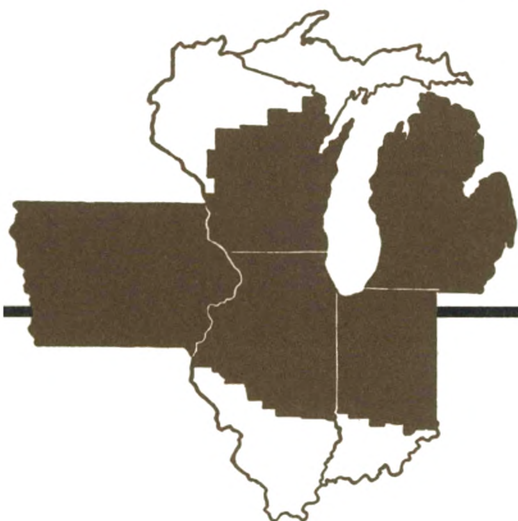
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1963 July

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Trends in banking and finance

Bank loans grew much more rapidly in the past year than in the preceding twelve months of the current business upswing. At member banks in the Seventh Federal Reserve District total loans have risen 25 per cent since the low point of the recent recession in February 1961, with almost two-thirds of the gain occurring in the past twelve months. The accelerated growth in the later period was especially marked in the major cities.

Detailed data available from the spring condition reports indicate that this pattern was general for all of the major loan categories. Real estate loans produced the biggest dollar gains over the period as a whole, accounting for about 30 per cent of total loan growth in the two years ending last spring. At the same time, a substantial amount of funds was channeled into very liquid types of loans —to security dealers and brokers and to other banks and nonbank financial institutions.

The largest gains in real estate loans in the 1962-63 period were in Chicago and Detroit and consisted mainly of Government-underwritten residential mortgages. Although Chicago banks reported the largest percentage increase in mortgages, their total holdings of real estate loans were still slightly less than 10 per cent of their total loans. In Detroit, last year's acquisitions boosted mortgage loans from 30 per cent to almost 33 per cent of total loans.

While mortgages have always been considered an appropriate outlet for time money, the recent move into mortgages by city banks reflects the absence of strong demand for business credit as well as the large growth in time deposits during the past two years.

Boost from auto paper

Consumers stepped up their bank borrowing sharply in the 1962-63 period, with the brisk pace of automobile purchases providing a major stimulus. As total automobile instalment paper outstanding in the United States rose 13 per cent, such paper in the portfolios of District banks increased about 20 per cent. Strong gains were reported at banks in four of the five major cities and at other banks in all five of the District states.

Loan trends are typically more stable from year to year in smaller communities than in

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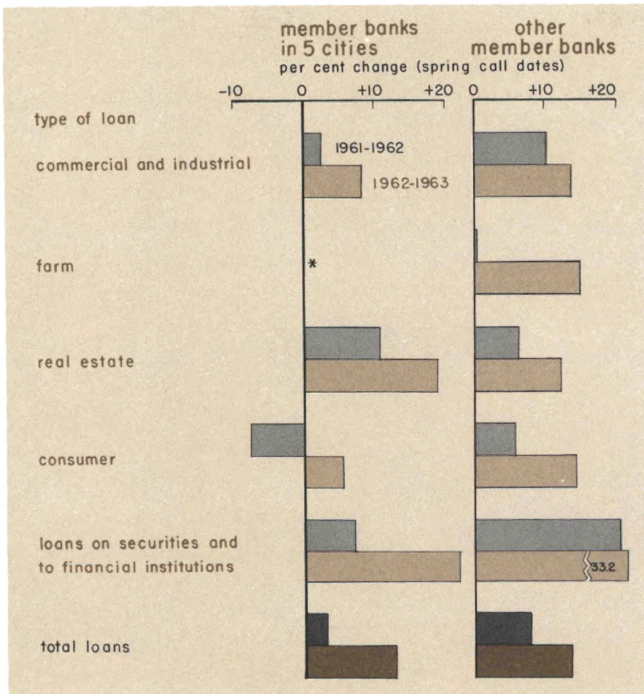
Loan growth accelerated in second year of business expansion



*Per cent change not shown due to small base.

the large cities. The cyclical variation in large cities reflects primarily the credit needs of large corporations. During the current business expansion, however, commercial and industrial loans rose faster in the smaller cities. The relatively slow demand for business credit at banks in the major cities may reflect both smaller over-all credit needs due to the rise in internally generated funds (as measured by retained earnings plus depreciation) and the fact that large businesses have access to other sources of credit, such as the commercial paper and securities markets.

Firmer money market; rates rise

In late May and early June, the money market "firmed" on a broad front. Virtually all short-term interest rates—on Treasury bills, commercial paper, acceptances and dealer loans—rose to the highest levels in three years. The supply of Federal funds—reserves which are loaned by some member banks to other banks on an overnight basis—"dried up" at times and rates stuck close to the discount rate of 3 per cent. Banks generally will not pay other banks more for reserves than the rate at which they can borrow from the Federal Reserve Banks.

Excess reserves—the amount by which the total reserves held by all member banks exceed required reserves — declined, and the amount of reserves borrowed from the Federal Reserve Banks rose. As a result, free reserves—excess reserves less borrowed reserves—declined to a three-year low. The relationship of these reserve measures is shown below for comparable periods of the past three years.

	First half of June		
	1961	1962	1963
	(million dollars)		
Total reserves	18,184*	18,976*	19,424
Less required reserves	17,584*	18,523*	19,054
Equals excess reserves	600	453	374
Less borrowed reserves	66	51	232
Equals free reserves	534	402	142

*Adjusted to current requirements.

The rise in short-term rates was accompa-

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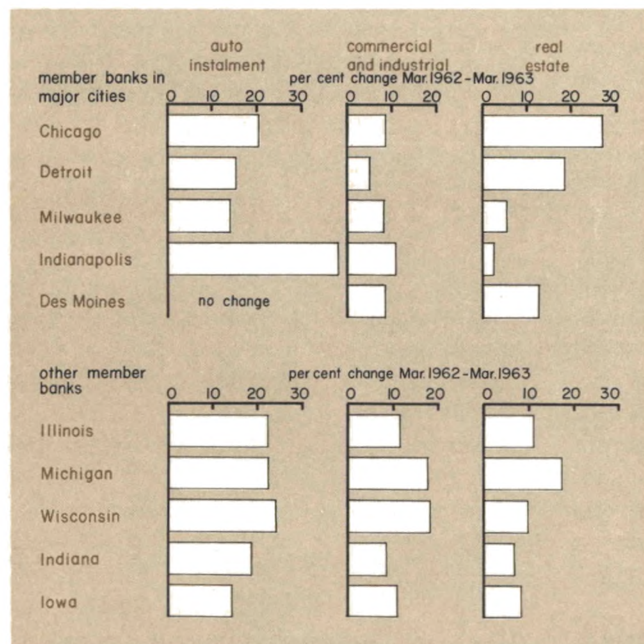
nied by higher yields in all sectors of the securities markets despite the continued rapid accumulation of investment funds and moderate volume of security issues. There is considerable evidence that much of this across-the-board increase in yields was a reflection, not of a basic change in supply-demand relationships for funds but of investors' expectations that credit supplies would be curtailed because free reserves had declined. The free reserve statistic has been interpreted by numerous observers in the press and elsewhere, as a measure of the availability of credit, that is, the ability of the banks to make loans and purchase investments. That this view is erroneous is illustrated by the experience of the past two years.

Since free reserves can be negative (when the amount of borrowing is greater than excess reserves), it should be clear that free reserves are not a measure of the amount of reserves available as a base for credit expansion. The amount of credit that can be extended in any given period depends not on free reserves nor even on the amount of excess reserves existing at the start of that period but rather on the reserves available during the period. The latter can rise (or decline) substantially with no effect on excess reserves if required reserves have changed by a like amount.

The total amount of reserves in the banking system sets limits to the amount of deposits and, therefore, the amount of loans and investments that banks can accommodate. A rise in free reserves merely indicates that banks are not using the available supply of reserves as fully as in the previous period. A fall in free reserves, on the other hand, indicates simply that unborrowed reserves were less than those needed to support deposits.

Auto loans up sharply in most District areas



The important point is that bank credit can rise rapidly in a period when free reserves decline and even when free reserves are a negative quantity. Conversely, total bank credit can decline as free reserves rise. This often happens when business activity levels off or declines with the accompanying easing of credit demands and with repayment of borrowings from the Federal Reserve Banks.

What, then, is the significance of free reserves? In periods of rapidly expanding business activity and strong demands for credit, the Federal Reserve may not pro-

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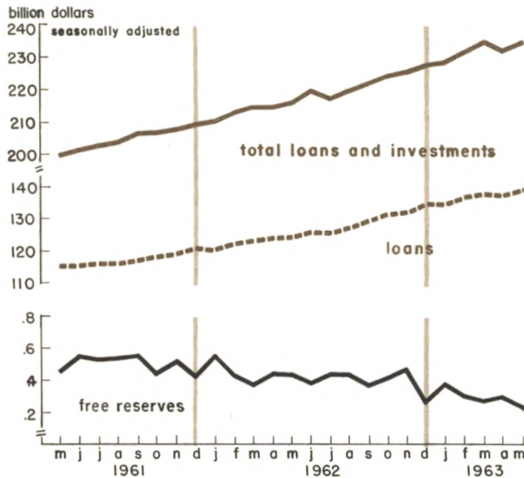
Bank credit has continued to rise while free reserves have declined



vide the full amount of reserves needed to support the continuation of rapid credit and deposit expansion. In such circumstances, the *relative* scarcity of reserves causes some banks to borrow at the discount window, thus reducing free reserves. Since such borrowing can be only a temporary source of reserves for individual banks, those that are borrowing feel pressure to expand credit less rapidly or even to reduce the amount of credit they have outstanding. This tends to be accompanied by rising interest rates.

That a falling level of free reserves does not necessarily indicate a decline in "credit availability" is illustrated by recent experience. The accompanying chart shows the movements in free reserves and bank credit over the past two years. Free reserves have declined gradually since early 1962, yet bank credit grew more rapidly after mid-1962 than before. Reflecting the strength of credit demands, loan growth was actually greatest in those months when free reserves showed the sharpest declines.

Great Lakes ports broaden Midwest links to world

The 1963 Great Lakes shipping season opened on a note of moderate optimism. Both imports and exports had risen substantially in 1962 as a wide variety of goods flowed through the St. Lawrence Seaway to and from a large number of countries. Seaway revenues, however, continued to lag behind long-term expectations, and this pattern seems certain to be maintained during 1963 despite expected further gains.

Some 877 million dollars worth of exports to Canada and overseas countries left the United States via Great Lakes ports in 1962, an increase of 17 per cent over 1961. Imports through these ports amounted to 540 million dollars, or 19 per cent more than in the preceding year. Tonnages were up 15 per cent for exports and 33 per cent for imports.

Almost half of the dollar value of Great Lakes exports and two-thirds of the imports move through Seventh Federal Reserve District ports. Measured by weight, the relative

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Exports and imports through Great Lakes ports located in the Seventh Federal Reserve District during the 1962 shipping season*

Great Lakes port	Leading commodities (million dollars)	Major sources and destinations (million dollars)
Chicago		
Exports Value—$221 million Weight—4,202 million lbs.	Corn (41), machinery and parts (27), soybeans (26), railway locomotives and parts (21), machine tools (12), hides and skins—raw (10), animal oils and fats—edible (10), all other (74).	Canada (52), Germany (28), United Kingdom (27), Netherlands (19), India (17), Italy (12), all other (66).
Imports Value—$169 million Weight—1,999 million lbs.	Standard newsprint paper (34), machinery and parts (18), distilled spirits, liquors and wines (17), rolled-finished steel mill products (13), auto trucks (11), all other (76).	Canada (39), West Germany (30), United Kingdom (28), Federation of Malaya (10), Japan (10), all other (52).
Detroit		
Exports Value—$81 million Weight—888 million lbs.	Machinery and parts (15), machine tools (15), auto trucks and accessories (10), rolled-finished steel mill products (9), auto trucks excluding parts (8), all other (24).	Argentina (13), United Kingdom (11), India (7), West Germany (7), Italy (6), Australia (5), all other (32).
Imports Value—$100 million Weight—5,029 million lbs.	Iron ore and concentrates (17), standard newsprint paper (15), rolled-finished steel mill products (12), iron-steel semi-finished products (11), all other (45).	Canada (44), United Kingdom (17), Belgium (11), West Germany (5), France (4), Japan (3), all other (16).
Milwaukee		
Exports Value—$52 million Weight—903 million lbs.	Machinery and parts (15), corn (8), dried milk (5), wheat flour semolina (4), all other (20).	Canada (8), United Kingdom (5), West Germany (5), Italy (3), Netherlands (3), all other (28).
Imports Value—$33 million Weight—489 million lbs.	Standard newsprint paper (9), barley and rye (4), rolled-finished steel mill products (3), all other (17).	Canada (15), United Kingdom (3), Belgium (2), France (2), Netherlands (2), West Germany (2), all other (7).
Saginaw-Bay City, Michigan		
Exports Value—$27 million Weight—458 million lbs.	Vegetables and preparations (7), synthetic resins (3), wheat (3), chemical specialties (3), all other (11).	Netherlands (9), Canada (8), United Kingdom (6), all other (4).
Imports Value—$10 million Weight—367 million lbs.	Pig iron (9), all other (1).	Canada (9), all other (1).
East Chicago, Indiana		
Exports Value—$1 million Weight—67 million lbs.	Iron and steel scrap (0.4), all other (0.9).	Italy (0.4), Canada (0.3), all other (0.6).
Imports Value—$17 million Weight—3,636 million lbs.	Iron ore and concentrates (16), all other (1).	Canada (15), all other (2).

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Great Lakes port	Leading commodities (million dollars)	Major sources and destinations (million dollars)
Green Bay, Wisconsin		
Exports Value—$7 million Weight—106 million lbs.	Wheat flour semolina (3), dried milk (3), all other (1).	Algeria (1), Morocco (1), India (1), Egypt (1), Italy (1), all other (2).
Imports Value—$8 million Weight—171 million lbs.	Wood pulp (6), sugar (1), all other (1).	Canada (4), Sweden (1), Finland (1), all other (2).
Racine-Kenosha, Wisconsin		
Exports Value—$8 million Weight—104 million lbs.	Auto trucks excluding parts (3), wheat flour semolina (2), animal oils and fats—edible (1), all other (2).	United Kingdom (2), Belgium (1), Netherlands (1), all other (4).
Imports Value—$4 million Weight—22 million lbs.	Auto trucks (3), all other (1).	West Germany (3), all other (1).
Marinette, Wisconsin		
Imports Value—$10 million Weight—172 million lbs.	Wood pulp	Canada
Muskegon, Michigan		
Exports Value—$3 million Weight—108 million lbs.	Iron and steel scrap (1), canned fruits except juices (1), all other (1).	Italy (0.9), West Germany (0.6), Netherlands (0.5), all other (1.2).
Imports Value—$4 million Weight—53 million lbs.	Standard newsprint paper (0.7), auto truck (0.6), wood pulp (0.5), all other (1.9).	Canada (1), United Kingdom (1), West Germany (1), all other (1).
Presque Isle, Michigan		
Exports Value—$6 million Weight—1,060 million lbs.	Iron ore and concentrates	Canada
Port Huron, Michigan		
Exports Value—$3 million Weight—38 million lbs.	Vegetables and preparations (2), all other (1).	France (0.4), United Kingdom (0.4) Algeria (0.3), all other (1.5).
Imports Value—$1 million Weight—68 million lbs.	Wood pulp (0.5), auto truck (0.3), all other (0.2)	Sweden (0.3), West Germany (0.3), all other (0.4).
South Haven, Michigan		
Imports Value—$3 million Weight—70 million lbs.	Wood pulp	Canada (1), Sweden (1), all other (1).

*April to November.

SOURCE: Based on data prepared by U. S. Bureau of the Census, as compiled by Chicago Association of Commerce and Industry.

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importance of District foreign trade via the Great Lakes is considerably less than it is by value, although the difference is not as pronounced for imports as for exports.

In the table on pages 6-7, 1962 exports and imports are listed for the District ports which dispatched or received commodities valued in excess of 1 million dollars. These comprise the great bulk of all foreign trade movements through District ports. For each port the total value and tonnage of shipments are noted as well as the leading commodities. In addition, the main buyers of exports and the principal sources of imports are shown.

Three cities—Chicago, Detroit and Milwaukee—accounted for 87 per cent of exports and 84 per cent of imports at District ports. The port of Chicago alone handled well over half of exports and nearly half of imports. While Chicago and Milwaukee were net exporters, Detroit had a net import balance.

Generally, the more foreign trade cargo handled by a port, the greater the variety in the composition of the trade. For example, Chicago's largest export commodity, corn, contributed less than one-fifth to the total value of its exports, but more than nine-tenths of Port Huron's exports consisted of one class of goods—vegetables and preparations.

On the import side, the varying degree of commodity diversification may be illustrated by Detroit and Green Bay: iron ore and concentrates, the motor car city's leading import, was less than one-fifth of the total; but wood pulp, the Wisconsin city's foremost import, accounted for more than three-fourths of the total. Extremes of specialization are illustrated by one-commodity ports: Presque Isle, Michigan, exporting iron ore and concentrates only, and Marinette, Wisconsin, importing wood pulp exclusively.

With regard to geographic orientation, exceptional is the port which ships to or receives from one country only; much more common is a wide variety of destinations and origins. Canada, the leading customer and supplier of the United States in over-all trade, was also prominent in both outbound and inbound waterborne District shipments. Canada ranked first in the imports received at almost all District ports and in the exports from two of the major ports—Chicago and Milwaukee. The United Kingdom occupied second or third place in shipments *from* the five largest and *to* the three largest ports. Several other European countries ranked high on both sides of the trade ledger.

"Big three" play major role

Chicago has two developed areas 13 miles apart that form its port. Navy Pier and docking facilities in the mouth of the Chicago River are adjacent to the downtown business district (Loop) while Calumet harbor, Lake Calumet and the river joining them are in the southeast heavy industry area. Both complexes are connected to the Illinois Waterway and Mississippi River system.

During 1962 a total of 192 ships arrived at Navy Pier from overseas and 370 ships in the Calumet area. While the downtown facilities handle general cargo almost exclusively, facilities at Lake Calumet and along Calumet River accommodate most of the bulk cargo as well as a large portion of the general cargo. Bulk cargo accounts for 95 per cent of Chicago's total tonnage.

More than 100 million dollars in public and private money has been invested in new port facilities in Chicago since the beginning of construction of the St. Lawrence Seaway in 1955. If the necessary additional funds are appropriated, the U. S. Army Corps of Engineers over a four-year period will deepen the Calumet River and Lake Calumet to 27 feet

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throughout. More than 4 million dollars has been expended in clearing the outer approaches to Calumet River.

In addition to its 41 regular-service overseas steamship companies, Chicago is presently served by 21 trunkline railroads and 20 scheduled airlines. Seven companies offer direct international service. Chicago is also the center of the greatest concentration of truck transportation in the world.

At the port of *Detroit,* a channel-deepening project by the Army Corps of Engineers was virtually completed at the end of 1962 but, unfortunately, a dispute over private versus public port development has slowed the addition of new port facilities. Detroit has 42 steamship lines providing regularly scheduled service to ports in 61 countries and is served by 11 railroads and 15 airlines.

Milwaukee is the only "big three" port whose export traffic declined in 1962. The drop-off from 1961 is attributed almost entirely to the contraction of industrial scrap shipments. These fell to about 5 per cent of total export tonnage from 43 per cent in 1961 as such large buyers as Belgium, Italy and France began to meet their requirements from scrap produced in Europe. During 1961 Milwaukee completed a six-year, 14 million dollar port expansion program; it hopes to gain increased shipment of heavy commodities such as ferroalloys and lumber products. The city is served by 33 steamship lines, three railroads and seven airlines.

Financing problems

The United States and Canada together have invested more than 460 million dollars in the seaway—the United States invested 130 million dollars—and additional hundreds of millions in improved port facilities. The initial debt had been scheduled to be paid off in 50 years, that is, by 2008. To meet the interest and amortization payments, ships using the seaway are assessed tolls for the use of the St. Lawrence River section.

In its four years of operation, the seaway has failed to produce anticipated revenues. At the close of 1962, the St. Lawrence Seaway Development Corporation (SLSDC)—the United States seaway authority—reported a net "deficit", relative to accumulated interest obligation, of more than 8 million dollars. The deficit probably will increase further in 1963.

A committee to review the seaway toll structure, appointed by the U. S. Secretary of Commerce, is to submit a report to the Secretary of Commerce by July 1, 1964, dealing with traffic forecasts, a reevaluation of developing potential markets and producing areas and other factors which may make overhauling the rate structure advisable.

A similar Canadian committee is working independently on the key questions pertaining to the successful operation of the seaway. Many Canadians are arguing for a reduction in toll rates. Canada is much more dependent on the seaway for getting her raw materials into the world markets than is the United States with its many alternative means of transportation.

The administration of the SLSDC regards refunding its debt as preferable to higher tolls. As a result, the governments of the two countries sharing the seaway may later be asked to refund their seaway debts at lower interest rates and to extend the maturities of the principal. If the United States and Canada should become deadlocked over the toll question, Canada could quite easily develop her own seaway by building an additional lock in the Great Lakes.

The outlook

Undoubtedly, the seaway will continue to

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be beset by important problems. It has failed to attract as much traffic in high-value goods as had been expected. Bulk shipments of grain also have not met early expectations. However, the great variety of products passing through the seaway and the large number of countries to which Midwest exports are moved and from which imports originate indicate that the seaway will play an increasingly important role in linking the Midwest even closer to markets throughout the world.

The patterns of personal income

The postwar rise in personal income provides striking evidence of the continued expansion of the American economy. It has made possible the stable growth in consumer purchases that has played a large role in preventing downturns in activity from developing into full-scale depressions.

At the present time personal income is at an annual rate of about 460 billion dollars compared with 189 billion in 1947. Throughout the period income grew at a compounded annual rate of almost 6 per cent. Of course, part of the increase reflected higher prices and part rising population. After adjustment for these factors, it appears that per capita personal income rose almost 2 per cent a year during the postwar period.

Personal income in the United States dur-

What is personal income?

Personal income, estimated monthly by the Department of Commerce, is the income received currently by individuals, unincorporated businesses and nonprofit institutions (including pension, trust and welfare funds). It consists of wages and salaries; other labor income (mainly employer contributions to pension, health and welfare funds); profits of unincorporated businesses and farms; dividends; interest and rents and transfer payments from government or business for which no service is rendered currently (mainly social insurance benefits, military pensions and relief). Personal income is the total of these components less individual contributions to social insurance funds.

About 95 per cent of personal income is received in money; the remainder is imputed. The principal imputations consist of the rental value of owner-occupied dwellings net of depreciation, taxes and maintenance; payments "in kind," such as employer-furnished meals, clothing and lodging; food and fuel raised and consumed on farms and "free" services furnished by financial institutions. Neither capital gains nor transfers from one person to another—such as gifts, insurance payouts and private pensions—are included in personal income. The theory is that such payments increase the total resources of individuals but not of the whole population.

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ing 1962 is estimated at $5,024 per full-time employee. Since many families contain more than one individual with an income, average income per family was $7,140. On a per capita basis, personal income has set a new record each year since 1954 and averaged $2,357 in 1962.

New highs also were reached last year in each of the states of the Seventh Federal Reserve District. During the 16-year period 1947-62, total personal income more than doubled in the District. However, the percentage gain was somewhat less than in the nation. Partly, this is because population growth was slower in most of the District states.

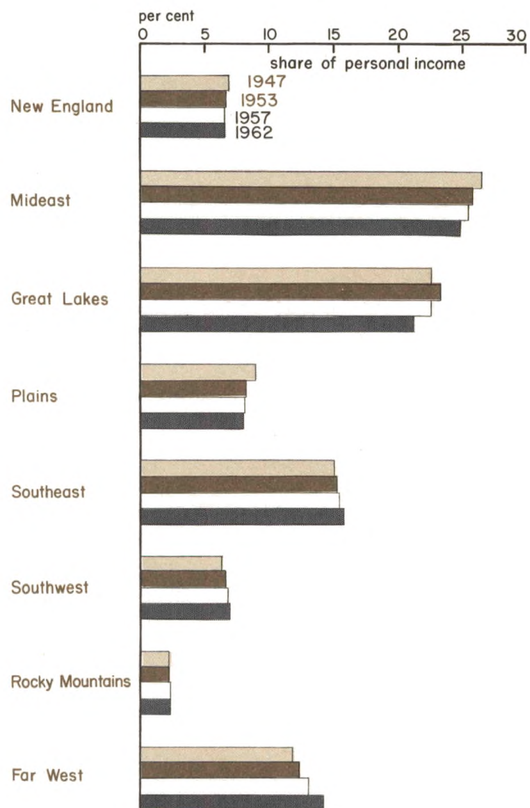
In the table on page 13 changes in income and population in this area are compared with the United States for three segments of the postwar period. Each time period selected begins and ends with a year of relatively high business activity. Also, 1947 was the first year of fairly "normal" production after World War II; 1953 marked the high tide of the Korean upswing, and 1957 saw the culmination of the capital spending boom of the mid-Fifties.

Income shifts

During the postwar period all states and regions of the United States have had substantial and more or less continuous increases in personal income. But the relative rates of growth of income have shifted appreciably.

In general, the states of the Southeast, Southwest, Rocky Mountains and West Coast have obtained larger shares of total income while the shares of the rest of the nation, including the Midwest, have declined. Two principal, interrelated factors—the rate of population growth and the rate at which primarily agricultural states have been industrialized—have been at work leading to accelerated gains in personal income.

Midwest share of personal income has declined since 1953



The basic pattern of the geographical shift in income outlined above was apparent in most regions for many years prior to the postwar period. For example, the Far West, led by California, accounted for about 9 per cent of total personal income in 1929. By 1947 this share had increased to 12 per cent and it rose to more than 14 per cent in 1962. At the other extreme, the mideastern states, including New York and Pennsylvania, accounted for 32 per cent of total personal income in

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1929, 27 per cent in 1947 and less than 25 per cent in 1962.

The share of personal income accounted for by some regions has not followed a steady path. For New England, the proportion of the nation's income, after declining for many years, has been quite stable since 1957. At about the same time, in the Southwest, where Texas is the largest state, a long rise in the proportion of income was halted, at least temporarily.

Increases in total personal income have not always been accompanied by increases in average income per capita. In the fastest growing region, the Far West, per capita income remains considerably higher than the national average, but the margin is lower now than in the early postwar period. On the other hand, per capita income has risen substantially in the Southeast relative to that of the nation, although it remains well below the average, as the area has industrialized.

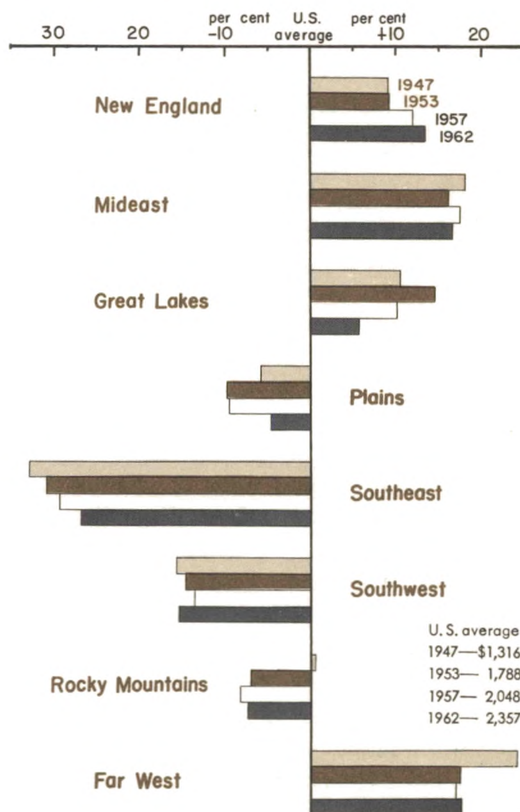
At present, Illinois is the only Seventh District state with per capita personal incomes well above the national average. In 1962 it was $2,830 or 20 per cent above the average. This is because the Chicago area, like other large cities, includes a heavy proportion of relatively high-paid executives, professional people and skilled factory workers.

In Michigan, incomes were substantially above the national average from the end of World War II to the mid-Fifties. Since then, there has been a relative decline in incomes largely as a result of changes in the automotive industry in volume of output, degree of automation and location of new facilities. In 1962 per capita income in Michigan was $2,353, 2 per cent above the nation.

Iowa, the District state most influenced by agricultural income, has seen sharp fluctuations in its share of total personal income. Peaks were reached in the high farm income years of 1948 and 1954 but per capita income was 7 per cent below the national average in 1962. In Indiana and Wisconsin the share of total personal income has been fairly stable in recent years at a level slightly below the nation.

The regions shown in the accompanying charts were selected by the Department of Commerce for analytical purposes. Illinois, Indiana, Michigan and Wisconsin are included in the "Great Lakes" region along with Ohio. Iowa is included in the "Plains"

Per capita income
in the Great Lakes area remains
above national average



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Midwest states gain less rapidly than the nation since the war

	1947-53	1953-57	1957-62	1947-62
Personal income		(per cent change)		
United States. .	+50	+23	+26	+132
Illinois.	+44	+22	+20	+110
Indiana.	+63	+15	+20	+125
Iowa.	+38	+24	+20	+105
Michigan	+64	+17	+13	+117
Wisconsin.	+49	+20	+24	+122
Population				
United States. .	+11	+8	+9	+29
Illinois.	+7	+7	+6	+22
Indiana.	+11	+8	+4	+25
Iowa.	+5	+4	+1	+11
Michigan	+12	+11	+6	+32
Wisconsin.	+8	+9	+8	+26
Per capita personal income				
United States. .	+36	+15	+15	+79
Illinois.	+34	+14	+13	+73
Indiana.	+47	+6	+16	+81
Iowa.	+31	+20	+18	+85
Michigan	+47	+5	+7	+65
Wisconsin.	+38	+10	+16	+76

region where farm income is relatively larger than in the states east of the Mississippi.

Sources of personal income

The postwar period has brought changes in the proportion of personal income derived from various sources. For the most part these shifts represent a continuance of trends in evidence since the late Twenties.

In 1929 only 60 per cent of all personal income was accounted for by wages and salaries and employers' contributions to private pension funds and similar fringe payments. By 1947 this proportion was about 65 per cent and in recent years about 70 per cent.

Within the wage and salary component of personal income, the most significant change has been in the government category, including civilians and the armed forces. The proportion of government wages and salaries to all wages and salaries rose from less than 6 per cent in 1929 to 13 per cent in 1947 and increased further to 19 per cent in 1962.

Income from payments such as social security, welfare and unemployment compensation — transfer payments — was less than 2 per cent of the total in 1929 but rose to 6 per cent in 1947 and 8 per cent in 1962.

The relative rise in wages and salaries and transfer payments has been accompanied by a decline in the share of income accounted for by the net earnings of farms and unincorporated, businesses and property income from rents, dividends and interest. But trends in these segments have not been steady. The proportion accounted for by property income dropped from 22 per cent in 1929 to 11 per

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cent in 1947 but by 1962 recovered to 13 per cent.

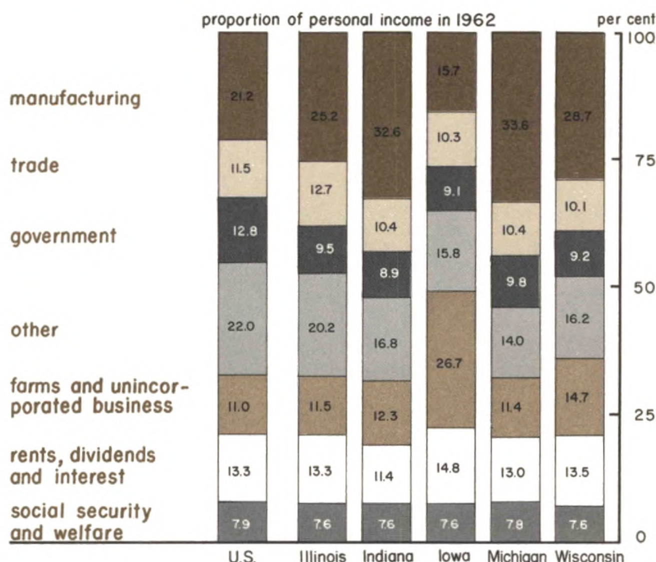
Proprietors' income for both farmers and other unincorporated businesses was a somewhat higher proportion of total personal income in 1947 than in 1929. In fact, farm proprietors' net income was at a peak both absolutely and relatively in 1948 when it was 8 per cent of the total. By 1962 this proportion had declined to 3 per cent. Other proprietors' share dropped from 11 per cent to 8 per cent during the same period.

When the decline in proprietors' income and property income is considered, it should be remembered that capital gains are not included in these estimates. Many owners of farms, small businesses, stocks and real estate have benefited from substantial increases in wealth resulting from the rise in the prices of these assets. Whether or not gains have been realized in cash, they are not counted as personal income.

Sources of income in Iowa differ most among the District states from the national pattern. Only a little over half of Iowa personal income comes from wages and salaries. Income from farms and unincorporated businesses is more than twice as large relatively in Iowa as in the nation.

Within the wages and salaries component of personal income, District states have a somewhat smaller proportion accounted for by government wages and salaries than the rest of the nation. Manufacturing wages and salaries are relatively more important in all District states except Iowa than in the nation. In Indiana and Michigan one-third of all personal income is obtained from factory wages and salaries compared with about one-fifth for the nation as a whole.

Factory earnings largest source of personal income in all District states except Iowa



1963 and beyond

Developments thus far in 1963 suggest that personal income will be about 5 per cent higher than last year. After adjustments for population growth and higher prices, the rise in per capita "real" income probably will be about 2 per cent or slightly above the national average for the postwar period. In the Midwest the current trend in income is about in line with the national picture.

What of the future? Available evidence points to a continuance of the steady uptrend in personal income in the years ahead. In fact, many analysts foresee an improvement in the economic growth rate during the next five or ten years. Increases in activity are not likely to be hampered by material or

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manpower bottlenecks, and vast opportunities exist in the exploitation of recent scientific and technological advances in the production of goods and services.

There seems to be no reason to expect appreciable changes in the proportion of income received from various sources in 1963 or subsequent years. If the pattern of income distribution since World War II has contributed to stability and growth, it can be expected to continue to do so in the future.

The Seventh District now accounts for a somewhat smaller proportion of total personal income than in earlier postwar years when backlogs of demand for durable goods were being filled. But such trends are not irreversible. The advantages of location and availability of materials and skilled manpower that enabled the Midwest to grow more rapidly than the nation in some periods of the past continue to be vital factors in any evaluation of prospects for the region.

Defense of the dollar — a Midwest view

A speech by Charles J. Scanlon, President, Federal Reserve Bank of Chicago, before the annual meeting of the Indiana Bankers Association, French Lick, Indiana, June 13, 1963.

In 1962, for the fifth year in a row, the United States had a sizable deficit in its balance of international payments. So what! Here in the Midwest, and close to the population center of the nation, is it of any real concern that last year Americans spent, invested, loaned and gave away abroad more than other countries spent, invested or loaned in the United States?

One's natural instinct may be to say: "No, the problem is far removed from us." But we all know that is unrealistic.

In the early postwar years, while the United States was engaged in a massive foreign aid program to help get Europe and Japan back onto their feet economically, it was reasonable that we operate with a deficit in our balance of international payments. This helped to rebuild the reserves of European countries and, along with the recovery of their productive potential, enabled the industrial nations of the free world to move more rapidly toward freer trade and convertible currencies.

But as the United States has continued to run deficits in its balance of payments with the rest of the world, we have, in a sense, acquired a large "demand" liability.

Deficit causes gold loss

The amount of the deficit, as measured in our system of accounting, is the rise in foreign liquid dollar claims plus our net sales of gold to foreign countries. (A small offset occurs in the form of any increase in our holdings of foreign convertible currencies.) Last year, this deficit amounted to 2.2 billion dollars and in the past five years a total of nearly 16 billion. Of this amount, nearly 7 billion is reflected in the decline in United States holdings of monetary gold and about 9 billion in a rise in foreign liquid dollar claims.

When foreign firms and individuals acquire more dollars than they desire to hold, the excess is converted into other currencies. In this process the dollars gravitate to foreign central

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banks and treasuries which can use the dollars to purchase gold from the U. S. Treasury if they desire to do so. As their holdings of dollars rise, foreign central banks tend to convert more of them into gold. Also, at any time the confidence in the future value of the dollar is shaken, the demand for gold rises.

In each of the past two years the United States gold stock declined by roughly 1 billion dollars. Our total monetary gold stock is now somewhat less than 16 billion dollars. Of this amount, roughly 12 billion is held as reserve for the deposit and note liabilities of the Federal Reserve Banks.

This reserve requirement can be suspended by action of the Board of Governors of the Federal Reserve System, or reduced or eliminated by action of the Congress. One or more of these actions presumably would be taken, if needed. But this would not provide any lasting solution for the payments deficit. At best, it would provide additional time to bring our current international transactions into balance.

The necessity for a shift in posture with respect to our balance of payments began to be recognized in 1959. In 1958, after a small surplus in 1957—attributable largely to the surge in exports as a result of the Suez crisis—the United States ran a deficit of 3.5 billion dollars in its international payments. Our gold reserves declined more than 2 billion dollars. In 1959 and 1960 the deficits were somewhat larger than in 1958 but the outflow of gold was smaller.

By the latter part of 1959 it was clear that additional steps were required to curb the deficit in our international payments and stem the build-up of foreign liquid dollar claims. The postwar shortage of dollars as a reserve currency had been largely filled, at least for the time being. European currencies were now convertible and, as confidence in these currencies rose, the dollar weakened in some exchange markets. Occasionally the dollar declined to levels requiring intervention by foreign central banks in order to hold their currencies within the range prescribed by the International Monetary Fund.

It may be recalled that in October 1960 the dollar was sold heavily and there was a surge of gold buying on the London market at prices far above the United States price of approximately $35 an ounce. This brought the problem into clear focus. Greater effort had to be directed toward resolving the balance of payments deficit.

Before discussing the actions that have been taken to help deal with this problem, it will be helpful to review briefly the structure of the United States international payments and receipts.

Structure of the balance of payments

The United States exports substantially more goods than it buys abroad. The net balance in our favor on commercial merchandise trade in 1962 was about 2 billion dollars—with exports of 18.3 billion and imports of 16.2 billion. In addition, we had 2.3 billion of Government-financed merchandise exports for a total balance on trade of about 4.4 billion dollars.

We also had a net balance in our favor in another broad category of transactions which are lumped together under the general heading, services. This includes, for example, shipping, insurance, tourist expenditures, and the like. Included also are two items which merit specific mention. One is the income from private foreign investments—3.7 billion dollars. The other is the outgo in the form of military expenditures abroad—about 3 billion dollars.

Over-all, "services" showed a small net balance in favor of the United States. On trade and services combined, then, the United States had a net balance of about 4.8 billion dollars.

Another important group of transactions includes the grants and capital flows.

Government grants and loans provided a net capital outflow of about 3 billion dollars.

Private capital transactions also resulted in a net outflow of about 3 billion dollars, of which 1.4 billion was net direct private investment abroad, largely in industrial and commercial facilities. A somewhat smaller amount was for long-term portfolio investment. Included in this

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is the purchase by Americans of bond issues floated by foreign firms and governments in the United States capital markets as well as purchase of stocks and bonds on foreign exchanges and the making of long-term loans abroad. (It may be of interest to note that the inflow of foreign long-term capital for investment in this country totaled about 1 billion dollars and the outflow of dollars for remittances and pensions abroad was on the order of 900 million.)

Over-all, the grants and capital category accounted for a net outflow of nearly 6 billion dollars.

In addition, there was a net outflow of nearly a billion dollars in other transactions, about which very little is known.

The over-all deficit, therefore, as noted at the beginning of my remarks, was about 2.2 billion dollars.

Furthermore, and this is important, in the absence of some special transactions, including prepayment of debt by France, Sweden and Italy, borrowing of foreign currencies against non-negotiable bonds by the U. S. Treasury, Germany's allocation of funds for military purchases in the United States, and United States subscriptions to international financial institutions, the deficit in the United States balance of international payments would have been around 3.7 billion dollars, or somewhat greater than in 1961.

Although we had a sizable surplus on trade and sizable deficits on grants, capital and unrecorded transactions, it is not possible to pinpoint the specific sources or causes of the balance of payments deficit. Both the receipts and the payments include a multitude of transactions and the deficit is the net result of all transactions, not just one or a few in isolation.

Balancing the account

The export surplus on goods and services has not been great enough to cover the net outflow of private capital and Government expenditures on foreign military and economic aid programs. But this does not lead to the conclusion that reducing our foreign military expenditures by, say, a billion dollars would reduce our deficit by the same amount. Presumably most of the dollars acquired abroad under such programs are used to pay for United States exports. Therefore, our surplus on exports would be expected to decline, although probably by less than a billion dollars, hence, leaving some net improvement in the payments balance.

Successive administrations and congresses have reviewed our foreign military and aid expenditures and concluded that for the present at least these programs are necessary. Individuals may agree or disagree with these findings. But in the absence of a larger cut-back in U. S. Government spending abroad, it has been concluded that balance should be achieved, if possible, by boosting exports.

Another possibility is to restrict the freedom of Americans to invest and travel abroad or the freedom of other countries to borrow from our banks or issue securities for sale in our capital markets. But private investment abroad increases future earnings of foreign exchange and any move to provide arbitrary restrictions on capital flows would be inconsistent with the role of the United States dollar as a key reserve currency and with our basic international objective of encouraging relatively free trade. Such action by us probably would cause some foreign holders of dollar assets to lose confidence in the dollar as a freely convertible reserve currency with resulting increase in the outflow of gold. Likewise, it probably would cause some Americans to place more funds abroad, anticipating that such restrictions on transfers of capital might be tightened in the future.

Our Government's policy, therefore, includes the promotion of exports by United States business, efforts to get restrictions against imports of American goods removed abroad, and encouragement of further development and freeing-up of capital markets outside the United States. These moves are consistent with our basic international economic policy. But since

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they require time to become effective, even if implemented successfully, a number of interim measures have been taken to help safeguard the dollar internationally while these basic shifts are accomplished.

Beginning in 1959 foreign aid provided through the Development Loan Fund was "tied", that is, the dollars had to be spent on goods purchased in the United States. In the summer of the same year the Secretary of the Treasury and Undersecretary of State (for Economic Affairs) visited Europe and urged such countries as Germany, France and Italy to assume part of the cost of extending aid to underdeveloped areas and to step-up their procurement of military hardware from the United States. United States officials have also urged countries that restrict access to their capital markets by foreign borrowers, especially those countries that have acquired large reserves of foreign exchange, to remove such restrictions. Negotiations to reduce restrictions against imports of American goods are being continued.

Meanwhile, domestic policies have been shaped to help moderate the pressures on the dollar. The Federal Reserve System has adapted its monetary policies in response to the payments deficit. While providing ample reserves to commercial banks to encourage and support expansion in domestic business activity, short-term interest rates have been supported so as to minimize large flows of funds abroad in search of higher interest rates.

Undoubtedly, some of the liquidity provided to encourage domestic economic expansion has spilled abroad and worsened our payments situation. Also, an even easier monetary policy might have provided some additional stimulus to domestic business, although possibly at the cost of unsound speculative activity in securities and real estate markets. The problem has been to achieve proper balance.

That credit has been, and is, readily available is seen in the near-record rise—19 billion dollars—in the total bank credit last year and the slow downward drift of interest rates on mortgages and some other long-term credits.

Short-term interest rates, as indicated by yields on 90-day Treasury bills, have been held within the relatively narrow range of about 2.6 to 3 per cent (slightly higher in recent weeks). This was accomplished by a large amount of Treasury borrowing in the short end of the market, Federal Reserve open market purchases of securities of intermediate and long maturities, reduction of reserve requirements applicable to member bank deposits, raising the maximum permissible interest rates on time deposits and suspension for three years of the interest rate ceiling on time deposits of foreign official institutions. These actions helped to limit short-term flows of funds abroad.

But with large foreign holdings of liquid dollar claims, it is possible for the dollar to come under severe pressure at any time and for large and erratic demands for gold to develop.

Stabilizing the exchange market

The U. S. Treasury had begun limited operations in foreign exchange in March 1961, following the flight from sterling after revaluation of the German Mark and Dutch Guilder.

In February 1962 the Open Market Committee of the Federal Reserve System authorized transactions in foreign currencies, utilizing resources of the Federal Reserve System. These operations are undertaken to prevent disorderly movements in the rates at which the dollar is traded for other currencies and to cushion speculative flows of volatile capital which might cause gold losses that would tend to undermine confidence in the dollar.

The foreign currencies operations of the Treasury and the Federal Reserve are closely coordinated. All the transactions are conducted by the New York Reserve Bank as agent for the Treasury and the Open Market Committee of the Federal Reserve System.

One difficulty in initiating the operations was the absence of any significant inventory of foreign currencies, since the United States, unlike most other countries, had held its reserves entirely in gold. Initially, the Federal Reserve

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purchased small amounts of some currencies from the Stabilization Fund of the Treasury and opened, or reactivated, accounts with the foreign central banks responsible for these currencies.

Later the System entered into swap arrangements with foreign central banks and the Bank for International Settlements. Under these arrangements a central bank agrees to exchange on request its own currency for the currency of another country up to some predetermined amount over a specified period of time.

The general outline of such arrangements may be described as follows, although the details of individual agreements vary somewhat.

1. A swap constitutes a reciprocal "line of credit" under which a central bank agrees to exchange on request its own currency for the currency of the other party up to a maximum amount over a limited period of time, such as three months or six months.

2. If such a standby swap between the Federal Reserve and the Bank of England, for example, were to be drawn upon by the Federal Reserve, the Federal Reserve would credit the dollar account of the Bank of England with 50 million dollars at a rate of, say, $2.80 to the pound while obtaining in exchange a credit on the books of the Bank of England of about 18 million pounds. Both parties would agree to reverse the transaction on a specified date, say, within three months, at the same rate of exchange, thus providing each with forward cover against the remote risk of a devaluation of either currency.

3. The foreign currency obtained by each party as a result of such cross credits to each other's accounts would, unless disbursed in exchange operations, be invested in a time deposit or other investment instrument, earning an identical rate of interest of, say, 2 per cent and subject to call on two days' notice.

4. After consultation with the other, each party would be free to draw upon the foreign currency acquired under the swap to conduct spot transactions or meet forward exchange obligations.

5. Swap arrangements are renewable upon agreement of both parties.

By the end of last year swap arrangements had been entered into with the central banks of eight major European countries, with the Bank for International Settlements in Basle, Switzerland, and with the Bank of Canada, for a total of 900 million dollars. Since then, the swap network has been further enlarged to cover an additional European central bank and a total amount of 1,500 million dollars.

At present, actual use of the reciprocal credit lines either by the Federal Reserve or the other countries amounts to only a minor fraction of the total facilities available. The Federal Reserve's net debtor position was 61 million dollars as of the end of April.

It would be erroneous, therefore, to assume that the United States has been building up a staggering debt position vis-a-vis the foreign central banks. But it has established a network of arrangements which enable the various countries to utilize currencies of other countries on a moment's notice to support existing official rates of exchange.

In the meantime the *Treasury* has widened the scope of its foreign exchange operations through a series of short- and medium-term *borrowings*. These began before the end of 1962, but did not assume substantial dimensions until January of this year. During that month over 300 million dollars in special nonmarketable Treasury securities were sold to Germany, Switzerland, Canada and Italy. The securities are redeemable in the currencies of the respective countries. Interest rates have been around 3 per cent and maturities between one and two years.

By June 1 the Treasury had borrowed something over 600 million dollars in this way. These Treasury issues provide foreign countries with an advantageous investment for balance-of-payments surpluses which might otherwise raise their dollar reserves above traditional or legal limits and hence be sold to the U. S. Treasury for gold.

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The funds acquired through these new arrangements have been used in System and Treasury operations to minimize disturbing fluctuations in both spot and forward exchange markets and to reduce the flow of dollars into foreign official reserves. By mopping up temporary pools of dollars, large short-term drains on the gold stock of the United States are minimized—drains which might initiate large speculative runs on the dollar.

Another facet of the current international monetary arrangements is the almost continuous consultation that takes place in the regular meetings of the Bank for International Settlements and the Organization for Economic Cooperation and Development. There are contacts at both the technical and official levels. These assure that each country is aware of possible repercussions of any actions it may take.

One result of this type of international cooperation is the development of a "gold pool," which came into being early in 1961. Managed by the Bank of England, it operates in the London gold market, absorbing or releasing gold when the price tends to fall below or rise above certain levels. The participating central banks share in these transactions on a pro rata basis. In dampening speculation in gold, the "pool" hopefully serves as a shock absorber and helps to stabilize currencies. If wide fluctuations in gold prices can be prevented, the prestige of convertible currencies is enhanced.

Supporting these first lines of defense of the convertible international currencies are the borrowing arrangements provided for member countries of the International Monetary Fund. These arrangements were supplemented last fall by a special agreement between 10 major industrial countries which made available to the fund up to 6 billion dollars of additional reserves in case of need. The United States share in these standby facilities amounts to 2 billion dollars. If the dollar were to come under serious and sustained pressure, threatening the entire international monetary system, the United States could draw on a substantial amount of convertible currency reserves from this source as well.

Conclusion

It must be emphasized that—valuable though they may be, especially in emergencies—none of the dollar defense arrangements discussed here go to the root of the problem of how to bring our foreign receipts and payments into balance. No Federal Reserve or Treasury official concerned with these defensive arrangements has any illusions on this point. These arrangements are no substitute for actions to correct basic imbalances in the international payments of the various countries. But it is equally recognized that such defenses against speculation and other short-term flows can, and do, provide a margin of time during which appropriate policy solutions can be developed and carried out in an orderly manner.

In the final analysis, we must be sufficiently competitive in world markets so that we earn abroad enough to finance our foreign expenditures, investments and grants. Our goods and services must compete effectively with those offered by foreign producers—in our domestic market, in the home markets of producers abroad and in third countries where the products of United States and foreign firms meet on "neutral" ground. This requires that our factories, farms, transportation and financing be highly efficient. Wage and price policies are especially important. Featherbedding, whether by labor, management, farmers, government workers, school teachers or others, must be tossed overboard. Any benefits of higher wages or prices are temporary and illusory if the result is lost markets, reduced profits or rising unemployment. Our goal must be efficient as well as full use of resources. Herein lies the long-run answer to the United States balance of international payments as well as many other economic problems. Monetary and fiscal policies can facilitate the making of the necessary adjustments but alone they cannot solve the problem. This we, as responsible citizens, must bear in mind as we participate in the making of domestic monetary, fiscal, wage and price policies, in both the private and public sectors.

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