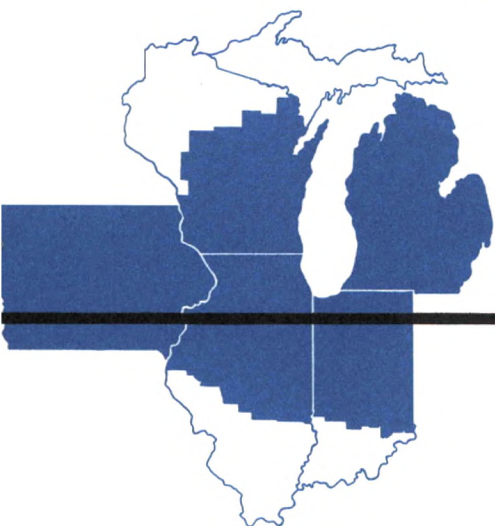


A review by the **Federal Reserve Bank of Chicago**

Business Conditions

1962 August



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THE Trend OF BUSINESS

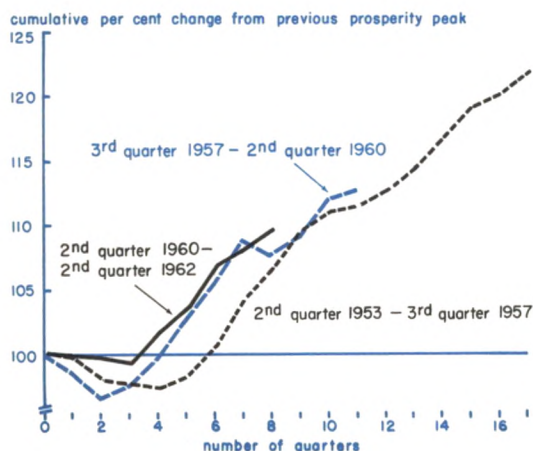
Employment, personal income and industrial production leveled off in June while retail sales declined from the advanced rate of the spring. Only construction, among the broad measures of activity, continued to rise as the first half of 1962 drew to a close. These national trends were in evidence in most large industrial areas of the Midwest.

The current business expansion which began early in 1961 has been marked by two interruptions—in September and again in January—but in each case the upswing resumed after a brief pause. It remains to be seen whether the slowdown evident at mid-

year will be of longer duration, or even give way to a general business decline.

During the postwar period, upswings in activity have averaged about three years in length. Within these movements there have been frequent periods when the major indicators of activity leveled or declined without a reversal of the basic upward movement. Pauses which occurred in 1947, 1951 and 1956, for example, were followed by one to two years of further business improvement. The recent leveling of activity has been closely related to the reduced rate of build-up of business inventories between the first and second quarters of the year as steel users cut back stocks of that metal. However, if demand for goods and services is maintained, business inventories over-all probably would not be reduced.

Rise in spending on goods and services since pre-recession peak compares favorably with previous upswings



Inventory building slows

The entire decline in purchases of goods and services in the 1960-61 recession has been attributed to a shift in business inventories, according to recently revised estimates published by the Department of Commerce. The annual rate of total spending in the first quarter of 1962 is now estimated at 545 billion dollars, while the spending rate advanced to 552 billion in the second quarter. This was well below the 565 billion commonly projected at the beginning of the year.

Both before and after the 1959 steel strike, business inventories rose at an annual rate of

more than 10 billion dollars. At the start of 1962 many observers believed that accumulation might reach these proportions prior to the expiration of the existing steel industry labor contract at the end of June. The rate of inventory accumulation did rise during 1961 and reached a rate of almost 7 billion dollars in the first quarter of 1962. However, there was a drop to about 3.5 billion in the second quarter. With this change in inventories taken into account, it appears that purchases of goods and services "for use rather than resale" rose 10.2 billion dollars in the second quarter, compared with 5.7 billion in the first.

The cutback in steel inventories in recent months has been accompanied by a marked slackening in the rate of build-up in some other lines. During the spring quarter most other durable and nondurable goods producers and many trade firms slowed their additions to inventory or actually reduced stocks which were believed to be excessive. In March, 50 per cent of the purchasing agents of Chicago, representing a variety of firms, reported higher inventories compared with the previous month while only 5 per cent reported lower inventories. In June, 23 per cent reported higher inventories while 22 per cent reported reductions.

Business managers always attempt to keep inventories at minimum levels consistent with profitable operations. However, they are willing to increase stocks when "lead-times" (the period of advance notice required by suppliers to assure delivery) are lengthening or expected to lengthen and when prices are rising or expected to rise.

Early in 1962 there was some tendency for lead-times to stretch out—a normal development in a business expansion. But this proved to be temporary and was reversed in the spring as it became apparent that manufacturing firms had ample capacity to maintain

delivery schedules in the face of rising demand. Average wholesale prices, meanwhile, remained stable with many individual prices actually being reduced, contrary to earlier expectations. In mid-July, *Purchasing Week's* index of prices of 17 industrial raw materials was 5 per cent lower than in January.

Contrasts: construction and durables

The most vigorous sector of the economy continues to be construction. The value of new construction put in place reached a seasonally adjusted annual rate of 63 billion dollars in June, 11 per cent above the same month of 1961 which had been a near record. Further increases may be in store judging by the strength in new construction contracts. For the first five months of the year construction contracts, nationally, were 17 per cent above the same period of 1961. In the Midwest, contracts through May were only 4 per cent above last year.

In contrast to the favorable trend in construction is the sluggishness in new orders reported by durable goods manufacturers across the nation. New orders for durables declined steadily from a rate of 16.4 billion dollars in January to 15.3 billion in June. Through April, however, this decline was entirely attributable to a sharp drop in steel orders. In May and June steel orders rose, but orders for all other types of durable goods declined and were below shipments.

At the end of June unfilled orders of durable goods manufacturers amounted to 44.1 billion dollars, down 2.2 billion from February—the high for the year. This order backlog represented only 2.8 months' shipments, slightly less than a year ago and well below the level of earlier years.

Retail trade declines

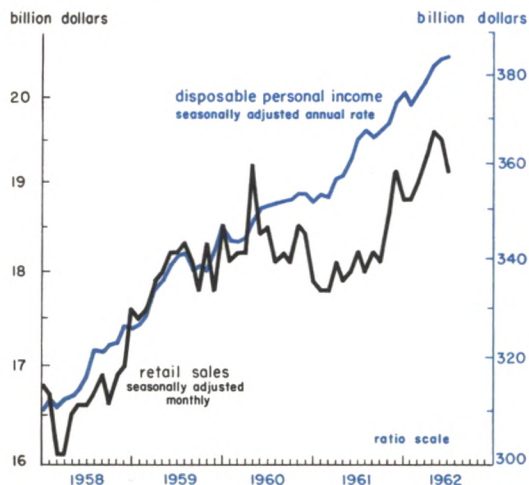
There was a distinct slowing in consumer

buying in June which extended to most retail lines. Perhaps this was in part a reaction to the very high level of retail purchases in April and May. Reports for early July pointed to a reversal of the downtrend.

Total auto deliveries to American customers, including imports, declined to a seasonally adjusted annual rate of about 6.9 million units in June from an average of about 7.2 in the previous two months. June department store sales declined by more than 3 per cent from the April-May average, both in the nation and in the Seventh District.

Despite the June decline, retail sales in the second quarter as a whole, at an annual rate of 233 billion dollars, were 2 per cent higher than in the first quarter and 8 per cent above the level of a year earlier. These increases were somewhat greater than the corresponding gains in personal income.

Retail sales declined in May and June while rise in income continued at a slower pace



Most categories of retail sales were substantially higher in the second quarter than in the comparable period of 1961. Nondurables were up 6 per cent and durables, led by automobiles, 12 per cent. For each of these groups second quarter sales were at a record high.

Farm prospects

As a result of favorable weather conditions throughout most of the nation, it appears that crop production during 1962 will be a near record and farm income will equal or slightly exceed the improved level of 1961. Prospects are especially promising in the Corn Belt states where moisture and temperature conditions through mid-July have been described as "unbelievably good."

High crop production is being achieved despite the fact that farmers have idled almost 50 million acres this year under the Government's feed grain and wheat programs. As a result, acreage planted in all crops totals less than 300 million acres—the smallest in many years.

During the past two years hog prices have been high relative to corn prices. In the earlier postwar period hog-corn price ratios comparable to those currently prevailing have been followed by rapid increases in hog production and, in turn, by declines in hog prices. But hog production has increased very slowly the past two years and, indeed, the 1962 spring pig crop was slightly lower than that of a year earlier. In part, this reflects uncertainties surrounding operation of the Government's feed grain program. With reduced supplies, hog prices in recent weeks have been somewhat higher than a year ago. Because the fall pig crop is expected to be no more than 1 per cent above that of 1961, market prices for hogs are likely to remain relatively strong well into next year.

Trends

IN BANKING AND FINANCE

Growth of commercial bank time deposits in June was greater than in May although below the very large increases in the first four months of the year. Moreover, reports from Midwest banks indicate that in the latest two months corporate accounts have declined and individual accounts have risen in relative importance as sources of the increase in time deposits.

Time deposits have been rising rapidly since about mid-1960. During the first six months of 1962 the increase at all commercial banks in the United States was 9.1 billion dollars. This compares with 6.5 billion in the corresponding period of 1961 and 1.6 billion in the first half of 1960. The exceptionally large growth in the first half of last year, compared with 1960, reflected—in addition to a

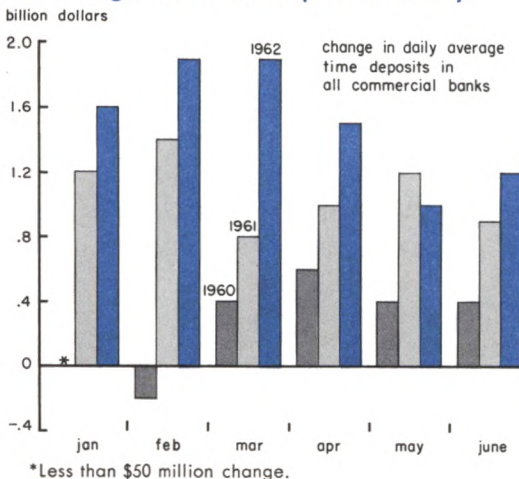
high rate of saving by individuals—the issuance of special noninterest bearing time certificates of deposit to a large retail firm as a part of a credit transaction and the development of a market for negotiable time certificates of deposit issued by large banks. The further rise in the current year reflects mainly the effects of higher interest rates paid by most banks for time deposits.

A significant aspect of the growth in time deposits during the first half of 1962 has been the rising proportion attributable to accounts other than personal savings-type deposits. While savings accounts comprise the bulk of commercial bank time deposits (almost 80 per cent at member banks), much of the fluctuation in the rate of growth has been due to variations in other types of time deposits, particularly those held by corporations.

Because the corporate accounts are mainly concentrated in large banks in major cities, time deposits at these banks have generally risen faster than at banks in smaller centers and in rural areas. For example, the large member banks in the five major cities of the Seventh Federal Reserve District reporting such information weekly had an 18 per cent increase in time deposits during the first six months of 1962, while at banks outside these major cities the increase was half as much.

Although corporate deposits constitute only about one-eighth of the time deposits of these banks, they accounted for almost half of the increase in total time deposits in April. During May and June, however, corporations accounted for a smaller portion of the increase. The volume of negotiable time cer-

Time deposit growth rose in June following declines in April and May



tificates of deposit issued primarily by large banks and mainly to corporations had risen rapidly from January to about mid-April. By mid-June this expansion ceased and outstandings remained quite stable despite somewhat higher rates offered on these instruments in recent weeks.

Meanwhile, personal savings-type deposits at the reporting banks rose rapidly in May and June. Besides corporate and personal accounts, time deposits include special purpose open accounts and deposits held by state and local governments. These have not shown any consistent pattern of change in recent months.

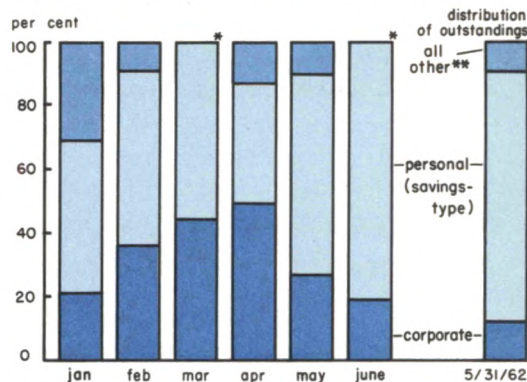
Interest rates higher

Yields in all sectors of the money and capital markets moved up through mid-July from the reduced levels reached in late spring. The three-month Treasury bill rate showed the greatest rise, increasing from about $2\frac{3}{4}$ to about 3 per cent during this period. The increase in short-term rates was largely attributable to continued efforts by the Treasury and Federal Reserve to keep these rates competitive with those on similar investments available abroad. Of particular importance was the Treasury's program of raising funds by adding 200 million dollars weekly to the regular bill auctions. In addition, the short-term market may have been influenced by recent actions of the Canadian Government to bolster the Canadian dollar, including an increase in the central bank discount rate to 6 per cent and sharp upward adjustments in money market rates. These measures apparently gave rise to expectations that rates here would move up in response to a return flow of funds to Canada from the United States market as confidence in the Canadian dollar was restored.

Increased yields on intermediate- and long-term Government securities were, in part, related to developments in the short area but

Corporate share of time deposit growth fell in recent months

Distribution of increase in time deposits of weekly reporting banks in five major cities in the Seventh District



*"All other" deposits declined slightly.

**Includes deposits of states and municipalities and non-corporate open accounts.

also reflected uncertainties as to the outlook for monetary policy and the amount and nature of the Treasury's forthcoming financing operations. By mid-July the average yield on long-term bonds exceeded 4 per cent for the first time since early March.

Available evidence shows very little change in the cost of short-term bank loans to businesses in the Midwest. Interest rates on business loans maturing within one year, made during the first half of June by large banks in the District, were only slightly higher than in March (4.91 per cent compared with 4.88 per cent). Although the number of loans made by the reporting banks in this period was somewhat larger than a year ago, the total dollar volume—mainly due to the decline in very large loans—was about 6 per cent less.

Margin requirements cut

Effective July 10, the Board of Governors of the Federal Reserve System reduced mar-

gin requirements for stock market credit extended by brokers and banks (under Regulations T and U) from 70 to 50 per cent of the value of the securities. This means that the purchaser of a listed stock can now borrow up to 50 per cent of the purchase price instead of the previous maximum of 30 per cent.

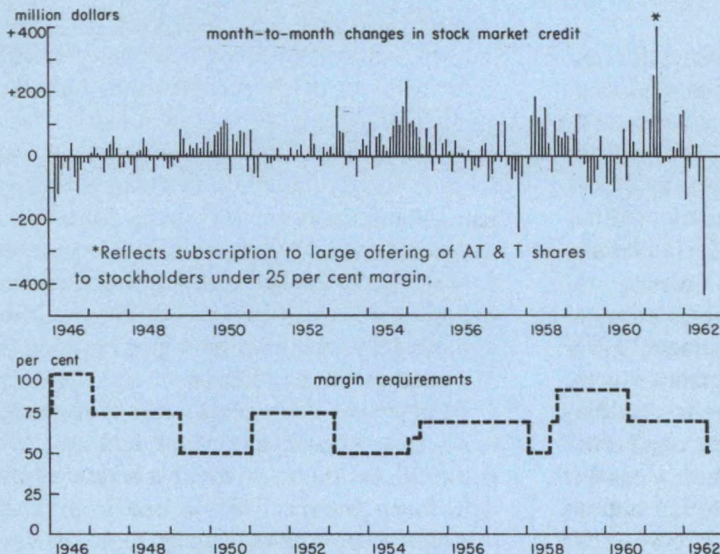
Since the Board was first given authority to

regulate stock market credit under the Securities and Exchange Act of 1934, margin requirements have varied from 25 to 100 per cent, with the latter in effect for about a year—from January 1946 to January 1947. Changes during the postwar period are shown in the accompanying chart.

The regulation of stock market credit is

“for the purpose of preventing excessive use of credit for the purchase or carrying of securities,” not to affect stock prices. Most changes in margin requirements in recent years have followed trends in the amount of stock market credit extended. Margin requirements have been raised when credit—as measured by customers’ debit balances with stock exchange firms and loans from banks—showed a tendency to rise sharply and have been adjusted downward when the volume of credit declined. The most recent change followed a substantial reduction in the amount of stock market credit (as sellers of stocks paid off loans) in May and June and was consistent with the abatement of the speculative psychology that had characterized the earlier period of rising stock prices.

Changes in margin requirements have often followed large increases or decreases in stock market credit



Regulations T and U limit the amount of credit that can be extended by brokers and dealers on listed securities (those registered on a national securities exchange) and by banks on stocks used as collateral for loans for the purpose of purchasing or carrying listed securities. These regulations prescribe the maximum loan value as a percentage of the market value at the time of purchase. The margin requirement represents the buyer's equity as a proportion of the purchase price of the stock. Requirements are uniform for brokers and banks and apply equally to purchases and short sales.

Economic growth and the Federal area redevelopment program

In 1957-58 an estimated 14,000 separate area development programs were in existence in the United States. These programs, involving public as well as private funds and talents, ranged all the way from advertising the advantages of industrial location in particular communities to the provision of low-cost credit, cash assistance and tax concessions for new plant investments.

The number of such programs has doubtless increased in recent years as many localities have felt the effects of the closing or removal of key industrial plants, shifts in military procurement and falling employment in the mining and railroad industries. Other sections have been adversely affected by the decline of farm population and reduced employment resulting from the installation of labor-saving machinery in local plants. While such changes are a normal ingredient of economic progress, they may have affected relatively more areas recently than in earlier years and there is, in any event, a greater tendency to respond with a specific program of direct action.

Local economic development programs, therefore, have focused increasingly upon measures to boost employment in labor surplus areas. In 1961 the U. S. Government became an active partner in this effort.

Emphasis on industrial growth

Industrial activity, particularly manufacturing, gains top billing in most area development programs. Establishment of a new factory in the community, or expansion of an existing

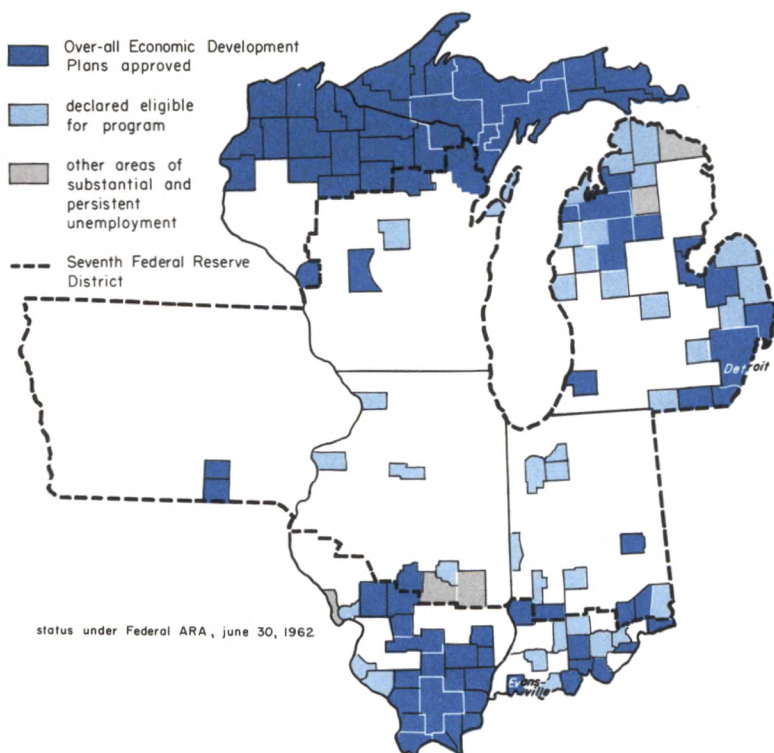
one, tends to increase local income as the "export" of goods into a regional or national market is matched by a return flow of money.

A big portion of the addition to income will, of course, pour out again—in the form of payments to outside suppliers, interest and dividends to nonresident investors and tax remittances to the Federal and state governments. But some of the added income—indeed, a major share of it in the "typical" instance—will be disbursed within the community, mainly as wages, payments to local suppliers of materials and services, and taxes for school, city, county and other local governmental purposes. A new plant facility thus means jobs for some who otherwise would be unemployed—and quite possibly a burden on welfare budgets—besides additional income to bolster the local economy in general.

The stimulation of local economic development is viewed with suspicion in some quarters as a "beggar-my-neighbor" practice. What one area may gain, it is contended, another must forego. This will, of course, be true unless promotional activity on balance gives rise to a greater over-all rate of industrial expansion than would otherwise occur.

It is sometimes argued further that promotional efforts may take a toll in productive efficiency. Communities and regions offering inducements, it is pointed out, may not be places where industrial development "ought" to take place, giving due weight to such other factors as proximity to suppliers and markets and the availability of utility and community services, transportation and banking facilities

Area redevelopment activities under way in five midwestern states



and an adequate supply of skilled labor.

Business firms seeking locations for new plant facilities generally favor localities where labor is readily available: other things the same, a labor-surplus community has more appeal than one with little available manpower. In a sense, development efforts amount to acquainting the business community with the existence of areas where labor of requisite training and experience is in excess supply and in some cases offering incentives to investment within them. The financial inducement, in turn, may be viewed as a substitute for the lower and therefore tempting wage

level that the presence of unemployment indicates would prevail in the absence of wage floors established by law, collective bargaining or other influences.

The savings in welfare costs, increases in property values, expansion of business sales and, in general, the advance in local income associated with economic growth constitute a potential source of financial support for development efforts. Thus, local merchants sometimes band together to raise funds to finance construction of industrial buildings for lease (or donation) to occupants agreeing to provide specified numbers of jobs. The prospect of direct earnings on the capital raised is

secondary. The "return" instead is the boost to retail sales produced by the new jobs and income and, perhaps in addition, property tax savings accompanying a cut in relief rolls.

Similarly, the community as a whole may try to promote development by offering cash grants from local tax funds or assisting in a less direct fashion by using its credit as a municipal borrower to raise the needed capital. Full or partial waiver of property tax liability on plants conventionally financed is another form of financial inducement and often a fairly "inexpensive" one. The presence of the new industrial facility is unlikely to

affect the expenditure side of the local budget to the same extent that it will the revenue side if subject to taxation at the full rate. Development aid becomes a matter of foregoing part of the margin between the tax revenue that the plant otherwise would provide and the governmental costs occasioned by its presence in return for a variety of spillover benefits.

Effects not always localized

Problems posed by local unemployment frequently spread to a wider area than the local community directly involved. Drains on state unemployment insurance reserves, assistance and other welfare funds, as well as the loss of taxpaying capacity on the part of the unemployed, mean that the labor surplus areas to some degree affect the entire state. Reflecting this, the statutes of substantially all the states now authorize the formation of private industrial development corporations designed to help finance business investment. Moreover, 15 states have set up statewide development corporations or authorities financed by tax appropriations or borrowings. These agencies characteristically provide low-cost credit to local development corporations which, in turn, make financial aid available to business firms. None of these agencies are in operation in the Seventh Federal Reserve District states; Illinois passed legislation establishing an industrial development authority in 1961, but the state Supreme Court ruled it unconstitutional earlier this year.

Pressure for direct state action to aid distressed areas appears to reflect in part limitations on the taxing and borrowing powers of local governments and legal barriers to tax exemption for any but a few purposes.

A state government's ability to aid area economic development frequently is limited by the same kinds of legal obstacles as those confronting the local governments. Moreover,

the budgetary pressures from other quarters—such as school aid, assistance to the needy, higher education and public hospitals—has severely limited the states' capacity to assume new financial responsibilities, notwithstanding prospects of longer-term benefits. Particularly hard hit are states where the unemployment problem has been especially serious.

In Michigan, for example, 65 per cent of the total population is located in areas where unemployment conditions for many months have been "substantial and persistent." The proportion of total population in "labor surplus" areas in the other Seventh District states is lower: Indiana, 17 per cent; Wisconsin, 11; Illinois, 8; and Iowa, less than 1 per cent. For West Virginia, on the other hand, the ratio is 96 per cent, while for both Kentucky and Pennsylvania, it is more than 50 per cent. Nationally, labor surplus communities account for nearly one-fifth of the population.

Substantial and persistent labor surplus is, of course, a matter of somewhat arbitrary definition. In the past several years it has become common practice to regard unemployment in a given labor market as "substantial" if the proportion of the labor force currently out of work and seeking employment is at least 6 per cent. The unemployment problem is said to be "persistent" if the local rate was twice as high as the United States average in one of the preceding two years, 75 per cent higher for two of the preceding three, or 50 per cent higher in three of the prior four years.

These criteria have taken on added significance with the adoption of the Federal Area Redevelopment Act (ARA) in early 1961. The new program is specifically designed to assist communities in the substantial and persistent labor surplus category—along with certain Indian reservations and farming counties where low income may be a better indicator of labor surplus than unemployment.

Assistance for labor-surplus areas

The legislation establishing the area redevelopment program authorizes a maximum of 200 million dollars in industrial and commercial loans to be evenly divided between urban and rural labor surplus areas and 100 million dollars in loans to municipalities. Grants for municipal projects are limited to a total of 75 million dollars. To help pay for local research and development activities, 4.5 million dollars is available yearly. The manpower retraining aspect of the program is supported by an expenditure authorization of 14.5 million dollars a year—4.5 million for instruction and 10 million for subsistence payments to trainees.

Aid in the form of **loans for industrial (or commercial) purposes** is available to finance up to 65 per cent of the cost of approved business undertakings. Credit is provided when it is not readily obtainable from conventional sources on "reasonable" terms. At least 10 per cent of the project cost must be supplied by some responsible state or local agency or non-governmental development organization. The project must be expected to contribute to a lasting improvement in the local employment sit-

uation. The credit may be used to finance the purchase or development of land and structures and, where the need is demonstrated, the cost of equipment. These funds are not to supply working capital, nor may they be used to pay for relocation of existing firms. Loan maturities are limited to 25 years and the interest charged has been 4 per cent.

Federal area redevelopment **credit for municipal public works** is available for projects directly linked to industrial development. Examples are water and sewer line extensions to serve new plants or additions to pumping capacity installed in order to accommodate industrial users. Again, there is the requirement that ARA assistance be confined to instances where funds are not otherwise available at a "reasonable" cost. Loan maturities may be as long as 40 years and the interest rate charged to date has been $3\frac{3}{8}$ per cent. **Cash grants for municipal use** may be made where the proposed project clearly will serve a pressing need, would not otherwise be financially feasible and the recipient municipality participates in the financing to the extent of its ability.

Federal funds for local growth

The area redevelopment program offers several kinds of assistance. One is credit for industrial or commercial development. Another is financial assistance—both credit and cash grants—for municipal public improvements. Technical guidance also is available for local development planning and the program includes a small-scale manpower retraining effort now largely superseded by the Manpower Development and Training Act adopted earlier this year.

Before aid can be extended to an "eligible" area, a suitable over-all economic development plan (OEDP) must be approved by a responsible agency of the state government and by the U. S. Department of Commerce. At midyear such plans had been finally approved for some 520 labor surplus areas. These covered 571 individual counties, plus 21 Indian reservations. Population of the areas thus approved for ARA aid totaled nearly 24 million: 17 million in 201 urban counties and the remainder in 370 rural communities. The largest labor markets receiving

ARA approval on their proposed development plans were Detroit and Pittsburgh.

By the end of June OEDP's had been approved for 12 urban and 19 rural counties in Michigan with a total population of 4.6 million. In Illinois, 23 southern counties having about a half million residents had secured approval for their plans. Twelve Indiana counties (433,000 inhabitants), 20 Wisconsin counties (370,000)—mostly in the northern part of the state—and two small Iowa rural counties (only 26,000) were also covered by approved plans.

Through the end of June, 5.5 million dollars in ARA funds had been released to specific projects in Seventh District states. Four industrial loans had been made, totaling 1.4 million dollars: one in Upper Michigan, one in southern Indiana and two in southern Illinois. Some 2.5 million dollars in public facilities aid had been provided—half as credits and half in the form of grants—for projects in Upper Michigan, southern Indiana and southern Illinois. A total of 290 thousand dollars also had been made available under six technical assistance or planning grants. Another 1.25 million dollars had been approved for manpower retraining—700 thousand in Michigan, 300 thousand in Illinois and 250 thousand in Indiana.

By midyear the ARA had approved individual projects throughout the nation calling for the disbursement of roughly 50 million dollars. Although this represented only one-third of the total ARA funds available for the fiscal year ended June 30, there were indications that projects moving through administrative "pipelines" were likely to utilize fully the programs' financial resources.

Efforts have been made to make the ARA a coordinating agency for the numerous Federal services and activities that focus on economic development. One example of this re-

lates to the activities of the Small Business Administration. Loans made by the SBA to firms in labor surplus communities carry an interest charge of only 4 per cent, whereas the rate on all other SBA loans is 5½ per cent. In the 12-month period ended March 31, 1962, SBA 4 per cent loans totaled almost 160 million dollars, or approximately 40 per cent of all loans made by the agency during this period. Almost 21 million dollars of these 4 per cent loans went to firms in the Seventh District—13 million to Michigan alone.

Moreover, SBA field personnel have assisted in processing applications for ARA assistance. The community facilities administration in the Housing and Home Finance Agency similarly screens applications for ARA aid for local public works.

ARA not a cure-all

An examination of some 40 individual industrial loans made under ARA during the past year indicates that about 5,000 new jobs were created by an investment of slightly less than 18 million dollars in land and structures. More than half of this investment was financed under ARA, the remainder—plus the additional funds required for machinery and equipment and working capital—came from local sources and from SBA. The investment in land and structures, thus, works out to about \$3,600 per job "created."

With total unemployment in the United States currently in excess of 4 million, it is obvious that the 450 million dollar ARA program cannot be expected to supply jobs for all the unemployed. There are, however, good reasons for judging that it may be of significant help to some especially distressed communities that might otherwise remain troublesome even in the face of a substantial pickup in national output and the total demand for labor.

New light on United States exports

In 1961 both the trade surplus and the balance of payments position of the United States improved substantially from the previous year. The trade surplus—the excess of merchandise exports over merchandise imports—rose by roughly 700 million dollars to 5.4 billion while the deficit in the over-all balance of international payments declined by about 1.4 billion to 2.5 billion dollars.

The improvement in the trade surplus stemmed primarily from an increase in exports and, to a lesser extent, a drop in imports. Exports rose from 19.5 billion dollars in 1960 to 19.9 billion dollars in 1961. This increase, however, made only a modest contribution to the reduction in the over-all balance of payments deficit since more than four-fifths of the gain was directly financed by Government loans and grants under the various foreign economic assistance programs. Such exports rose by almost 400 million dollars to 2.2 billion in 1961, while those financed through commercial channels increased by less than 100 million to about 17.7 billion dollars.¹

In contrast to most privately financed exports, those financed under Government assistance programs have no direct impact on the deficit or surplus in our balance of inter-

national payments since they do not involve transfer of dollars or convertible currencies from abroad to the accounts of American citizens during the current balance of payments accounting period.

However, exports financed by Government loans which are repayable in dollars, such as those extended by the Export-Import Bank, will ultimately result in a return flow of dollars from abroad as the loans are repaid. But there is a substantial time lag. For example, Export-Import Bank exporter credits, which are used exclusively to finance United States exports, carry maturities ranging up to a maximum of seven years while Agency for International Development loans can be for a maximum of 40 years. Moreover, AID loans customarily contain a lengthy grace period during which no repayments are required.

The majority of privately financed merchandise exports, on the other hand, have a favorable impact on the United States balance of international payments in that they involve payment by foreigners in dollars or other convertible currencies during the same accounting period. A small and hard to estimate portion of such exports, however, do not result in immediate “money payments” from abroad. These include primarily goods sold on longer-term credit or linked to the outflow of private long-term capital incident to the overseas expansion of American business firms.

In the table below, merchandise exports financed by Government loans and grants have been subtracted from the trade balance for 1960 and 1961. This indicates that the

¹Data on Government-financed exports are compiled by the U. S. Department of Commerce. They include exports under the “Food for Peace” program, the Agency for International Development, the Export-Import Bank and other smaller programs. Although the data on Government-financed exports are incomplete in some respects and are not available for years prior to 1960, they contribute to a clearer understanding of the impact of these programs on the balance of international payments.

What is a balance of international payments?

A balance of international payments is a record of a nation's total economic transactions with the rest of the world during a given period of time. It is not a balance sheet since it does not show a nation's total assets abroad or its total liabilities to foreigners, but rather provides a summary of its total *receipts from* foreign individuals, corporations, governments and international organizations, and its *payments to* them. It includes transactions related to the sup-

plying of goods and services, the lending and investing of short- and long-term funds and the granting of aid.

Total receipts always equal total payments during any given accounting period. Deficits and surpluses are measured by changes in selected receipts and payments categories. With respect to the United States, it is customary to refer to net sales (or purchases) of gold and convertible currencies by the U. S. Treasury and

the Federal Reserve System, plus the net increase (or decrease) in our liquid dollar liabilities to foreigners as the overall "deficit" (or "surplus") in the balance of payments.

In every year since 1958 the United States has incurred a sizable over-all deficit in its balance of international payments. The cumulative deficit for the four-year period totaled 13.6 billion dollars. About 5.5 billion, or two-fifths, of this deficit was covered by sales of gold to foreigners, and the remainder by a rise in foreign deposits in domestic banks, holdings of U. S. Treasury securities and other liquid dollar assets.

The major components in the United States balance of payments are summarized in the accompanying table.

United States balance of international payments					Total 1958- 1961
	1958	1959	1960	1961	1961
billion dollars; payments (—)					
Nonmilitary trade and services:					
Merchandise exports	16.3	16.3	19.5	19.9	72.0
Service exports	6.8	7.2	7.2	7.8	29.0
	23.1	23.5	26.7	27.7	101.0
Merchandise imports	—13.0	—15.3	—14.7	—14.5	—57.5
Service imports	—4.7	—5.1	—5.4	—5.5	—20.7
	—17.7	—20.3	—20.1	—20.0	—78.2
Balance on trade and services	5.4	3.1	6.6	7.7	22.8
Other major transactions:					
Military expenditures abroad (net)	—3.1	—2.8	—2.7	—2.5	—11.1
Government grants and loans (net)	—2.6	—2.0	—2.8	—2.8	—10.2
U. S. private capital:					
Long-term loans and investments	—2.5	—2.3	—2.5	—2.5	—9.8
Short-term loans and investments	—0.4	—0.1	—1.3	—1.5	—3.3
Foreign long-term loans and investments in the U. S.	—	0.7	0.2	0.6	1.5
Remittances and pensions	—0.7	—0.8	—0.8	—0.9	—3.2
Balance	—9.3	—7.3	—10.0	—9.6	—36.1
Unrecorded transactions:	0.4	0.5	—0.6	—0.6	—0.3
Over-all balance: deficit (—)	—3.5	—3.7	—3.9	—2.5	—13.6
Balancing items:					
Decrease in official holdings of gold and convertible foreign currency	2.3	0.7	1.7	0.8	5.5
Increase in foreign liquid dollar claims on U. S.	1.2	3.0	2.2	1.7	8.1
	3.5	3.7	3.9	2.5	13.6

Note: Totals may not balance due to rounding.

SOURCE: U. S. Department of Commerce.

improvement in the trade surplus, excluding Government-financed exports, between 1960 and 1961 is attributable almost exclusively to a decline in imports rather than to a rise in exports.

United States exports and imports
(military items excluded)

	1960	1961
	(billion dollars)	
Merchandise exports . . .	19,459	19,915
Less: Government-financed exports	1,798	2,183
Privately financed exports .	17,661	17,732
Less: Merchandise imports .	14,723	14,514
Trade surplus excluding government-financed exports .	2,938	3,218
Trade surplus including government-financed exports .	4,736	5,401

SOURCE: U. S. Department of Commerce.

Government-financed exports up

Merchandise exports financed by Government loans and grants have risen much faster than privately financed exports since the early part of 1960. Part of the increase in Government-financed exports is attributable to a tightening of procurement procedures, initiated as far back as the fall of 1959, to assure that a larger percentage of foreign aid funds would be spent directly in the United States. An increase in Export-Import Bank exporter credits associated with the financing of large foreign purchases of American commercial jet aircraft was a further contributing factor. Another important factor has been the continued expansion of "Food for Peace" exports under Public Law 480 and other "special" Government programs for disposing of surplus farm commodities.

Farm products account for more than half the exports under Government assistance programs

	1960	1961
	(million dollars)	
"Food for Peace" . . .	1,196	1,239
Agency for International Development	390	499
Export-Import Bank . . .	364	621
Other programs	4	4
Total	1,798	2,183

Note: Utilization of foreign currencies acquired under these programs, mainly for Government purchases abroad, have been deducted from the totals to obtain the Government-financed export figures shown in the balance of payments statement. In 1960 such expenditures amounted to 156 million dollars and in 1961, 180 million.

SOURCE: U. S. Department of Commerce.

Although Government-financed exports have no direct impact on the United States balance of payments, they undoubtedly have some indirect effects, but these are difficult to measure. They depend largely on whether the foreign country would have obtained the goods elsewhere if Government financing had not been available. Moreover, these exports help to alleviate pressures on the balance of payments of the recipient countries and tend to strengthen their currencies relative to the dollar.

Trade outlook encouraging

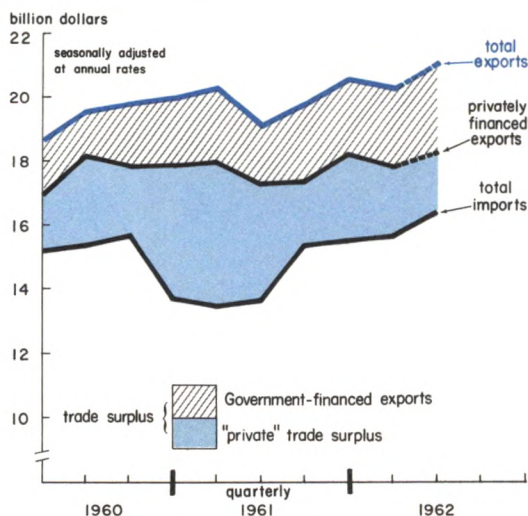
Eliminating the deficit in the United States balance of payments will require either cutting back our expenditures and investments abroad, increasing our overseas dollar earn-

ings or attracting additional foreign investment to this country. Efforts are being made, with some success, to reduce the dollar outflow connected with our overseas military programs and to persuade foreign industrial countries to boost their economic aid to underdeveloped areas. However, the major effect may be to restrain further increases in dollar expenditures abroad rather than to reduce them below present levels. At the same time imports of industrial raw materials and tropical foodstuffs to this country will probably rise with the growth of the domestic economy. Major attention, therefore, has focused on policies for boosting exports which have a favorable impact on our balance of payments.

In 1961 privately financed exports amounted to 17.7 billion dollars—an increase of less than 100 million from the previous year. Although such exports were at a seasonally adjusted annual rate of 17.8 billion dollars in the first quarter of 1962, this represents a decrease of nearly 200 million from the year-ago period and nearly 400 million since the fourth quarter. During May and June these exports probably rose again to the relatively high fourth quarter level.

Merchandise imports, on the other hand, have risen from an annual rate of 13.5 billion

Decline in "private" trade surplus during past year reflects sharp rise in imports



SOURCE: U. S. Department of Commerce.

dollars in the first quarter of 1961 to 15.7 billion in the first quarter of 1962 as domestic business activity increased. The succeeding three months have seen a further increase to a rate of 16.4 billion. This country's "private" trade surplus, therefore, declined sharply from the first quarter of 1961 to the first quarter of this year.

But the scene may be changing. During the last two years prices and wages in other major industrial countries have increased at a substantially faster pace than in this country. If these trends continue, the demand for privately financed American exports should strengthen materially. Moreover, the modest increase in imports to 3.0 per cent of gross national product in the first quarter of this year in contrast to 3.2 per cent in 1959 may be a further indication of basic improvement in the United States trade position.

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