

THE UNPLEASANT
ARITHMETIC
OF BUDGET
AND TRADE DEFICITS

	Budget Deficit	Trade Deficit (or surplus)
1980	-61 bil.	+32 bil.
1981	-64 bil.	+34 bil.
1982	-146 bil.	+26 bil.
1983	-176 bil.	-6 bil.
1984	-170 bil.	-59 bil.
1985	-198 bil.	-79 bil.
1986	-205 bil.	-105 bil.

THE UNPLEASANT ARITHMETIC OF BUDGET AND TRADE DEFICITS

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“The Unpleasant Arithmetic of Budget and Trade Deficits,” the title of our 1986 *Annual Report*, was selected to attract attention. This choice was intentional, for the relation between the foreign trade and federal budget deficits is seldom acknowledged and poorly understood. As a consequence, it is appropriate, and perhaps essential, that further analysis be devoted to this issue.

In this essay we argue that the budget deficit, while regarded in some quarters as rather benign, is in fact a principal cause of the trade gap and the sectoral problems in our domestic economy that have accompanied it. We demonstrate, moreover, that satisfactory correction of the trade imbalance requires sustained reductions in the budget deficit. Other proposed solutions to the trade problem—protectionist legislation and accommodative monetary policy—are either doomed to failure or likely to prove exceedingly costly. Indeed, although the trade deficit is a serious problem, it may in fact be the best way we have of dealing with persistent imbalances in our fiscal affairs.



Gary H. Stern
President



THE UNPLEASANT ARITHMETIC OF BUDGET AND TRADE DEFICITS

The United States foreign trade deficit continues to rank near the top of disturbing economic issues. A number of explanations for the trade imbalance have been proffered, including unfair trade practices abroad, the dollar's high international value, financial problems of some large developing countries, and sluggish growth elsewhere in the industrial world. Depending on the explanation selected, alternative remedies have been proposed. Much of the discussion to date, though, has failed to consider the mix of macroeconomic policies—that is, fiscal and monetary policies—in contributing to the recent trade imbalance.

With a few exceptions, little is understood of the relationship between federal government budget deficits and trade deficits. Consequently, solutions to our trade deficit tend to emphasize policy measures that are either impotent or very costly. Typical recommendations include protectionist policies to reduce imports without regard to how our trading partners might respond, or accommodative monetary policy to reduce the dollar's international value without considering its domestic value. These recommendations ignore the consequences of reducing the trade deficit without a corresponding reduction in the budget deficit.

The unpleasant arithmetic of budget and trade deficits shows that, with aggregate savings fixed, large budget deficits inevitably will be accompanied by foreign trade deficits or a slowing in domestic investment. Further, improvement in the trade balance, if achieved without comparable reductions in the budget deficit, may not necessarily be beneficial. If, for example, improvement comes through import restrictions, it will simply result in growing weakness in private investment. And while accommodative monetary policy may drive down the international value of the dollar, it is not clear that this development, in and of itself, will lead to a significant improvement in the trade balance. In fact, if the economy is at full employment so that aggregate savings are fixed, accommodative monetary policy could worsen the trade balance.

In this essay we first review economic performance over the past several years with reference both to the effects of large budget deficits and to the growing trade problem. The initial question is whether those concerned that outsized budget deficits would “crowd out” domestic investment were simply “crying wolf.” We find that they were not, but that their concern was misplaced. Instead of reducing domestic investment, these deficits appeared to reduce net exports. We demonstrate this other type of crowding out by introducing a basic GNP accounting identity. This identity, along with some standard economic assumptions, has a significant implication for reducing the trade deficit: reduction in the budget deficit is essential to satisfactory resolution of the trade gap. We then contrast this conclusion with two alternative remedies to the trade problem, namely protectionism and monetary accommodation, and argue that both are seriously flawed.

Crowding Out or Crying Wolf?

For the past five years, persistently large federal budget deficits to many observers have been among the most troubling aspects of the economy. According to conventional analysis, these massive budget deficits would result in inordinately high real interest rates as the government’s demand for funds collided with private financing requirements. In the process, high real interest rates would crowd out private financing. Following this line of reasoning, residential construction, business investment in plant and equipment, and perhaps consumer spending on durable goods would be hard hit by the stance of fiscal policy, especially if monetary policy was nonaccommodative. Moreover, it was anticipated that with these large sectors remaining sluggish, the overall expansion would be subdued.

Although the federal government deficit increased to over \$200 billion by 1986, these dire predictions did not come true. Real interest rates did rise, but consumer spending on durables increased steadily and substantially through the expansion, and housing activity was strong. A marked pickup in business plant and equipment spending occurred as well, at least during the first three years of the expansion.

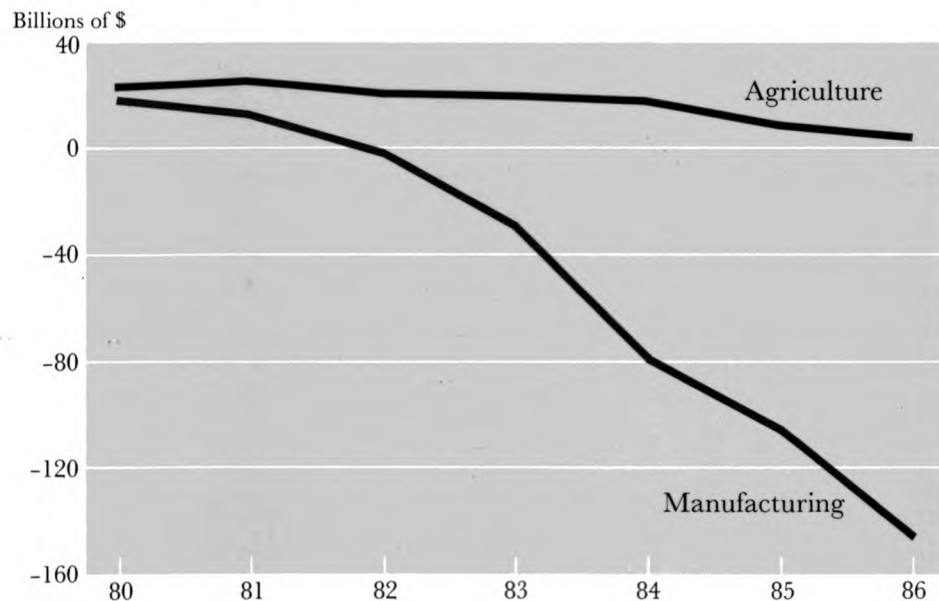
The economy’s overall growth, too, surpassed expectations. It expanded uninterruptedly from 1983 through 1986 at a 4 percent annual rate, with growth in the first two years of the expansion averaging a robust 5.6 percent per annum. Over the whole period, total employment climbed about 12 million workers. Market interest rates dropped perceptibly and inflation was subdued, averaging just over 3 percent.

These relatively favorable statistics do not mean that large budget deficits had no adverse consequences for economic performance, although identification of the effects of the budget deficits was sufficiently difficult that those who have expressed concern appear to have been crying wolf. But a component of economic activity that clearly has not fared well as the expansion has proceeded is the foreign trade balance: the difference between U.S. exports and imports. Over the four-year period ending with 1986, goods and services produced abroad and imported into the United States rose by an estimated \$176 billion. During this same period, exports gained only \$45 billion, so the trade balance deteriorated by \$131 billion.

Within this deterioration in the trade balance, two sectors in particular stand out. While the U.S. agricultural trade balance is still in surplus, it has diminished significantly in recent years, falling from over \$18 billion in 1983 to just over \$2 billion in 1986. Thus, agriculture has contributed about \$16 billion to a worsened trade situation over the past four years (see chart 1).

Serious deterioration occurred as well in manufacturing, especially in low-technology. (Low-tech manufacturing includes non-

*Chart 1 U.S. Balance of Trade of Manufactured and Agricultural Goods, 1980-1986
(Exports less Imports)*



Source: Bureau of The Census, U.S. Department of Commerce

electrical machinery, some fabricated metal products, household appliances, autos, ships, and railroad equipment. High-tech includes production of electronic components, computers, aircraft, and defense equipment.) Not unexpectedly, low-tech is an area where the United States has run a trade deficit for years. The deficit recently has widened materially. In high-tech manufacturing a trade surplus persists, although it has narrowed perceptibly over the past few years.

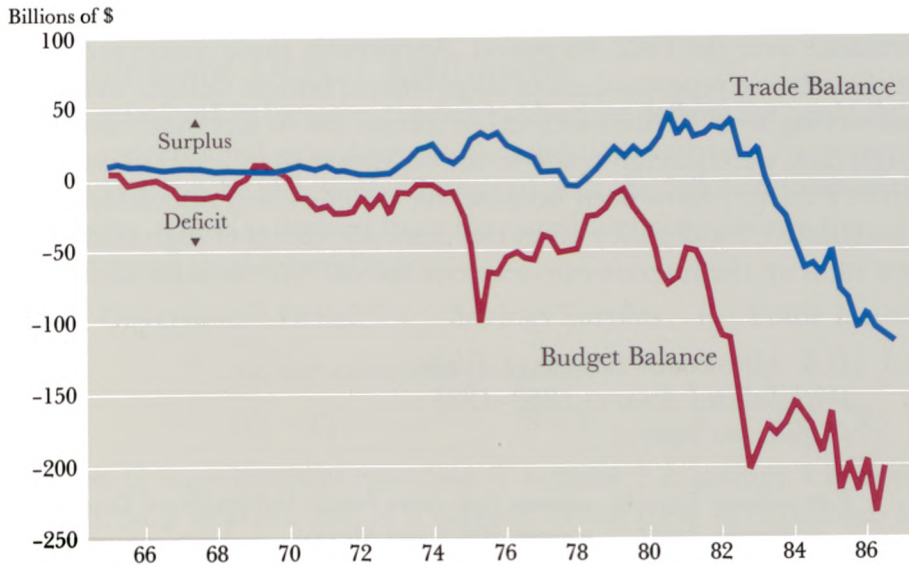
The decline in manufacturing trade is reflected in both employment and output statistics. Employment in manufacturing declined by more than 300,000 workers between the middle of 1984 and the end of 1986, and expansion in industrial production in the United States slowed to an annual average rate of 1.5 percent in 1985 and 1986, down dramatically from the pace of the first two years of the expansion.

Root Causes

Enormous trade deficits have accompanied the large federal budget deficits (see chart 2). This fact does not necessarily mean that budget deficits are responsible for the trade problem. Indeed, several other determining factors are commonly cited for the pronounced deterioration in our trade balance in the 1980s. One such factor is the marked appreciation of the dollar relative to many other currencies, as it made U.S. goods relatively expensive domestically and around the world. Another factor is robust growth in our domestic demand compared with sluggish expansion abroad—particularly in much of Western Europe and Japan—as our domestic market pulled in products from around the world. Finally, a third frequently cited factor is curtailed demand by those developing countries with international debt problems, particularly those that formerly represented large markets for us.

Although a useful description of some of what has happened in the world economy in the 1980s, these explanations of our trade problem—relying as they do on either the relative value of the dollar, slow growth elsewhere in the industrialized world, or special financial problems of some developing countries—do not get at root causes. For it is the mix of fiscal and monetary policies pursued by countries around the world that ultimately affects interest rates, exchange rates, and domestic growth; these variables are not independent of policy fundamentals. That is, it is fiscal policy—government spending and tax policies—and monetary policy that are relatively exogenous to the economic process and that determine, at least in part, economic performance.

Chart 2 *Dual Deficits*
Quarterly, 1965-1986



Source: Bureau of Economic Analysis, U.S. Department of Commerce

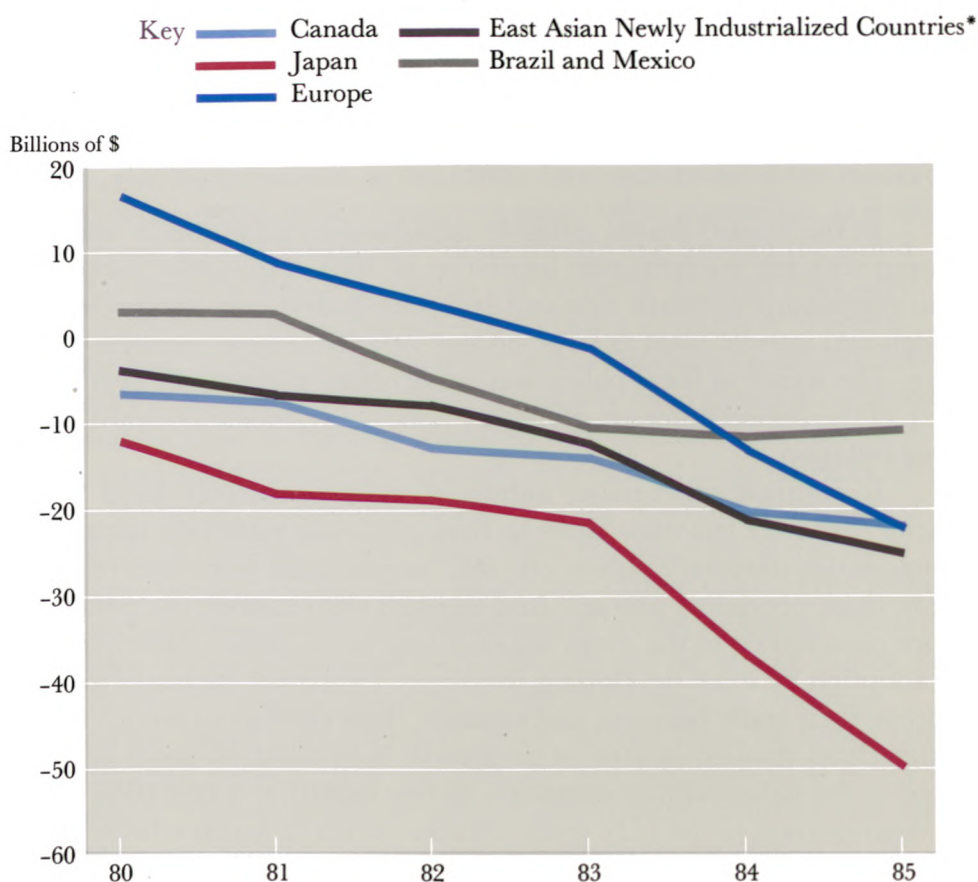
In the United States, a highly expansionary fiscal policy was enacted with the tax reduction legislation of 1981. This policy succeeded in stimulating domestic demand and contributed, not unexpectedly, to high real interest rates as large budget deficits became commonplace. The stance of fiscal policy was particularly telling since over much of the period domestic monetary policy was oriented toward subduing inflation.

In contrast, other major industrial countries adopted fiscal policies that were less stimulative so that, given our relatively nonaccommodative monetary policy, our real interest rates were high relative to those prevailing abroad. And through this channel, the policy stance contributed to the sharp appreciation of the dollar. Moreover, the adoption by some developing countries of austerity measures to improve their trade balances and enhance their abilities to service their foreign debts resulted in little or no growth in demand for goods produced in the industrialized countries. In this regard, it is revealing that the deterioration in the U.S. trade balance occurred across a broad spectrum of trading partners (see chart 3). Since the early 1980s, the U.S. trade gap with virtually all major areas of the world has widened; perhaps particularly striking is the swing from surplus to deficit in

trade with both Europe and Latin America, in part a consequence of the problems that have beset the global economy in recent years.

What we have described to this point is a set of economic policies which contributed to the marked worsening in U.S. trade performance over the 1982-86 period. Apparently those concerned about the adverse repercussions of large federal budget deficits were not just crying wolf. Serious sectoral problems did in fact materialize, although they were foreign-trade-sensitive, rather than interest-rate-sensitive. This may have been because the income effect associated with stimulative fiscal policy offset the domestic effects of high real interest rates on the interest-rate-sensitive sectors. At the same time,

Chart 3 U.S. Merchandise Balance of Trade With Selected Areas in 1980-1985 (Exports less Imports)



*Includes Hong Kong, South Korea, Singapore and Taiwan

Source: International Trade Administration, U.S. Department of Commerce

the income effect and the high dollar reinforced each other with regard to our imports, while the high dollar lowered world demand for our exports.

Unpleasant Deficit Arithmetic

The relationship between the federal budget deficit, the trade deficit, and conventional crowding out of domestic investment by government spending can be effectively illustrated with the following accounting identity, which is derived from the condition in economics that output must equal total expenditures:

$$\text{Government Deficit} = \text{Savings Surplus} + \text{Trade Deficit}$$

or, for analytical purposes,

$$(G - T) = (S - I) + (M - X)$$

where G is government spending, T is taxes, S is savings, I is investment, M is imports, and X is exports. While these variables can be defined in several ways, for this discussion we let G and T refer only to the federal government (G is inclusive of interest on the debt), so that S is gross private savings including that of state and local governments. (See table for recent U.S. history of this identity.)

The identity says that a given budget deficit (the difference between federal expenditures and tax receipts) must be equal to the sum of the savings surplus (the difference between domestic savings and investment) and the trade deficit (the difference between imports and exports). Or equivalently it says that the federal government has two sources of credit: a government deficit can be funded by domestic savings or by foreign lenders. (The trade deficit, $M - X$, represents the net amount of funds we must borrow from abroad.) The identity also implies that given fiscal policy, a narrowing of the savings surplus (e.g., because investment increases) must be accompanied by deterioration in trade. While some might object to focusing on a given fiscal policy because a budget deficit could result from changes in other components of the identity, it is this deficit, and this deficit alone, that is largely under the control of policymakers.

The implications of this simple expression are striking when coupled with assumptions about the economy. The conventional view of crowding out, for example, assumes that the trade balance is both relatively small and slow to change; hence, it largely ignores the trade deficit and focuses on the relation between the government deficit and the savings surplus. Given this assumption, an increase in the budget

*Table National Income Accounting Identity by Component
(in Billions of Dollars)*

	Budget* Deficit (G-T)	Savings Surplus (S-I)	Trade* Deficit (M-X)
1965-69**	2.4	9.6	-7.1
1970-74**	13.7	23.9	-10.2
1975-79**	42.9	57.8	-14.9
1980	61.3	93.4	-32.1
1981	63.8	97.7	-33.9
1982	145.9	172.2	-26.3
1983	176.0	169.9	6.1
1984	170.0	111.3	58.7
1985	198.0	119.1	78.9
1986	204.9	99.7	105.2

*Positive numbers indicate deficits; negative numbers indicate surpluses.

**Annual average.

Source: Bureau of Economic Analysis, U.S. Department of Commerce.

deficit must be matched by an increase in the savings surplus. Further, assuming that the economy is operating at full employment so that real income and savings are fixed (and assuming savings are not responsive to changes in interest rates), a budget deficit increase will result in higher real interest rates and depress private investment.

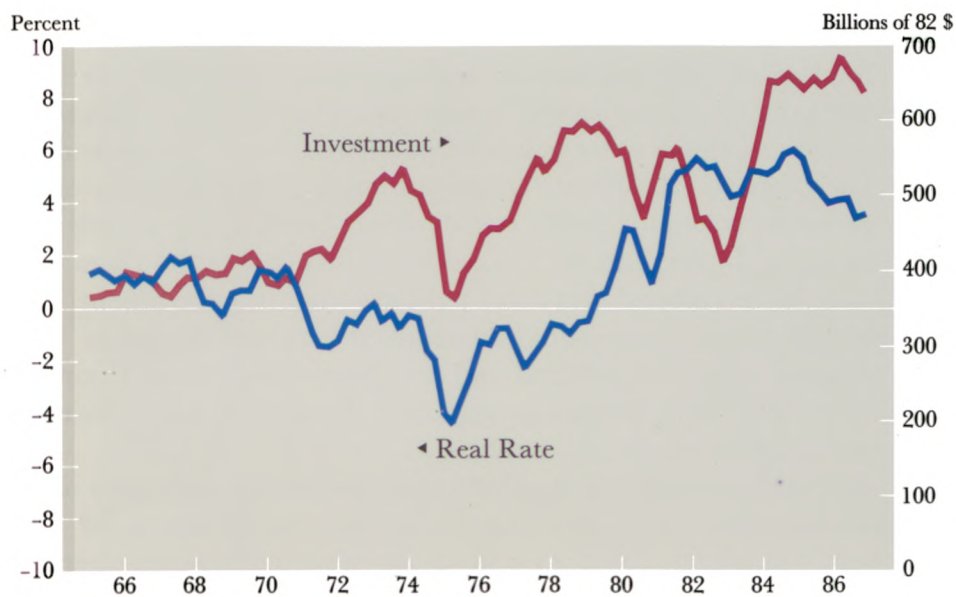
While the conventional crowding out story is indeed plausible, it is not what happened as the current economic expansion progressed. Instead, much of the adjustment to large budget deficits came in the widening of the trade deficit. High real interest rates drove up the value of the dollar internationally and through this channel contributed to the deterioration in trade. At the same time, domestic investment was apparently little inhibited by high real rates, especially in the early years of the expansion (see chart 4).

The identity helps to demonstrate the relationship between the federal budget and trade deficits. Assuming that the economy is at full employment so that aggregate savings (S) in our economy are fixed, an increase in the budget deficit must either depress domestic investment (I) or result in deterioration in the trade deficit (M - X). This aspect of the unpleasant arithmetic of budget and trade deficits is often overlooked. It has very significant implications for policies aimed only at

improving our trade position. The identity tells us that if the trade gap narrows while the budget deficit does not, or if it diminishes more than the budget deficit, then the savings surplus must increase. If aggregate savings are fixed, however, investment must fall in these circumstances. Thus, improvement in our trade position would not lead to strengthening in private sector economic activity, as it would be offset by attendant weakening in investment.

This description of the implications of the identity does not explain how the adjustment might actually occur. There are any number of scenarios that might play out, but prices, interest rates and exchange rates in particular, are likely to be central to all of them. For illustrative purposes, consider the combination of a fall in the dollar, a reduction in the trade deficit, and no progress on the budget deficit. In that circumstance, we know that the savings surplus must widen and, on our assumption of being at full employment, the adjustment will not come through increased savings. Hence, investment must fall, in response perhaps to higher interest rates. In the context of this example, a rise in interest rates would not be at all surprising if funds from abroad had to be attracted or retained in the face of a dollar falling, in

Chart 4 Real Gross Private Domestic Investment and Real Interest Rate Quarterly, 1965-1986*



*Real rate is difference between 4 quarter moving average in 3 month T-Bill and 4 quarter percent change in GNP deflator
 Source: Bureau of Economic Analysis, U.S. Department of Commerce and the Federal Reserve Bank of New York

part as a consequence of growing reluctance of foreign investors to acquire dollar-denominated assets.

The identity depicted above thus demonstrates that improvement in our trade position is not sufficient, in and of itself, to assure a healthier private economy. Weakened domestic investment spending could counterbalance diminution of the trade gap.

Promise of the Plaza

As we have seen, the stance of fiscal policy is at the heart of our trade imbalance and the associated sectoral problems. Correction of the trade problem thus requires addressing macroeconomic policies appropriately. We believe that the so-called Plaza Agreement (fall 1985) was such an attempt.

In the abstract, international coordination of macroeconomic policies should be beneficial. As a consequence of highly integrated global financial and product markets, one country's policy choice affects the economic performance of many others. One country's borrowing may affect world interest rate levels, and its demand may influence world prices. As a result of this interdependence, economic performance and welfare can be improved if coordinated policies are implemented rather than if, alternatively, each country determines policy on the assumption that policies of other countries are fixed. There is value to international policy cooperation irrespective of the state of trade flows or, for that matter, of the business cycle.

September 1985 marked the beginning of an overt effort to coordinate policies among several major industrial countries, with the objective of achieving a more balanced pattern of world growth and trade. The effort was the Plaza Agreement among the G-5 countries, which called for economic policy coordination, particularly among West Germany, Japan, and the United States. As part of the Plaza strategy, it was envisioned that fiscal policies—that is, government spending and tax policies—would be modified here and abroad in order to adjust aggregate demand and realign exchange rates. Coordinated intervention in the foreign exchange markets by major central banks was a second aspect of the strategy.

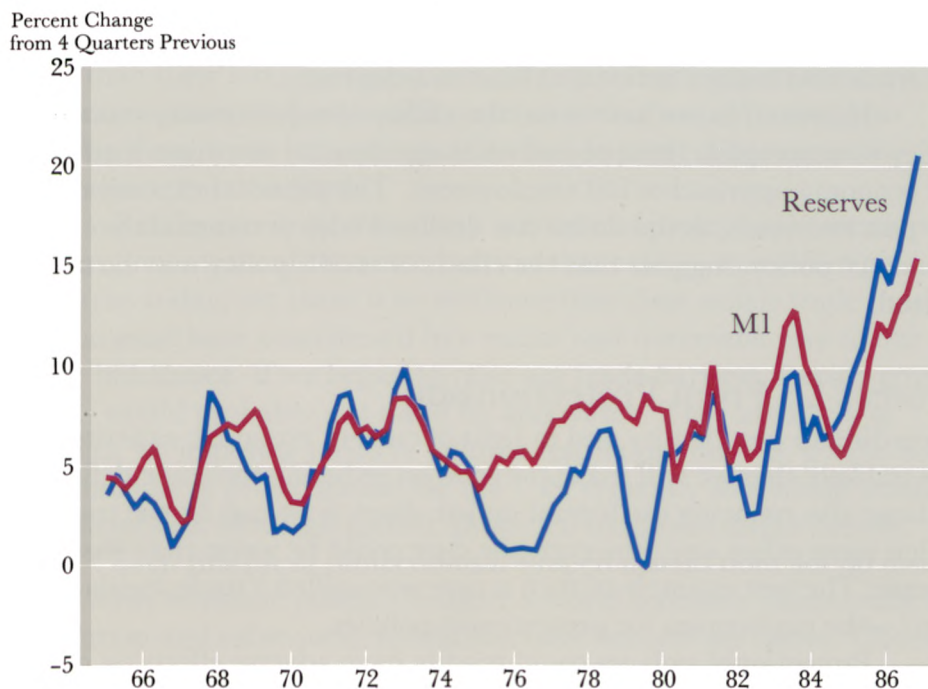
As events unfolded, it appeared that some of the objectives of the Plaza Agreement were achieved. To be sure, the decline of the dollar began in March 1985, prior to the agreement. However, there was coordinated intervention in the foreign exchange markets by major central banks in the wake of the Plaza Agreement which was accompanied, for a time, by sympathetic reductions in interest rates. The dollar declined appreciably.

Misgivings

Despite this apparent success, there should be serious misgivings about the way in which the Plaza Agreement has been implemented. As a key part of that agreement, it was intended that U.S. fiscal policy would be altered to reduce, in a meaningful and sustained way, the federal budget deficit. Although there has been some movement to a lower deficit, the burden of adjustment to achieve Plaza Agreement objectives so far has fallen to monetary policy.

Consequently, U.S. monetary policy was decidedly more accommodative in much of 1985 and 1986 than it had been earlier in the economic expansion. Growth in M1, the narrow monetary aggregate, was exceedingly rapid in those years, and bank reserves increased substantially (see chart 5). This accommodative policy contributed to the decline in the dollar but simultaneously served to bolster demand for goods and services in this country. Thus the decline in the dollar has not as yet generated any demonstrable improvement in the trade balance, and it is possible that it never will.

Chart 5 Growth in Money Supply (M1) and Total Reserves Quarterly, Annual Rate, 1965-1986



Source: Board of Governors of the Federal Reserve System

Again, the GNP accounting identity can help to elucidate the consequences of various policy choices. A less stimulative fiscal policy will be accompanied by improvement in the trade balance and/or in domestic investment, as a decline in real interest rates aids these sectors. However, stimulative monetary policy, under the assumption of full employment, should reduce the nominal value of the dollar but will also contribute to inflation, at least over time, leading to little if any improvement in the terms of trade and in the trade balance. Indeed, if the drop in interest rates leads to a substantial increase in investment, the identity implies that the terms of trade must worsen so as to increase the trade deficit.

Of course, the economy over the last two years was not at full employment. Consequently, the stimulative monetary policy may have had some positive effects on the trade balance. In the first instance, such a policy lowers real interest rates and the foreign exchange value of the dollar. Lower interest rates in turn stimulate domestic investment so that aggregate income is higher than it otherwise would be. The income effect by itself worsens the trade deficit as the rise in income induces consumers to buy more imports. However, this effect can be more than offset by the terms of trade if the dollar falls without a corresponding rise in domestic prices. Moreover, as income increases, the budget deficit should narrow as tax revenues climb. In short, in these circumstances accommodative monetary policy can ameliorate the trade and budget deficits, at least to a degree.

However, as we have seen, the ability of expansionary monetary policy to accomplish these objectives is significantly circumscribed as the economy approaches full employment. The practical experience of the past two years, as the dollar has declined with accommodative monetary policy, suggests that the effects of such a policy may be small indeed.

Protect Us From Protectionism

According to our identity and in light of current economic experience, it is unlikely that we will make progress on reducing the trade deficit without also reducing the federal deficit. Even if we can fix the trade deficit some other way, however, the cure could be worse than the disease. The best example of such a cure is so-called “trade legislation”—the euphemism for protectionist policies.

Protectionist policies could readily have adverse effects on our domestic economy. To the extent that they succeed in restricting the volume of imports, they will raise prices of imported goods, and thus

the American consumer will pay for the policies. There is evidence to suggest, moreover, that low-income consumers bear a disproportionate share of these costs. According to a recent staff study by the Federal Reserve Bank of New York, the cost to U.S. consumers of trade protection on clothing, sugar, and automobiles is not only high but also regressive, in that the cost of protection is many times larger for low-income consumers than it is for those with high incomes.

Further, if competition is restrained by protectionism, there may be room for domestic producers to raise prices and, if this process gains momentum, it could foster rapid inflation. As the GNP identity discussed earlier makes clear, if the economy is at full employment, protectionist measures that successfully reduce the trade deficit must either depress domestic investment or reduce the government deficit. The latter reaction would result as protectionism adds to inflation and tax revenues climb with nominal income. This effect is likely to be small, however. The burden instead will more likely fall on investment as the private and public sectors will have to compete for more limited capital funds.

Protectionist policies, too, could make it difficult for domestic industries to compete effectively here and abroad, if import prices were to rise beyond levels faced by foreign firms. For example, if foreign steel were barred from the United States or if its price rose significantly, U.S. manufacturers that use steel as an input would face higher costs than their foreign competitors. We should not expect these manufacturers to do well if we handicap them in this way. We may also wonder if our trade balance would in fact improve if our manufacturers were thus shackled.

Retaliation is another likely outcome of protectionist measures. We are well aware of the trade barriers that exist in many foreign countries today, yet there is no evidence that these unfair trade practices abroad have contributed in a major and systematic way to our trade imbalance. If we began to raise our trade barriers, foreign governments would probably not stand by and watch. They are likely to retaliate by imposing tariffs or volume restrictions on U.S. goods. So the outcome of protectionism for the U.S. economy as a whole would be deleterious, although specific protected industries might benefit.

Even this list of protectionism's repercussions does not do justice to its flaws as public policy. Consider a world economy where trade legislation and subsequent retaliation have become pervasive. Under these circumstances, a logical outcome would be a significant contraction in trade worldwide. Such a contraction would be expensive, in the

sense that employment and production would necessarily be curtailed around the world. This is, of course, the conventional description of a worldwide recession, and it would be accompanied by higher prices for many products than otherwise would be the case.

Conclusion

The performance of the U.S. economy over the past several years, characterized by growing federal budget deficits, together with deterioration in the trade balance, can be better understood with the analytical strictures of deficit arithmetic. This arithmetic shows that budget deficits can indeed crowd out private sector activity, but perhaps in ways that were more subtle than initially anticipated. The GNP accounting identity also makes clear that in the absence of increases in the volume of domestic savings, the only effective way to alter the arithmetic favorably is to reduce the government's deficit. If such a policy is not implemented, improvement in the trade balance will result in weakening in investment spending.

To be sure, reduction of the budget deficit is neither a riskless nor a new policy prescription. Nonetheless, it remains a sound one. At this stage, such action would strengthen the private sector of the economy and would spur improvement in the trade situation. Improving the trade balance, in and of itself, though, should not be a policy goal. Protectionist policies aimed at this objective will surely miss the mark. Progress on the trade issue is also questionable if we rely solely on accommodative monetary policy. The unpleasant arithmetic of budget and trade deficits in fact suggests that such a policy could actually exacerbate the trade problem. At the same time, it could trigger a reacceleration of inflation.

In summary, if we cannot correct our fiscal imbalance, it may not be wise to try to redress our trade imbalance.

—Gary H. Stern

Statement of Condition

Earnings and Expenses

Directors

Officers

Statement of Condition* (In Thousands)

	December 31, 1986	December 31, 1985
<i>Assets</i>		
Gold Certificate Account	\$168,000	\$156,000
Interdistrict Settlement Fund	78,225	(38,542)
Special Drawing Rights Certificate Account	66,000	63,000
Coin	20,068	21,680
Loans to Depository Institutions	206,210	2,810
Securities:		
Federal Agency Obligations	113,125	108,417
U.S. Government Securities	<u>2,855,458</u>	<u>2,342,928</u>
Total Securities	\$2,968,583	\$2,451,345
Cash Items in Process of Collection	492,649	654,339
Bank Premises and Equipment—		
Less: Depreciation of \$23,628 and \$21,664	35,976	35,684
Foreign Currencies	312,642	231,495
Other Assets	<u>48,279</u>	<u>81,347</u>
Total Assets	<u>\$4,396,632</u>	<u>\$3,659,158</u>
<i>Liabilities</i>		
Federal Reserve Notes ¹	\$2,838,142	\$2,390,476
Deposits:		
Depository Institutions	884,056	470,703
Foreign	4,950	4,950
Other Deposits	<u>11,708</u>	<u>12,588</u>
Total Deposits	\$900,714	\$488,241
Deferred Availability	495,471	630,410
Other Liabilities	<u>40,035</u>	<u>33,045</u>
Total Liabilities	\$4,274,362	\$3,542,172
<i>Capital Accounts</i>		
Capital Paid In	\$61,135	\$58,493
Surplus	<u>61,135</u>	<u>58,493</u>
Total Capital Accounts	\$122,270	\$116,986
Total Liabilities and Capital Accounts	<u>\$4,396,632</u>	<u>\$3,659,158</u>

¹Amount is net of notes held by the Bank of \$545 million in 1986 and \$608 million in 1985.

Earnings and Expenses (In Thousands)

For the Year Ended December 31	<u>1986</u>	<u>1985</u>
<i>Current Earnings</i>		
Interest on U.S. Government Securities and Federal Agency Obligations	\$224,145	\$222,590
Earnings on Foreign Currency Investments	12,988	7,526
Interest on Loans to Depository Institutions	1,156	2,413
Revenue from Priced Services	35,416	34,280
All Other Earnings	<u>390</u>	<u>298</u>
Total Current Earnings	\$274,095	\$267,107
<i>Current Expenses</i>		
Salaries and Other Personnel Expenses	\$26,434	\$25,621
Retirement and Other Benefits	5,725	6,016
Travel	787	1,055
Postage and Shipping	5,682	5,585
Communications	525	672
Materials and Supplies	1,864	1,866
Building Expenses:		
Real Estate Taxes	2,500	2,294
Depreciation—Bank Premises	1,050	1,041
Utilities	843	857
Rent and Other Building Expenses	700	692
Furniture and Operating Equipment:		
Rentals	1,014	1,761
Depreciation and Miscellaneous Purchases	4,296	3,601
Repairs and Maintenance	1,915	1,579
Cost of Earnings Credits	5,577	6,177
Other Operating Expenses	1,877	1,572
Net Shared Costs Received from Other FR Banks	<u>1,889</u>	<u>1,638</u>
Total	\$62,678	\$62,027
Reimbursed Expenses ²	<u>(3,587)</u>	<u>(2,804)</u>
Net Expenses	\$59,091	\$59,223
<i>Current Net Earnings</i>	\$215,004	\$207,884
Net Additions ³	64,005	41,001
Less:		
Assessment by Board of Governors:		
Board Expenditures	3,191	2,572
Federal Reserve Currency Costs	2,381	2,131
Dividends Paid	3,554	3,391
Payments to U.S. Treasury	<u>267,241</u>	<u>236,602</u>
Transferred to Surplus	<u>\$2,642</u>	<u>\$4,189</u>
<i>Surplus Account</i>		
Surplus, January 1	\$58,493	\$54,304
Transferred to Surplus—as above	<u>2,642</u>	<u>4,189</u>
Surplus, December 31	<u>\$61,135</u>	<u>\$58,493</u>

²Reimbursements due from the U.S. Treasury and other Federal agencies; \$1,973 was unreimbursed in 1986 and \$245 in 1985.

³This item consists mainly of unrealized net gains related to revaluation of assets denominated in foreign currencies to market rates.

Federal Reserve Bank of Minneapolis

Helena Branch

JOHN B. DAVIS, JR.
Chairman and Federal Reserve Agent

MARCIA S. ANDERSON
Chairman

MICHAEL W. WRIGHT
Deputy Chairman

WARREN H. ROSS
Vice Chairman

*Class A Elected by Member Banks**Appointed by Board of Governors*

BURTON P. ALLEN, JR.
President, First National Bank
Milaca, Minnesota

MARCIA S. ANDERSON
President, Bridger Canyon Stallion Station, Inc.
Bozeman, Montana

THOMAS M. STRONG
President, Citizens State Bank
Ontonagon, Michigan

WARREN H. ROSS
President, Ross 8-7 Ranch, Inc.
Chinook, Montana

DUANE W. RING
President, Norwest Bank La Crosse, N.A.
La Crosse, Wisconsin

*Appointed by Board of Directors FRB of Minneapolis**Class B Elected by Member Banks*

SEABROOK PATES
President and General Manager
Midland Implement Co., Inc.
Billings, Montana

HAROLD F. ZIGMUND
(Retired Chairman, Blandin Paper Co.)
Minneapolis, Minnesota

DALE W. ANDERSON
President, Norwest Bank Great Falls, N.A.
Great Falls, Montana

WILLIAM L. MATHERS
President, Mathers Land Company
Miles City, Montana

F. CHARLES MERCORD
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