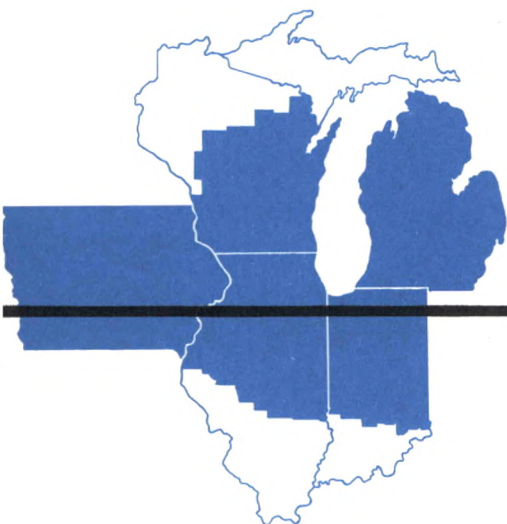


*A review by the* **Federal Reserve Bank of Chicago**

# Business Conditions

**1962 April**



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# THE Trend OF BUSINESS

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Most business and Government spokesmen have "stuck to their guns." Although there was evidence early in the year that the rise in business that got under way about a year ago had halted, at least temporarily, most analysts continued to expect substantial further gains during the remainder of 1962. Many estimate that the year as a whole will show a rise over last year roughly comparable to the large increases in 1955 and 1959.

Confidence is based on continued strength in manufacturers' new orders and construction contract awards. In addition, inventories are at moderate levels relative to sales, capital expenditure programs are being revised upward, Government expenditures are increasing, consumers have expressed feelings of confidence and well-being in recent polls and banks and other financial institutions are in a position to accommodate higher loan demands. Such conditions suggest further increases in activity, particularly since the current expansion is only one year old. Most periods of business expansion following recessions have been two to three times as long.

There also is evidence that business was better early in 1962 than was indicated by some reports. Unusually severe weather in important areas in mid-January when surveys were made of employment and hours worked per week apparently biased these figures for the month. And these data, of course, affect estimates of personal income. The mid-February survey showed sharp increases in em-

ployment and the average factory workweek, seasonally adjusted, and personal income also rebounded. Nevertheless, it is clear that the rapid upward momentum evident last fall slowed significantly in the winter.

Since the low point of the recession was reached in February 1961, most measures of activity have shown appreciable gains. By February 1962, nonfarm employment was up 1.3 million, or 2.2 per cent, while the rate of unemployment declined from 6.9 to 5.6 per cent of the labor force. Retail sales had risen 6.5 per cent, and industrial production was up 13 per cent.

## **Defense business rises**

Orders for military equipment were increasing sharply in late 1961, and this trend apparently has continued into the current year. In the fourth quarter of last year prime contracts for procurement by the Department of Defense totaled almost 7 billion dollars and were 39 per cent higher than in the same period of 1960.

Some indication of the impact of defense business on various areas can be obtained by analyzing the location of prime contractors. However, a significant volume of prime contracts does not give rise to activity in the state in which the headquarters of the contractor is located; subcontracts are often made to firms in other states. It is probable that the volume of defense work in the Midwest is understated because large firms commonly are headquartered in the East.

In the fourth quarter of 1961, 11 per cent of all prime contracts awarded by the Department of Defense went to firms headquartered in the five Seventh District states. This compares with 8 per cent in the same period of the previous year. The dollar volume of orders to firms in the area was nearly double the year-earlier amount, mainly because of increased emphasis on military vehicles.

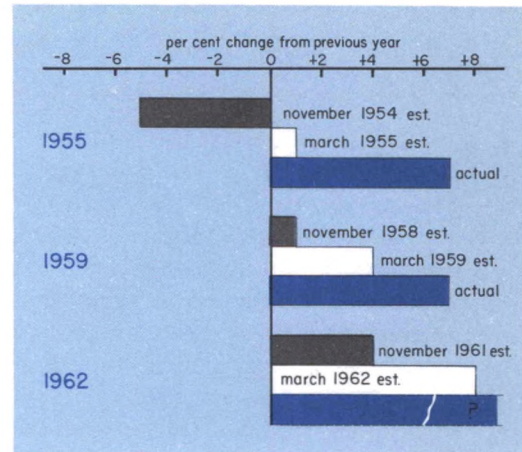
### Boost from capital outlays

A recent Department of Commerce survey of expenditures on new plant and equipment planned by United States business firms during 1962 indicates an 8 per cent rise over last year's level. Total outlays are expected to reach 37.2 billion dollars this year, slightly more than in 1957, the previous record year. Planned expenditures apparently have been raised somewhat since last fall. In November a similar survey conducted by McGraw-Hill indicated a rise of 4 per cent.

A gradual lifting of capital expenditure plans during a period of business upswing has been noted in other years (see chart). In both 1955 and 1959 the total indicated by the Government's March survey was larger than the McGraw-Hill survey of the preceding November but still fell short of actual results. Moreover, if it were not for the long steel strike in 1959, it is likely that capital expenditures would have been even higher in that year because some projects were delayed by steel shortages.

Large capital expenditure gains are scheduled for 1962 in hard goods manufacturing, particularly iron and steel, nonferrous metals, nonelectrical machinery and motor vehicles. In total, durable goods producers expect to increase their expenditures by 16 per cent as compared with a rise of only 3 per cent projected by nondurable goods firms. Nevertheless, as a group, durable goods manufacturers

## Business capital spending plans have increased since last fall



SOURCE: McGraw-Hill and the Department of Commerce.

anticipate spending 9 per cent less than in record 1957, while nondurable goods industries' plans are within 4 per cent of their 1957 record.

Aside from manufacturing, the commercial and railroad categories are planning the largest increases, 19 and 11 per cent, respectively. Commercial projects, however, which include financial business and communications in addition to stores and office buildings, are expected to set a new high in 1962, while projected railroad outlays have been substantially exceeded in several past years.

### Capital outlays and the cycle

The failure of the anticipations survey to show a larger gain has proved disappointing to those who had looked to this sector to provide a stronger push to the general economy. It is pointed out that the projected rise in business plant and equipment expenditures is no greater than the increase projected for the

gross national product—the total of all types of spending. Under these circumstances the proportion of capital expenditures to total activity would remain at the 1961 level, the lowest of the postwar period.

The Government survey of plant and equipment excludes agriculture, equipment written off in the year of acquisition, investments of United States firms overseas and outlays of nonprofit organizations, such as churches, hospitals and private schools. By this definition capital expenditures amounted to 6.6 per cent of the total production of goods and services in 1961. In 1956 and 1957 the proportion was 8.4 per cent and in 1947 and 1948 it was even higher.

As noted above, estimates of capital expenditures typically understate actual results in a period of business expansion. In addition, the proposed tax credit on new equipment purchases (virtually the equivalent of a price cut of this amount for eligible types of

equipment) and further liberalization of depreciation allowances (now under consideration) presumably would stimulate outlays.

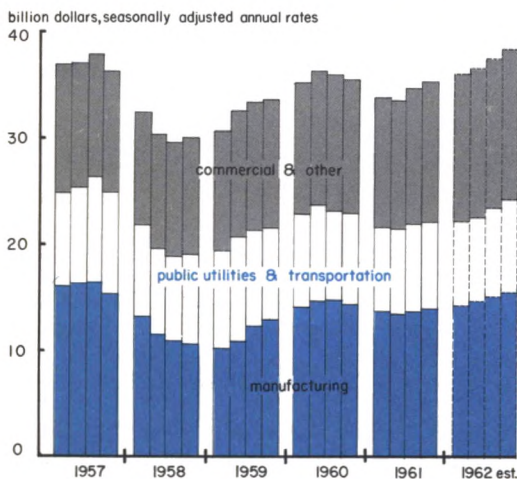
If the 1956-57 proportion to gross national product were to be reached in 1962, capital expenditures would have to rise to almost 48 billion dollars. Only a strong and persistent rise in demand which exerted pressure on capacity to produce major industrial materials would likely bring about such a result. Earlier in the postwar period capital expenditures expressly slated for “expansion” amounted to half of the total while currently three-fourths are for modernization and replacement.

A note of optimism can be gained from the fact that capital outlays began to rise in the quarter following the first increase in general activity while in earlier postwar recoveries the lag was two to three quarters. As a result, in the first quarter of 1962 business capital expenditures were 7 per cent higher than a year earlier at the trough of the business cycle. One year after the lows in general activity in 1949 and 1958, capital outlays had not regained their level at the cycle trough. After one year of the 1954-55 rise in activity these expenditures had risen only 1 per cent.

In the past, sharp increases in capital outlays usually have accompanied large gains in total activity. However, the relationship has not been a stable one. In some years of expansion increases in plant and equipment have been relatively larger than the increase in gross national product, while in other years the reverse has been true. The cause and effect between these clearly works both ways. Certainly a capital expenditure boom stimulates other types of spending, but such a development does not occur unless demand prospects warrant a high level of investment.

There has been widespread debate in recent years as to whether the growth of the economy in general and capital expenditures

## Plant and equipment spending expected to rise throughout 1962



in particular were at optimum rates. Since World War II, expenditures on new plant and equipment totaled over 450 billion dollars—7.5 per cent of all spending on goods and services. During these years the real value (adjusted for price changes) of structures and equipment in manufacturing has risen by over 75 per cent, and the net investment in other important lines such as utilities has increased even more rapidly. Certainly, this has stimulated and supported other types of

spending while making it possible to increase production. In most lines of activity there still is considerable unused capacity even though industrial production over-all is at a record level.

With demand pressures less intense than five or ten years ago, it is encouraging that capital outlays are heading for a record in 1962 even though the proportion of these outlays to total spending is below the average of recent years.

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## Electric power consumption— an output indicator in Milwaukee

Changes in industrial consumption of electric power in the United States have been very similar to changes in manufacturing activity since about 1955. Although manufacturing has tended to show larger swings than a crude index of industrial electric power consumption, the direction of movement generally has been the same. Furthermore, if the necessary data were available to adjust the power series for shifts in use by different industries, it probably would show an even closer similarity to the index of industrial production.

To provide an indicator of changes in manufacturing output in important Midwest metropolitan areas, data have been collected in cooperation with electric utility firms on electric power used by various kinds of manufacturing establishments. These data have been analyzed and combined into indexes. While there are no data available on total production

of manufactured goods in Midwest areas with which these indexes can be compared, they are believed to provide reliable indications of changes in industrial activity.

An index of electric power consumed by manufacturing establishments in the Milwaukee metropolitan area—Milwaukee and Waukesha counties—is published here for the first time. Similar indexes have been prepared for the Detroit and Indianapolis areas (*Business Conditions*, April 1959 and January 1961, respectively). These power series are not a substitute for other regional data such as bank debits, employment or retail sales, each of which has its own use in identifying changes in particular sectors of the local economy.

### Recovery in Milwaukee

At the end of 1961, manufacturing output in both Milwaukee and the United States was at record levels. Until December, however,

Milwaukee's recovery from the recession, as measured by the index of electric power used in manufacturing, had been less rapid than for the nation. In the fourth quarter of 1961 manufacturing activity in the Milwaukee area was 9 per cent above the recession low in the first quarter of the year, while the increase for the United States, as measured by the manufacturing component of the Federal Reserve Board index of industrial production, was 12 per cent. For the year as a whole, production in Milwaukee was only 3 per cent above 1960 but in the nation, it was up almost 5 per cent.

The slower pace of recovery in the Milwaukee area was largely a reflection of the lagging performance of the nonelectrical machinery industry which accounts for more than one-fourth of the area's total manufacturing output. By the end of 1961, production of construction and mining equipment, farm machinery, machine tools and other capital goods in Milwaukee plants was still 5 per cent below the peak rate attained during 1959. Production at transportation equipment and electrical machinery establishments, on the other hand, reached new highs in the third quarter of 1961 and continued to expand further through the fourth quarter. Plants producing fabricated metals products also achieved record rates in the fourth quarter. Expansion in these sectors, however, was not sufficient to offset the slower recovery in the nonelectrical machinery industry.

### Production trends

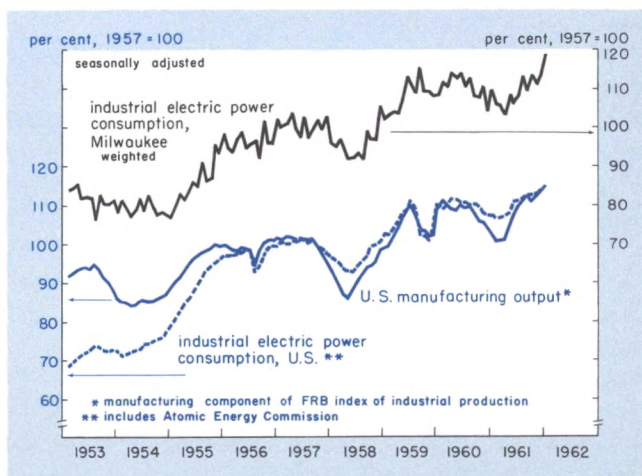
Since 1956 industrial electric power consumption in both Milwaukee and the United States has

increased by more than 13 per cent, while national manufacturing output has risen about 10 per cent. Manufacturing employment, however, has declined.

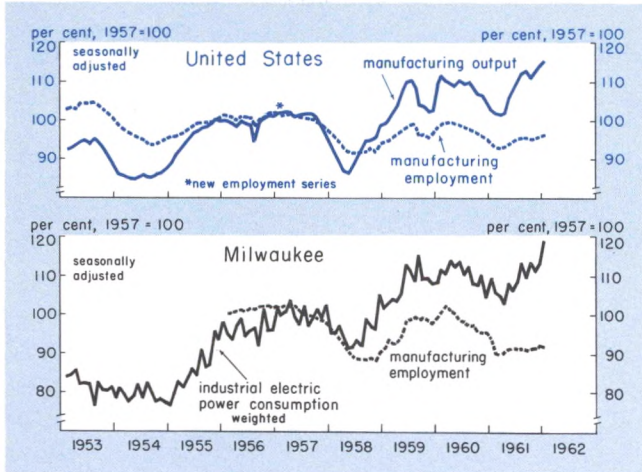
	1956-61 change	
	Milwaukee	United States
Industrial electric power consumption	+13.5%	+13.3%
Manufacturing output	—	+ 9.5
Manufacturing employment	-10.0	- 6.0

These trends are an indication of the rising output per worker in American industry, achieved in large measure through substantial expenditures for plant modernization and installation of improved machinery and equipment. Electricity has come into wider use for plant lighting and air conditioning and is substituted increasingly for other production inputs, such as labor, coal and gas. While this may have caused industrial consumption of electric power to rise faster than production

### U. S. industrial electric power consumption and manufacturing output have exhibited similar cyclical fluctuations since 1955



## Manufacturing employment in recent years has declined relative to industrial activity in both Milwaukee and the United States



in recent years, it should strengthen the reliability of electric power consumption as an indicator of manufacturing activity in future years.

Manufacturing output also has recovered more rapidly from recession than employment. This typically reflects the attainment of more efficient plant operations in the early stages of recovery as production schedules are stepped up and some workers are shifted from maintenance to production activities to accommodate the increased flow of new orders. In addition, the average length of the workweek typically rises before hiring of new workers is increased substantially.

During the 1958 recovery, seasonally adjusted United States manufacturing output had passed its pre-recession record in the first half of 1959, but manufacturing employment never regained its previous peak. In the 1961 upturn, production exceeded the pre-recession peak shortly after midyear, while employment by the end of the year was still

about 4 per cent below its 1960 high.

In Milwaukee, manufacturing employment also responded somewhat more sluggishly than production in the 1958 upturn, but in contrast to the nation, employment reached a new high in early 1960, reflecting in large measure vigorous gains in the transportation equipment industry. However, production rose 9 per cent between the first and fourth quarters of 1961, while manufacturing employment increased less than 2 per cent.

### Cyclical changes

In two of the last three recessions manufacturing in the Milwaukee area has fared better than in the United States. During the 1953-54 business recession, production at Milwaukee plants remained relatively stable while total domestic manufacturing output declined more than 11 per cent. In the 1957-58 downturn, Milwaukee manufacturing activity declined but not as severely as in the nation. On the other hand, during the 1960-61 recession Milwaukee's decline was slightly greater.

Swings in Milwaukee manufacturing activity have been roughly equal to those experienced by Indianapolis but much less pronounced than those in Detroit. During the 1960-61 recession, however, Milwaukee's decline was greater and of longer duration than that of Indianapolis.

The "mix" of manufacturing output differs between metropolitan areas and since market demand for all products does not follow the same cyclical pattern, fluctuations in total manufacturing activity will doubtless vary from one area to another. In general, pro-

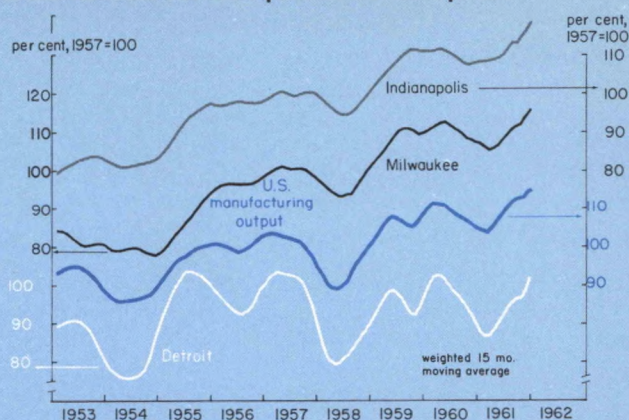
duction of nondurables—for example, food, chemicals and publishing—is relatively stable and metropolitan areas specializing in this type of output tend to experience relatively smaller swings in total manufacturing activity than those areas with a heavy concentration of durable goods industries—machinery, steel and automobiles.

Greater stability of manufacturing in Indianapolis, compared with Detroit since 1953 and with Milwaukee in recent years, reflects the greater importance of nondurable goods production in that area. Food, chemical and other nondurable goods industries account for more than 39 per cent of total manufacturing output in Indianapolis but account for only 31 per cent in Milwaukee and 20 per cent in Detroit.

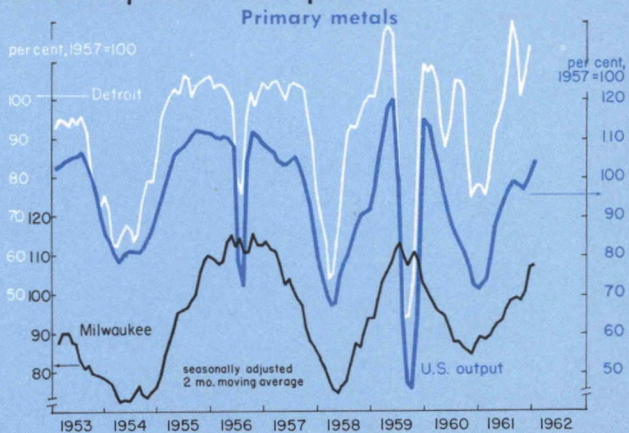
Manufacturing activity in Detroit is dominated by the transportation equipment industry—notably automobiles. That industry directly accounts for 47 per cent of total Detroit output and indirectly an even greater percentage, since many Detroit area plants in the machinery and fabricated and primary metals categories produce equipment used in the assembly of automobiles and trucks.

Economic activity in the Milwaukee area, on the other hand, is heavily influenced by the levels of capital investment both in the United States and abroad. Construction and mining machinery,

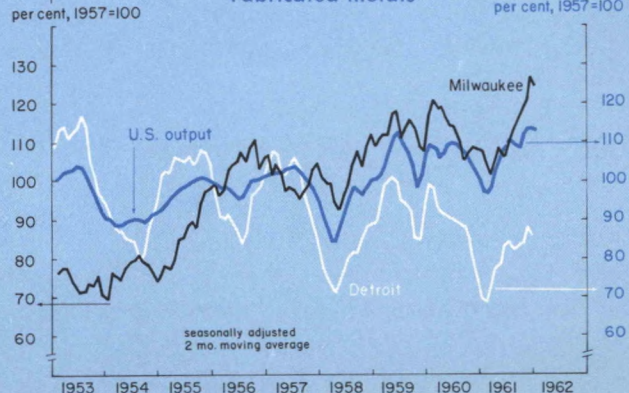
### Industrial electric power consumption



### Electric power consumption

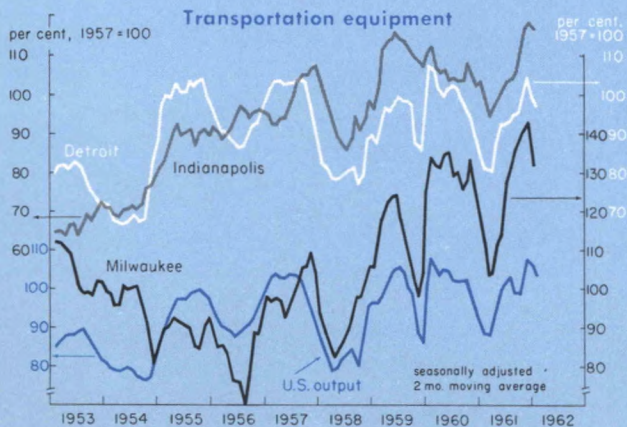
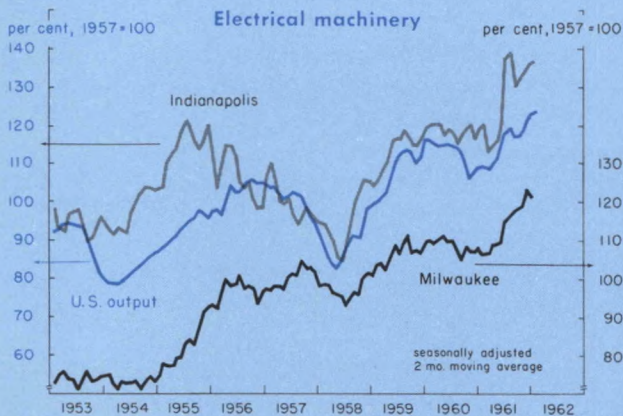
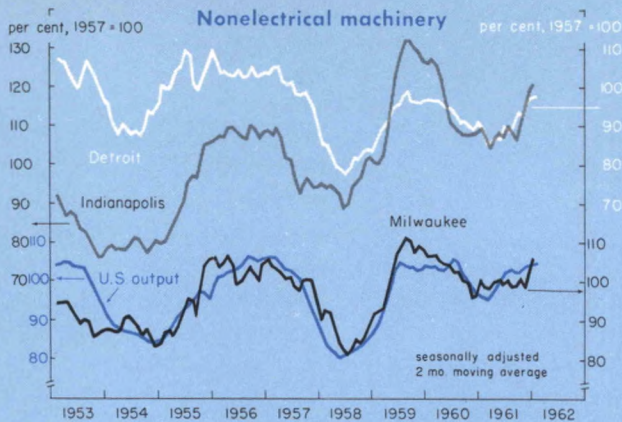


### Fabricated metals





## Electric power consumption



structural metal products, electric power generating machinery, electric transmission, distribution and switching apparatus and general industrial machinery produced in large quantities in Milwaukee's plants are essential to construction programs—private and public. Although less vulnerable than a community like Detroit to the changing fortunes of one or a few large firms or industries, Milwaukee is subject to year-to-year changes in manufacturing because of the uneven pace at which investment in capital goods occurs.

### Patterns in durable goods

In both Milwaukee and Detroit *primary metals* manufacturing accounts for about 10 per cent of total manufacturing output but less than 5 per cent in Indianapolis. Cyclical changes in output in this industry have occurred simultaneously in all three metropolitan areas, but the declines (and recoveries) in Milwaukee and Indianapolis have not been as sharp as in Detroit. This is attributable to several factors: in Milwaukee and Indianapolis the primary metals industry is largely composed of plants producing castings and forgings while in Detroit—also a major producer of castings and forgings—the industry has a sizable volume of basic steel.

The *fabricated metals* industry in Milwaukee accounts for approximately 8 per cent of total output—about the same as De-

troit but relatively more than in either Indianapolis or the United States. Early in 1960 Milwaukee production of such items as furnaces, plumbing fixtures, water meters, locks, pressure tanks and cans began a decline which continued into the first quarter of 1961. Since that time production has staged a vigorous recovery, reaching a new high by the end of the year.

The largest concentration of manufacturing in Milwaukee is represented by the *non-electrical machinery* industry—accounting for 28 per cent of the area's total production. The cyclical pattern of this industry in Milwaukee has been similar to that for the nation although Milwaukee's decline from 1959 to the autumn of 1960 was greater and its subsequent recovery somewhat less rapid. In Indianapolis the nonelectrical machinery industry has undergone wider fluctuations than in Milwaukee. However, the over-all impact of the Indianapolis economy has not been as

pronounced as in Milwaukee since the industry accounts for only 12 per cent of the area's manufacturing output or less than half as much as in Milwaukee.

The *electrical machinery* industry is the second most important manufacturing sector in Milwaukee, accounting for almost 17 per cent of the area's total production. During the most recent recession the industry experienced only a modest decline and since early 1961 activity has increased 18 per cent.

One of the most volatile sectors of Milwaukee manufacturing is the *transportation equipment* industry, reflecting in large part the dominant position of one automobile firm. The industry registered rather sharp declines and recoveries in 1958, 1959 and 1961. These fluctuations were much greater than those in the Detroit industry, which consists of a much larger number of establishments. The over-all impact on the Milwaukee area economy was less pronounced,

### The Milwaukee electric power index

Changes in the aggregate amount of electric power used by all industries in an area would not necessarily be a reliable indicator of changes in production as the relationship between physical output and the amount of electric power consumed varies greatly among individual industries. For example, for each dollar of output the primary metals industry uses more than nine times as much electric power as the machinery industry and seven times as much as the transportation equipment industry. In order to take account of these differences, the Milwaukee as well as the Detroit and Indianapolis electric power indexes were developed by weighting the power consumed by *each industry* with

a measure of "value added per kilowatt hour" (1957=100) so that differences in the relative amounts of power consumed by individual industries would not distort indications of over-all changes in output in each area. The electric power series for the individual industries—shown in the charts on pages 8 and 9—are not adjusted in this manner but are adjusted for seasonal variation.

The Milwaukee electric power data used in this article were furnished by the Wisconsin Electric Power Company, while data for Detroit and Indianapolis were supplied by the Detroit Edison and Indianapolis Power and Light Companies, respectively.

however, since the transportation equipment industry accounts for only 5 per cent of Milwaukee's total manufacturing output, compared with 47 per cent for Detroit.

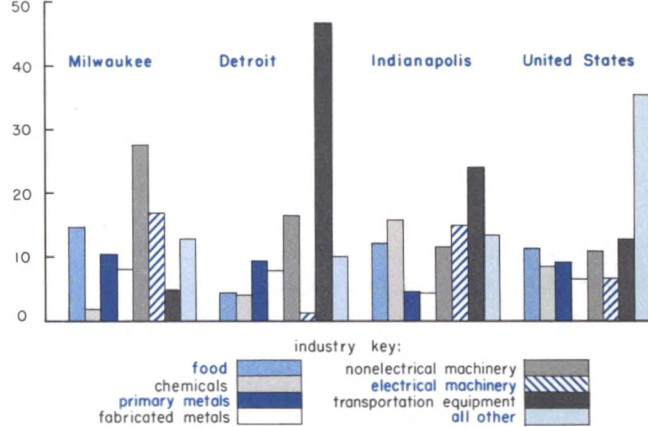
**Future encouraging**

In January manufacturing output as measured by the electric power index in Milwaukee dropped about 7 per cent from the December rate. Although considerably greater than the national fall off in industrial production, Milwaukee's decline was less than that experienced by either Detroit or Indianapolis. Furthermore, it now appears to have been only a temporary interruption in a rising trend of manufacturing activity.

Prospects for the Milwaukee area in 1962 appear encouraging. The latest Department of Commerce survey of business plans for expenditures on new plant and equipment indicates that such outlays will rise to a rec-

**Machinery industry dominates Milwaukee economy**

per cent of total "value added" in manufacturing in 1957



ord of 37.2 billion dollars in the current year, an increase of 8 per cent from 1961. Heavily oriented toward the manufacture of producers' goods, Milwaukee stands to benefit from this upturn in capital spending.

# The Federal Budget for 1963

The budgetary position of the Federal Government has an important bearing on the level and direction of business activity and, therefore, significant meaning for the formulation and implementation of monetary policy. A surplus in the Federal accounts, which indicates that the Government is withdrawing more funds from the economy—mainly in tax

collections—than it is returning in the form of expenditures, tends to offset a portion of private spending and dampen the pace of economic activity. Under a deficit, expenditures exceed revenues, so that the Government's influence tends to be stimulative. The portion of Federal expenditure financed by borrowing or by drawing down the Treasury's

cash balance rather than by current taxes supplements private outlays and thereby adds to total demand.

Changes in the use of credit in the private sector, of course, have similar effects. Rapid expansion of private debt helps to finance increased demand and is associated with high levels of activity while slower growth of private debt often is associated with easier demand conditions. In a sense, then, timely swings in the Federal accounts from surplus to deficit and back again can be viewed as offsetting shifts in the intensity with which credit is used in the private economy.

Because Federal transactions so strongly affect the private economy, adjusting tax rates or expenditure programs in order to achieve budgetary balance may produce results different from those that might be expected. This is because of the involved effects of taxes and spending upon the level of national income. It is possible, in certain circumstances, that cutting taxes or increasing expenditures may lead toward a surplus in the Federal accounts, while raising taxes or reducing expenditures could lead to a deficit.

During the current fiscal year, ending next June 30, the Federal Budget has been in the red—reflecting both the dip in tax collections and the rise in expenditures that took place

during the recession of 1960-61. On balance, therefore, the weight of the Government's influence has been on the side of expansion. For fiscal 1963, however, the Budget is expected to move into surplus, so that the role of fiscal action will be somewhat to restrain the private economy. This assumes, of course, that economic activity will continue to expand vigorously—a necessary development if fiscal restraint is to prevail.

Expenditure proposals submitted by the President for the next fiscal year, beginning July 1, 1962, call for an increase of about 6 billion dollars, compared with the estimated total for the current year, which, in turn, is estimated at 9 billion more than fiscal 1961 (see table). Increased outlays for defense and space research and development account for the bulk of the increase. A still more rapid climb in receipts—nearly 11 billion dollars from 1961 to this year, with a similar gain expected for fiscal 1963, explains why the budget balance has been shifting from deficit toward surplus and is expected to continue in this direction during the year ahead.

Projections of the pattern of economic expansion for the coming year are indicated in part by the calendar 1962 estimates used in preparation of the Budget.

	Calendar year		Increase
	1961	1962	
	(billions)		
Gross national product . . . . .	\$521	\$570	9%
Personal income . . . .	417	448	7
Corporate profits . . . .	46	56½	23

The last item is particularly significant, since a substantial rise in corporation income taxes is assumed in the revenue projections for fiscal 1962 and 1963. Projecting receipts from this source is especially difficult, owing to the tardiness with which corporate earnings data become available.

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### An automatic balance wheel

In practice, fiscal action is largely automatic. The decline in personal income and

corporate profits experienced during a recession, for example, reduce income tax collections. Recession tends at the same time to boost expenditures as, for example, unem-

### Measures of Federal receipts and expenditures

The cash and national income budgets differ chiefly in their treatment of corporation income taxes, although there are other differences. In the cash budget Government expenditures are assigned to the years or quarters when payments are made. In the national income budget they are assigned to the time intervals when liability for payment was incurred. The national income budget also ignores Federal disbursements to acquire existing assets, such as land and the home mortgages bought by Fanny Mae, on the ground that Government purchases of these have no direct effect on the economy's production.

Brief synopses of the Federal receipts, expenditures and surpluses or deficits for the year ended June 30, 1961, the current fiscal year and fiscal 1963 are shown on this page. (Entries are shown for the administrative budget as well as the cash and national income budgets. The sizable differences in the totals shown indicate why the administrative budget is lacking as an analyti-

	Fiscal years		
	1961 actual	1962 estimated	1963 projected
Receipts			
Administrative budget receipts . . .	77.7	82.1	93.0
Less: intragovernmental transactions . . .	4.2	4.0	3.9
Plus: receipts of trust funds . . .	23.8	24.5	27.5
Equals: cash budget receipts . . .	97.2	102.6	116.6
Plus: excess of tax accruals over collections . . . . .	-1.3	3.5	0.8
Less: other adjustments . . . . .	1.1	0.5	1.1
Equals: national income budget receipts . . . . .	94.8	105.6	116.3
Expenditures			
Administrative budget expenditures . . .	81.5	89.1	92.5
Less: intragovernmental transactions, other minor adjustments . . . . .	5.0	4.1	4.7
Plus: expenditures of trust funds, other minor adjustments . . . . .	23.0	26.1	27.0
Equals: cash budget expenditures . . .	99.5	111.1	114.8
Less: disbursements to acquire existing assets . . . . .	1.3	3.7	2.5
Less: other adjustments . . . . .	1.2	1.3	0.4
Equals: national income budget expenditures . . . . .	97.0	106.1	111.9
Deficit (-) or Surplus (+)			
Administrative budget . . . . .	-3.8	-7.0	+0.5
Cash budget . . . . .	-2.3	-8.5	+1.8
National income budget . . . . .	-2.2	-0.5	+4.4

cal tool.) The figures for both 1962 and 1963 were prepared some months ago and presented in the President's formal Budget for 1963.

ployment compensation and public assistance payments rise. Similarly, on the upturn, some types of expenditure tend to fall as employment increases and tax receipts pick up, often at a faster rate than income.

The amount of influence exerted by “built-in stabilizers” is, of course, limited, so that it may become desirable to modify the tax structure or alter expenditure programs to help achieve short-run stability in the economy.

Using tax and spending powers in the interest of economic stabilization has met with criticism on the ground that lags between plans and actions cause deficits and surpluses at the wrong times. Deficits, it is pointed out, often prevail while the private economy is expanding, and surpluses while business activity is contracting. Over-all, therefore, fiscal policy may be destabilizing, serving to aggravate instead of to lessen the severity of ups and downs in business activity.

### Alternative Federal budgets

The pros and cons of countercyclical fiscal policy are not clear cut. Difficulties in evaluating them center on the problem of determining when changes in Federal tax collections and expenditures have their major effects. This has led to the development of at least two different sets of Federal Government accounts, each of which is designed for a particular purpose. (This ignores the *administrative* or *conventional budget*, which encompasses only those activities of the Government that are financed through the general fund of the Treasury. This budget excludes the social security and unemployment compensation trust funds and, in recent years, the Federal highway trust fund—which altogether account for about 25 billion dollars in annual income and expenditure.)

The *consolidated cash budget* is broadly inclusive, covering the trust funds along with

the general fund. Over the years, this statement has come to be used widely by business analysts and others who attempt to assess the current and prospective influences of Federal activities on the economy.

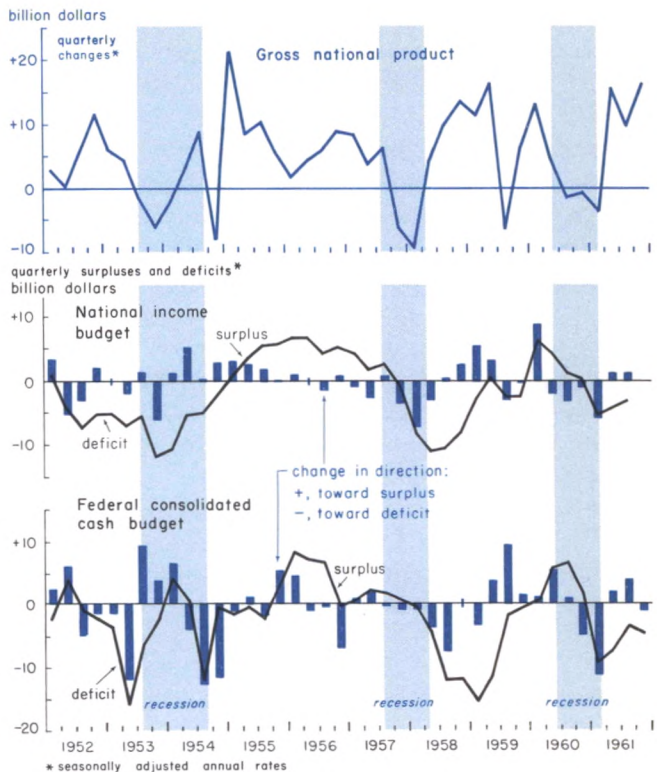
The cash budget is put together on cash accounting, as distinguished from accrual accounting, principles. This approach in effect views the Government’s fiscal actions from the vantage point of the Treasury. Tax receipts are attributed to the fiscal years or fiscal quarters when payments are received or are expected to be received. Similarly, expenditures are accounted for on a checks-issued basis.

Accrual accounting, on the other hand, assigns tax receipts or expenditures to the fiscal periods in which liabilities are incurred—for the payment of taxes on the part of businesses and individuals and for the payment of bills on the part of the Treasury. Business firms, for example, typically treat as part of their current expenses the tax obligations incurred as a result of their estimated taxable profits, even though the actual payment of taxes is not called for until some months later. At a time when profits are climbing, the liability for taxes on corporate income tends to exceed current tax payments. And, when profits are falling, current payments often will exceed currently accruing tax liabilities. During the present fiscal year, for example, Federal corporation income tax *payments* are expected to total 21.3 billion dollars. Yet corporation tax *liabilities* expected to accrue within this year are estimated at 24.6 billion dollars—3.6 billion more. The reason for this sizable difference is, of course, that corporate profits, seasonally adjusted, have been rising ever since the first quarter of 1961.

A statement of Federal receipts and expenditures on an accrual rather than cash basis appears in the 1963 Budget that the

## The Federal Budget and economic activity, 1952-61

The chart compares quarterly changes in gross national product, as an indicator of the direction of over-all business activity, with quarterly surpluses and deficits, seasonally adjusted, in the national income and cash budgets. The national income budget portrayed in general a pattern of more prompt response to changes in the state of the economy, moving more quickly from surplus toward deficit at the onset of contraction and back again from deficit toward surplus once business began to recover. During the 1957-58 recession, the Federal budget dropped into deficit status quickly, to judge from the national income statement, and promptly moved back toward the black ink side in the course of the ensuing expansion. The behavior of the cash budget, however, indicates that the deficit phase occurred for the most part after the recession had passed. In the 1960-



61 experience, the national income budget showed a move from surplus toward deficit that started coincidentally with the beginning of contraction. According to the cash budget, it was not until the recession was two quarters old that the surplus began to shrink. The vertical bars on the chart show quarter-to-quarter directions of movement in the Federal surplus

or deficit, a drop from the zero line indicating a reduction in surplus or increase in deficit, that is, a counter-recessionary move. Similarly, a rise from the base line is indicative of a reduction in the rate of deficit or increase in the surplus rate—a move tending to dampen the pace of economic expansion.

President submitted to Congress in January. Although the *national income budget* has been available for some years in the national income and product accounts, it became a part

of the official budget presentation only this year. This budget differs from the cash budget not only in its use of accrual accounting but also in its exclusion of various Federal credit

programs and the purchases and sales of existing assets. Such transactions have no impact on the current level of national income and product. Purchases and sales of home mortgages by the Federal National Mortgage Association—and, of course, sales and redemptions of the Government's direct obligations—are excluded also, on the ground that changes in the ownership of financial assets mainly affect liquidity within the economy and thus constitute *monetary* as distinct from *fiscal* actions.

How do the cash and national income budgets compare as measures of Federal fiscal transactions? And what are their implications for the effectiveness of fiscal action in the interest of economic stabilization?

#### **Fiscal policy by two measures**

The accompanying chart compares the surpluses and deficits in the cash and national

income budgets over the years since the war. In general, the pattern displayed by the national income budget squares more satisfactorily with the role cut out for fiscal action than does that of the cash budget. Moves from surplus to deficit and in the opposite direction have occurred more promptly and have been more consistently in the "right" direction at times when the level of economic activity was changing.

The main reason, again, is that corporation taxes are included on an accrual basis in the national income budget and on a payment or receipt basis in the cash budget. When business activity is turning downward, for example, corporate profits and, therefore, accruals of tax liability tend to move in step promptly. Tax payments, however, may continue to climb for two or three quarters, reflecting the pre-recession behavior of corporate profits. In an upturn, profits and tax liabilities usually pick up quickly, while tax payments do not rise until later.

Fiscal action *looks* better as an economic stabilizer or balance wheel when measured in terms of the national income budget than it does by the older and more familiar cash budget. The national income budget, in short, appears to give fiscal policy a more secure place in the arsenal of counter-cyclical measures than it seemed to merit before.

But this judgment assumes that the economic effects of fiscal actions are wholly registered at the stage of accrual, rather than when payments are made or receipts are recorded. That this is so is by no means a foregone conclusion. It is quite possible that certain effects occur at the accrual stage and others at the cash transaction stage. For the present, at least, both the national income budget and the consolidated cash budget are needed for the measurement and evaluation of fiscal actions.

#### **Banking data available**

*The first of a series of supplements to Banking and Monetary Statistics is now available from the Board of Governors of the Federal Reserve System. Section 10, "Member Bank Reserves and Related Items," contains a variety of statistical series which extend back to 1917 on an annual basis and to 1941 on a monthly basis, together with explanatory information. The original volume of 979 pages, published in 1943, is available at a cost of \$1.50. Supplement 10 costs 50 cents. Both can be obtained from: Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington 25, D. C.*