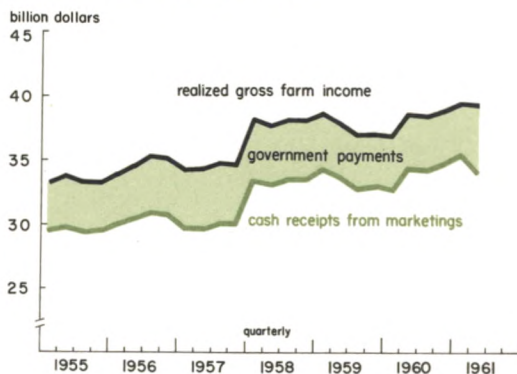
Industry forecasts place domestic auto sales at 6.5 to 7.0 million cars next year, including imports. The higher figure would be second only to 1955. Deliveries during 1961 are expected to total somewhat less than six million, including about 350,000 imports. While a disappointment in some quarters, this figure has been exceeded substantially in only three other years—1950, 1955 and 1960.

Steel output rises slowly

New orders for steel continue to be watched closely as an indicator of the strength of the general business expansion. Throughout the summer, customer demands upon the industry have been volatile with slow weeks following weeks of higher orders.

From late August through mid-September steel output was at an annual rate of slightly over 100 million tons or about two-thirds of current capacity. This rate had been attained for a period of four weeks last spring before the usual summer decline. Aside from the auto industry, which had not begun to order steel at the rate implied by fourth-quarter production schedules, and the farm machinery industry, which had cut back production during the summer, steel demand was described as "good" by industry spokesmen. There was no sign, however, that the step-up in the defense program, expectations of price increases or lengthening delivery schedules were causing most steel consumers to increase

Boost in Government payments holds farm income at high level in second quarter



inventories. With industrial production currently at a record level, steel output at a 100-million-ton annual rate does not suggest appreciable inventory building.

If expected orders from the auto industry materialize, steel production may rise to a rate of 120 million tons by year end, or about 80 per cent of capacity. From then on steel demand may be influenced strongly by the possibility of a work stoppage in mid-1962 when the industry's labor contract expires.

Farm income higher

Net farm income in the first half of 1961 rose to an annual rate of 12.6 billion dollars—about 12 per cent above the first half of 1960—as crops from the record harvest last year were marketed and farmers cashed Government checks received for land retired under the feed grain program. In the second half of this year, farm income is expected to remain substantially above year-earlier levels in view of higher support prices for major crops and dairy products, favorable weather in most major crop areas and increased Government payments under the various land retirement programs.

Despite a roughly 5 per cent reduction in over-all crop acreage, total production of crops this year is estimated to be down only 4 per cent from last year's record level. Yields per acre are at a new high reflecting good growing conditions and more intensive cultivation of remaining crop lands. While corn acreage was reduced 18 per cent from last year, production—estimated at 3.5 billion bushels—is the third largest on record and only 10 per cent below the 1960 harvest.

A record crop of soybeans, nearly 30 per cent above last year, is being harvested. High market prices last spring and announcement of an increase in support price caused farmers to plant 15 per cent more, and the yield per acre is about 10 per cent above the previous record in 1958.

Sales of farm machinery were sluggish during the summer even though farm income had risen. The smaller acreage planted to feed grains and severe drought in the Northern Plains apparently have kept the increase in farm income from being reflected in higher demands for machinery and equipment. However, demand is reported to have picked up somewhat in the fall.

Financing the business upsurge

Business firms will require a much larger volume of funds if the substantial rise in economic activity generally forecast for 1962 materializes. Capital expenditures, inventories and receivables—the principal uses of business funds—are now trending upward and may advance more rapidly in the months to come.

Recent surveys indicate business executives believe that the current upswing in economic activity will continue for a considerable period and, for the most part, that their firms will participate in the movement. At present only a modest aggregate rise in expenditures for new plant and equipment and addition to inventories is indicated, with

many firms reporting that they do not plan to commit larger amounts of funds to these uses. But surveys of this type typically understate actual developments in periods of general business improvement.

Forecasts by Government economists suggest that gross national product—total production of goods and services—may reach an annual rate of 540 billion dollars in the fourth quarter of this year and possibly 570 billion dollars in the second quarter of 1962. In the July-September period just passed, GNP was estimated to be at a 526 billion dollar rate, up 25 billion from the first quarter.

Because of the mildness of the 1960-61 recession and the fact that the recovery began earlier in the current year than in the initial year of each of the other postwar expansions, 1961 as a whole will show a moderate rise in aggregate activity over 1960. In the comparable years—1949, 1954 and 1958—total production was slightly below the previous year.

Official projections suggest that GNP in 1962 will be up about 10 per cent over 1961. This is almost identical with the increases recorded in 1950, 1955 and 1959. In 1950 total corporate uses of funds rose 80 per cent; in 1955, 76 per cent; and in 1959, 30 per cent. Obviously there is no precise relationship between changes in aggregate activity and changes in corporate needs for funds. But it seems likely that if the current upswing in business resembles the earlier postwar movements, a substantial increase in funds will be needed to accommodate larger investments in plant and equipment, inventories, receivables and other assets.

Sources and uses of funds

During 1961 United States business corporations will receive about 800 billion dollars

through the sales of goods and services. (Sales between firms cause this figure to be well above the gross national product.) But they will disperse an even larger amount for wages and salaries, materials and supplies, plant and equipment, tax bills, dividends and other purposes. The additional funds required, perhaps 15 to 20 billion dollars, will be obtained from outside borrowing and sales of stock.

A useful means of analyzing corporate money needs is provided in the Department of Commerce estimates of "Sources and Uses of Funds" for all corporations other than banks and insurance companies. Generally speaking, "sources" reflect changes in liability accounts and "uses," changes in asset accounts.

In the accompanying table, asset accounts are included with uses of funds when they have increased in a given year and with sources of funds when the amount declines. Likewise, liabilities are included with sources of funds when they rise and with uses of funds when they decline. In some years corporations as a group reduce certain assets such as inventories, cash or Government securities, thereby providing funds which can be used to increase other assets or to reduce liabilities. Similarly, liabilities such as bank loans or income taxes payable may be reduced, thereby using funds.

The most important difference from usual balance sheet procedure is that total capital expenditures on plant and equipment are counted as a use of funds, and credits to depreciation reserves are considered a source of funds. Under business accounting practice, the change in the capital equipment account shown on the balance sheet is a *net* figure after deducting depreciation.

Total funds applied by corporations in increasing assets or reducing liabilities have

Sources and uses of corporate funds*

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
	(billion dollars)									
Uses										
Plant and equipment expenditures	21.6	22.4	23.9	22.4	24.2	29.9	32.7	26.4	27.7	30.8
Increase of inventories	9.8	1.3	1.8	S	6.7	7.6	2.1	S	5.7	3.0
Increase of receivables	4.7	5.8	1.1	2.2	11.9	8.8	4.5	6.7	12.2	7.7
Increase of cash and Governments	2.8	0.1	1.8	—	5.0	S	S	2.7	3.6	S
Increase of other assets	0.6	0.4	—	0.8	2.8	3.0	1.3	1.9	2.7	2.9
Decrease of income tax liability	S	3.1	S	3.1	S	1.7	2.2	2.5	S	1.5
Decrease of bank and mortgage loans	S	S	S	0.6	S	S	S	S	S	S
Total	39.5	33.1	28.6	29.1	50.6	51.0	42.8	40.2	51.9	45.9
Sources										
Retained profits	10.0	7.4	7.9	6.3	10.9	10.5	8.9	5.7	9.1	7.4
Depreciation	9.0	10.4	11.8	13.5	15.7	17.3	19.1	20.3	21.5	22.9
Net new issues of stocks and bonds	6.3	7.9	7.1	5.9	6.9	7.9	10.5	9.5	7.8	8.0
Increase of bank and mortgage loans	5.4	3.1	0.4	U	5.4	5.4	1.7	1.0	5.3	3.4
Increase of income tax liability	4.3	U	0.6	U	3.8	U	U	U	2.4	U
Increase of trade payables	2.7	2.7	0.4	U	5.5	5.5	2.4	3.8	6.8	2.1
Increase of other liabilities	1.9	2.4	2.2	0.4	2.1	3.0	2.1	1.7	2.0	1.5
Reduction of cash and Governments	U	U	U	—	U	4.3	0.3	U	U	3.1
Reduction of inventories	U	U	U	1.6	U	U	U	2.4	U	U
Total	39.6	33.9	30.4	27.7	50.3	53.9	45.0	44.4	54.9	48.4

* Excludes banks and insurance companies.

S = Source. U = Use.

Note: Annual totals do not balance because of statistical discrepancies.

varied considerably in the postwar period, although the amount has not dropped below 40 billion dollars in any year since 1955 (see table). Total corporate uses in 1961 may be somewhat below 1960, mainly because of smaller investment in inventories and plant and equipment.

Business investment rising

Corporate capital expenditures on new plant and equipment during 1961 will be about 30 billion dollars, or 3 per cent less than in 1960, according to a recent Govern-

ment survey. However, the trend has been upward since the second quarter. In the past, upswings in capital expenditures have continued for considerable periods and tended to accelerate for a time after the initial stage. To illustrate, a year after the lows reached in 1949, 1955 and 1958 capital expenditure rates had risen 26, 28 and 12 per cent, respectively.

The underlying trend in inventories also is upward. Various surveys indicate that business firms plan to increase their inventories through the remainder of 1961 and into

1962. For 1961 as a whole the rise in inventories may be considerably less than last year's 3 billion dollar increase.

Inventories declined appreciably in earlier postwar years which marked the beginning of an upswing in business—1949, 1954 and 1958. In each case a substantial rise occurred in the following year. The current relatively low ratio of stocks to sales suggests that further increases in business activity would be accompanied by a sizable rise in inventories.

Although inventories require large amounts of funds, even larger amounts are needed to carry receivables. During the early postwar years corporate inventories were larger than receivables but by the end of 1960 corporate receivables were 40 per cent greater than the book value of their inventories. Although some portion of this change can be attributed to the adoption of inventory accounting methods which tend to produce book values lower than market values, it reflects primarily the sharp rise in corporate sales on a credit basis.

To some extent, corporate trade payables can be viewed as an offset to receivables. But in every year of the postwar period receivables of business corporations have risen more than their accounts payable. In the five year period 1956-60 the excess was almost 20 billion dollars. This situation reflects the increasingly important role played by the corporate sector in supplying funds to the rest of the economy through the extension of trade and consumer credit.

In years of very rapid credit expansion—1950, 1955 and 1959—corporate receivables have risen by 12 billion dollars or more and represented the largest single need for funds aside from capital expenditures. Consumer credit, including instalment credit and charge accounts, much of which is extended by

industrial corporations and finance companies, has grown rapidly during these years. Thus far in 1961 individuals have been sparing in their use of instalment credit, but any substantial increase in purchases of durable goods would doubtless be accompanied by a rise in instalment credit. Charge account credit, including "credit card" financing, also can be expected to grow with a continued rise in business activity.

Internal sources large

Funds generated "internally" in the form of retained earnings and depreciation will be at or near a record in 1961. Reflecting the mildness of the recent recession, corporate profits declined much less than in earlier periods of business decline and had begun to rise early this year. Meanwhile, depreciation continues to increase, although perhaps at a slower rate than a few years ago.

Throughout the postwar period retained earnings and depreciation have accounted

Rapid rise in corporate receivables since 1953 reflects growing importance of credit sales



for about two-thirds of all corporate sources of funds. While retained earnings have been volatile, ranging from 13 billion dollars in 1950 to 5.7 billion in 1958, depreciation has risen steadily. In 1946 corporate depreciation totaled 4.3 billion dollars. Ten years later depreciation reached 17 billion and in 1960, 23 billion. Large capital outlays during the postwar period and more rapid amortization permitted under the Revenue Act of 1954 account for this increase. Retained earnings have been depressed by the failure of corporate profit margins to hold at the rates of the early postwar years and by the steady increase in the dividend payout from 6 billion dollars in the early postwar years to over 14 billion estimated for this year.

The importance of depreciation in the business financial picture can hardly be exaggerated. While clearly a cost of doing business, corporate depreciation charges do not involve a cash disbursement, as for example, would the rental or leasing of machinery and buildings. Being a non-cash charge against income, depreciation funds are thus available to the firm for the purchase of new equipment or other uses. During the current year depreciation allowances probably will exceed all other sources of funds by a substantial margin.

Although money retained from cash inflow through the depreciation route can be used for any corporate purpose, it is often related to capital expenditures. In the early postwar period depreciation was at a very low level—equal to only one-third of corporate capital expenditures. By the mid-Fifties this ratio had risen to about 60 per cent and in the current year it may exceed 80 per cent.

Corporate tax liability changes

Since 1950 corporate tax payments have been greatly accelerated under several revi-

sions to the internal revenue code. Beginning in 1959 corporations have been required to pay up to half of the estimated current year's tax liability in the second half of the year in which it is incurred. Ten years ago the corporate tax liability for a given year was paid in four instalments beginning the following year. The effect of the speed-up in payment of corporate taxes has been to reduce the significance of income tax accruals as a temporary source of funds to business. In the early postwar years the tax liability on the books at the end of the year was about equal to the tax liability incurred during the year; it is now only about two-thirds as great. In 1959, the last year in which corporate profits rose sharply, tax accruals on the books increased only half as much during the year as did the tax liability incurred.

Security sales vs. bank loans

In the first nine months of 1961 business firms sold 8.8 billion dollars of securities for new capital—net of refunding issues. This was 25 per cent more than in the same period of last year and was exceeded only in the first three quarters of 1957. In the second quarter security sales—at 4.7 billion dollars—were especially large. A 965 million dollar equity issue by American Telephone and Telegraph Company and a 300 million dollar debenture issue by the U. S. Steel Corporation were included in this total. Even without these offerings second-quarter security sales had been exceeded only once. That was in the second quarter of 1958 which also followed a period of declining business activity. Raising long-term funds in these periods tends to defer an increase in bank loans as business begins to expand.

As in the initial stages of previous periods of rising activity, business loan demand at commercial banks has not increased signifi-

cantly in recent months even though industrial production has risen. At the end of July commercial and industrial loans at weekly reporting member banks of the Federal Reserve System were 850 million dollars less than at the start of the year. Modest loan growth did occur in August and September, but perhaps less than might have been expected seasonally even in the absence of a vigorous rise in economic activity.

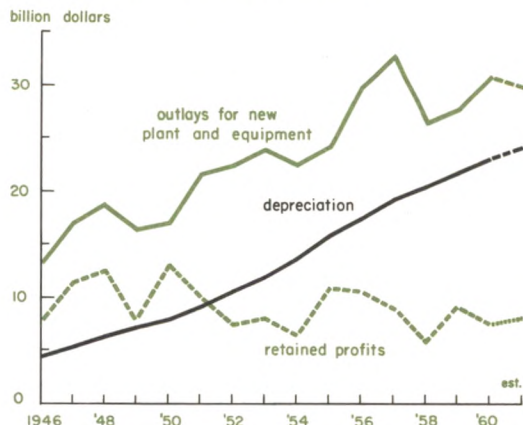
Commercial loans of banks seldom increase substantially in the first six to nine months of a business upturn but usually rise rapidly thereafter. The largest yearly increases in bank loans to business, 3.5 billion dollars or more, during the postwar period occurred in 1951, 1955 and 1959—each of these years being preceded by a considerable period of rising activity.

The fact that interest rates on prime commercial paper this year have averaged more than 1½ per cent lower than the prime rate on high-grade business loans at banks has encouraged business firms and finance companies to obtain a greater proportion of their financing needs from privately placed commercial paper than in the past. During the first half of 1961, when business loans of banks declined, commercial and finance company paper outstanding rose by over 300 million dollars.

Economizing on cash

Although corporate holdings of liquid assets—mainly cash and Government securities—have tended to rise during the postwar period along with other corporate assets and liabilities, there has been a fairly steady decline in corporate liquidity when compared with current liabilities. At the end of 1946 corporate holdings of cash and Governments almost equaled total current liabilities. By 1955 the ratio of cash and Governments to

Corporate depreciation and capital outlays have risen much faster than retained earnings



current liabilities had dropped below 50 per cent and by the end of 1960 it was down to 37 per cent.¹ The rather gradual decline in the liquidity ratio in recent years possibly indicates that this means of reducing over-all corporate needs for funds has largely been exhausted.

In recent years the large need for funds, coupled with the generally higher level of interest rates, has greatly enhanced efforts on the part of corporate treasurers to achieve more efficient cash management. A number of practices have contributed to this end, including attempts to accelerate collections of receivables and deposit of receipts from customers, closer management of multiple deposits and tailoring maturities of short-term investments to coincide with needs for funds, e.g., tax and dividend payments. The effort to utilize liquid funds effectively in large

¹To some extent corporate liquidity is understated because other near money assets, principally commercial paper, are not usually included in this ratio.

firms requires continuous analysis of cash inflow and outflow.

Although corporate bank deposits were near an all-time high at the end of 1960, there has been a steady decrease in the amount held relative to the volume of business in the postwar period. Corporate sales in the fourth quarter of 1960, on an annual rate basis, were 20 times as great as cash on hand at the end of the year. Five years earlier this ratio had been 17.6 while at the end of 1946 it was 12.4.

Summary

As yet there has been very little increase in total business needs for funds although the business expansion has been under way since early 1961. If the pattern of the past is repeated, however, and business activity con-

tinues to rise, a substantial increase in the amount of funds needed by business firms will develop in the next several months.

As in 1958, corporations this year have taken advantage of easier capital markets to float a large volume of new issues. And, as in earlier postwar business expansions, business loan demand at banks has lagged the rise in activity.

Requirements for corporate funds from the capital and money markets in the months to come will depend primarily upon two related factors. First, the extent of the rise in business activity and, second, the extent of the improvement in corporate profits. Since dividend pay-outs tend to rise very gradually, a surge in profits would be reflected largely in higher retained earnings and thus reduce dependence on outside sources of funds.

Recent trends in state tax legislation: fiscal pressures easing?

A further hike in state tax revenues is in prospect. Legislative sessions held this year in 47 of the 50 states resulted in a wide variety of changes in tax rates, including redefinitions of tax bases, adoptions of new kinds of taxes and some reductions and abandonments of taxes. The net effect of these measures is estimated to boost total state revenues about 6 per cent—from 19.2 billion dollars in the fiscal year ending in June 1961 to 20.3 billion in the current fiscal year.

Actual collections, of course, are likely to exceed the estimated amount since the

yield of state tax measures depends upon several factors in addition to tax rates and specifications of what is taxable. Among these are the level of retail sales, personal and business income, cigarette and liquor consumption and the intensity of highway use. The current rising trend in business, if maintained, will help to raise revenues above estimated levels.

In the District . . .

Of the five Seventh District states, *Illinois* made the most far-reaching changes in its tax

system during the recent session of its legislature. The basic sales tax rate was raised from 3 to 3½ per cent, and the definition of taxable transactions was broadened to cover several types previously excluded. The rate applicable to certain of the newly covered transactions was set at 3 per cent rather than 3½ per cent. Sales of books, magazines, records and materials used in construction, however, were made subject to the 3½ per cent tax. Including the permissive ½ per cent local tax in effect in most parts of the state, the Illinois rate now is equaled in only four of the other 35 states having a retail

sales tax. The temporary one cent addition to Illinois' three cents a pack tax on cigarettes, an increase adopted in 1959 specifically to finance bonuses for Korean veterans, was made permanent as a source of general revenue.

In *Wisconsin* the cigarette tax was raised from five to six cents per pack. A bill levying a new 3 per cent sales tax was vetoed by the Governor. The legislature, in recess since August 12, is scheduled to reconvene late in October when it is expected that further attention will be given to revenue matters. Neither *Iowa* nor *Indiana* made any material

Measuring state tax changes in 1959 and 1961

	Fiscal 1959 tax collections		Fiscal 1961 tax collections		Per cent increase	
	Actual	If 1960 taxes had applied ¹	Actual	If 1962 taxes had applied ¹	1959-60	1961-62
	(billion dollars)					
Consumption taxes	5.9	6.7	7.2	8.0	13	11
General sales	3.7	4.1	4.5	5.1	11	13
Tobacco	0.7	0.9	1.0	1.1	32	11
Alcoholic beverages	0.8	0.9	0.9	1.0	15	5
Other	0.7	0.8	0.8	0.8	7	5
Personal income taxes	1.8	2.1	2.3	2.4	20	3
Highway user charges	4.6	4.8	5.0	5.3	5	4
Gasoline taxes	3.1	3.3	3.4	3.6	7	4
Licenses	1.5	1.5	1.6	1.7	2	3
Corporation income taxes	1.0	1.1	1.3	1.3	8	6
Other business taxes	1.7	1.8	2.0	2.0	6	4
All other	1.1	1.2	1.4	1.4	3	2
Total	16.1	17.7	19.2	20.4	10	6

¹Estimated by applying rate increases to the prior year's receipts; effects of new taxes and changes in bases are state estimates.

changes in their tax systems this year. *Michigan* discontinued several "temporary" revenue measures but raised the sales tax rate one point to 4 per cent in January.

The effects of 1961 legislative action upon the tax revenues of the Seventh District states, again without attempting to give effect to changes in economic activity are estimated as follows:

	<i>Dollar change (millions)</i>	<i>Per cent change</i>
Illinois	+136	+16
Indiana	0	0
Iowa	0	0
Michigan	— 37	— 4
Wisconsin	+ 5	+ 1

Major changes in other states

Texas this year adopted a sales tax; Kentucky, which holds biennial legislative sessions in the even-numbered years, had adopted such a tax in 1960. These actions increased to 36 the number of states using a sales tax. West Virginia, the first state to adopt the sales tax—in 1921—added the income tax to its fiscal machinery in 1961. New Jersey also adopted a limited personal income tax this year; the tax is restricted to incomes earned out-of-state by residents and in New Jersey by nonresidents. Taxes on net income—personal, corporate or, most commonly, both—now are levied by 37 states. Virginia's adoption of a three cent a pack cigarette tax in 1960 left only three states—Colorado, North Carolina and Oregon—in which this tax is not used.

Rate advances and enlargement of bases under existing taxes, of course, have been more widespread than adoptions of new kinds of levies. Four states hiked their sales tax rates; five materially broadened the list of transactions taxable under their statutes. Income tax rates were increased by five states

and reduced by two. Gasoline tax rates were raised by six states—all 50 employ this tax—while cigarette tax rates were increased in 16 states and reduced in one.

Smaller increase than in 1959

Two years ago the revenue increase implied by legislation affecting state taxes was 10 per cent, considerably more than this year (see table). Is this an indication that the spending pressures confronting the states are beginning to abate somewhat, or does it merely mean that actions taken in 1959 produced enough additional revenue to permit some "catching up"? Some intimation that the latter is true is provided by the abrupt shift from deficits to surpluses after fiscal 1958. For nine consecutive years, 1950 through 1958, annual general expenditures of the states appreciably exceeded general revenues, culminating in a deficit of 2.4 billion dollars in fiscal 1958. The following year a 193 million dollar surplus was recorded, and this was followed by a still larger one—550 million dollars—in fiscal 1960.

The recent increase in cash balances held by the state governments may be another indication of easing financial pressure. In 1954 deposits and securities on hand other than those earmarked for insurance trust accounts and bond sinking funds were equivalent to seven months' general expenditures. Five years later, at the end of the fiscal year in which the numerous tax changes of 1959 were made, the ratio was down to 4.6 months. By the end of fiscal 1960, however, it had moved up slightly to 4.9 months, no doubt reflecting at least in part the far-reaching modifications in tax programs that took effect that year.

The 1961 legislative record also reveals that some of the states—California, Con-

necticut, Illinois and Pennsylvania, for example—plan to lean more heavily upon borrowing as an alternative to pay-as-you-go in the financing of capital outlays. Expectations of a larger measure of Federal aid may well be another influence tending to moderate prospective budgetary pressures and therefore working to lessen somewhat the need for increased state tax revenues.

Some observers contend, however, that state revenue systems will remain under pressure. They suggest that further upgrading of service standards and enlargement in the

range of services provided will require more revenue than existing tax rates and tax forms appear likely to provide.

To the extent that property tax revenues grow less rapidly than the demand for services and facilities provided by the local governments, municipalities will require increased state support for public education and other local governmental functions. Local tax revenues tend, of course, to grow more or less automatically as construction adds new property to the tax base. Because, however, of the segmented nature of the local

Income sources of the Seventh District state governments: fiscal 1960

	All states (millions)	Illinois	Indiana	Iowa (millions)	Michigan	Wisconsin
General tax revenues	\$18,257	\$836	\$399	\$277	\$943	\$426
Consumption taxes	6,864	522	220	106	476	48
General sales	4,302	375	189	81	363	—
Tobacco	923	49	17	11	54	21
Alcoholic beverages	871	32	14	14	51	15
Other	768	66	*	*	8	12
Personal income taxes	2,209	—	—	37	—	139
Highway user charges	4,908	247	139	106	222	116
Gasoline taxes	3,335	142	101	60	146	72
Licenses	1,573	105	38	46	76	44
Corporation income taxes	1,180	—	—	4	—	59
Other business taxes	1,408	41	20	10	174	14
All other taxes	1,688	26	20	14	71	50
Other income from state sources	3,853	81	92	97	296	64
Federal aid	6,382	338	128	121	217	117
Total state revenues	28,492	1,255	619	495	1,456	607
Net long-term borrowing	1,505	8	1	2	47	18
Total available	29,997	1,263	620	493	1,503	625

*Less than \$500,000.

governing units, additions to the tax rolls and increases in expenditure often occur in different places. The hard-pressed governmental bodies therefore are prompted to look to the states for financial assistance.

A turning point?

While there is evidence that spending pressures continue to grow rapidly there nonetheless is some indication that the period of critical pressure on state budgets may be passing. The key here is in the changing pattern of population growth. During the past 15 years, young persons and the aged have accounted for the great bulk of the growth in the nation's population. Programs serving chiefly these segments of the populace traditionally account for a big share of all state government expenditure. Total outlays by the states for public education and aid to dependent children (programs serving young people for the most part) and for old-age assistance and hospital services (directed mainly toward the aged population) in 1960 amounted to 13.2 billion dollars or nearly half of the 27.2 billion in general expenditures.

Although the numbers of children and the elderly are expected to increase further in the years ahead, this growth will be accompanied by a faster rise in the numbers of people from age 20 through 64. This will occur as

Income and general sales taxes have become increasingly common features of state revenue systems

	Number of states using		Per cent of all tax revenues	
	Fiscal 1947	Fiscal 1961*	Fiscal 1947	Fiscal 1961
General sales taxes	24	36	20	24
Net income taxes	33	37	15	19
Both	16	24	35	43
Cigarette taxes	32	47	4	5
Alcoholic beverage taxes	50	50	9	5
Other selective sales taxes	50	50	5	4
Business licenses, etc.	50	50	7	10
Highway user charges	50	50	28	26
All other	50	50	12	7
Total tax revenues	—	—	100	100

*As of September 1, 1961

the huge numbers of children born in 1941 and 1942 and since 1945 pass the 20-year mark. As these people enter the labor force and succeed in finding suitable jobs, personal income and consumer expenditures will probably rise at a faster pace than in recent years. This, in turn, should generate an "automatic" expansion of state revenues more nearly matching the rising volume of public expenditures geared to over-all population growth.

Standardized state taxes?

The 1961 legislative season brought to 24 the number of states using taxes on both incomes and retail sales. Fifteen years ago, only 16 states employed both of these levies. This development along with the more general use of other tax measures suggests a trend toward diversification of state revenue

**Postwar rise in state spending has outstripped revenue growth —
Federal aid and borrowings have filled gap**

	Billion dollars			Per cent		
	1947	1953	1960	1947	1953	1960
Where the money came from						
Revenue from state sources	7.3	12.9	22.1	80	79	74
Federal aid	1.4	2.6	6.4	15	16	21
Net long-term borrowing	0.5	0.8	1.5	5	5	5
Total*	9.2	16.3	30.0	100	100	100
Where the money went						
Operating expenses	3.6	8.0	13.2	51	50	45
Capital outlays	0.9	2.8	6.6	12	17	23
Aid to local units	2.6	5.4	9.3	37	33	32
Total	7.1	16.2	29.1	100	100	100

*Excludes trust fund transactions and changes in cash balances.

systems. While some states—Illinois is an example—have tax systems based predominantly on retail sales, others—like Wisconsin—rely predominantly on income taxes. But the number of such states has been declining. It may be significant that in 1961 a sales tax measure was passed by the Wisconsin legislature, while several proposals for income taxes were actively considered in Illinois.

The extent to which a state can exploit any given kind of tax often is limited by the practices of other states which “compete” with it as a site for new industrial development. Substantial differences between income or sales tax rates on the two sides of a common border may well constitute a deterrent to further increases by the state having the higher rates as well as an invitation to the

neighboring state to raise its rates. If spending pressures continue strong, the individual states may well move further in the direction of diversification of their revenue systems, with the types and levels of taxes tending to become more or less uniform.

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