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Fiscal-Monetary Policies: What Mix?

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What to Do About Them?

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[Editorial]

Uneven Impacts of Monetary Policy: What to Do About Them?

by David P. Eastburn

Events of the past year have demonstrated that monetary policy can have strongly uneven impacts. No one is particularly happy about this fact, least of all the Federal Reserve. For not only do these impacts raise obvious questions of equity, but they produce economic and political repercussions that make the Fed's job more difficult. If monetary policy is to be of maximum effectiveness in the future, serious consideration will have to be given to the unevenness of its impacts.

Three approaches might be explored:

1. Tolerate the uneven impacts
2. Remove market imperfections that help produce them
3. Deal with them selectively

Which of these approaches one takes depends to a great extent on his philosophy of monetary policy—the degree to which he would have it intervene in the market place to influence the allocation of resources.

1. *Tolerate them.* This is not simply a do-nothing position reflecting a callous disregard for the problem or for the human consequences of it. In its finest sense, this approach involves a careful calculation of costs and benefits.

Those who would take this approach believe that uneven impacts are a price for letting the market place work. They have no question about the trade-off. Although they might wish the market would allocate credit more evenly, they argue that intervention runs the risk of doing an

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FISCAL-MONETARY POLICIES: WHAT MIX?

by Clay J. Anderson

Fiscal policy is too easy; monetary policy is too tight. This is a view frequently expressed in recent months. The emphasis is on a different mix, not on a general increase in restraint.

The need for coordinating fiscal and monetary policies in order that one would not tend to offset the other has long been recognized. But varying the blend better to achieve economic goals is of fairly recent origin.

This article deals briefly with some of the principal considerations involved in using the fiscal-monetary mix as a tool of economic stabilization: the mechanics of fiscal and monetary policies; problems of implementation; suggested mixes to achieve certain objectives; and limitations on the effectiveness of varying the mix.

MECHANICS OF FISCAL POLICY

The Federal Government has become big business. It is the largest spender, the largest taxpayer, the largest borrower, and the largest buyer of our total output of goods and services.

That operations of such magnitude have important effects on the economy is not debatable. The crucial question is whether we use fiscal operations to help achieve our economic objectives.

General effects

Treasury operations have far-reaching effects. Over 50 million people and hundreds of thousands of corporations make income-tax payments to the Treasury. Millions of individuals and

business firms are recipients of funds paid out by the Treasury in its purchases of goods, services, and in social welfare benefits. Thus Treasury operations affect the spendable income of millions of consumers and business firms. It is useful to distinguish two types of effects: the direct impact, and secondary reactions initiated by the original transactions.

Direct. Treasury receipts transfer funds from taxpayers to the Government. Personal and corporate income taxes now run around \$100 billion a year. The immediate effect is apparent—the Government will have that much more to spend, and individuals and corporations less.

Government cash payments put additional funds in the hands of the public; they directly add to disposable income. Moreover, the Federal Government is our largest buyer. It takes about 10 per cent of our total output of goods and services. Government purchases are a strong prop under total demand.

With the Treasury siphoning in and paying out many billions of dollars, the net over-all effect depends on the relative magnitude of receipts and payments. If the Treasury takes in more than it pays out, the net direct effect is a reduction in funds at the disposal of the public. With less money to spend, total demand for goods and services should be less. If the Treasury pays out more than it takes in, the public has more to spend. Thus a surplus tends to reduce spendable funds and total demand; a deficit tends to increase them.

Actual results, however, may differ from the immediate impact. The final effect depends on disposition of the surplus or how a deficit is financed.

A surplus will have little, if any, restrictive effect if the excess receipts are returned to the public or replaced by the creation of new funds. Using a surplus to redeem Government securities held by the public shifts funds from taxpayers to holders of the securities. There is likely to be a redistribution of funds available for spending but there is no change in the total. Redeeming securities held by commercial banks results in a decrease in deposits and bank holdings of Government securities. But it also frees reserves, and may result in somewhat lower market rates; banks have sufficient reserves to expand loans and restore deposits to the former level. There is a net reduction in deposits and spendable funds only if the reserves released are held as excess (which is unlikely), used to repay indebtedness to the Reserve Banks, or absorbed through Federal Reserve action. Redemption of securities held by Federal Reserve Banks exerts the greatest restraint because the net result is a reduction in both bank reserves and deposits.

A fiscal surplus is not necessarily restrictive. It is not restrictive if Congress is induced to authorize a corresponding increase in expenditures. It is not restrictive if the surplus is used to redeem Government securities held by nonbank owners.* And it is not restrictive if used to retire bank-held securities unless monetary policy prevents use of the released reserves for additional loans and investments. In short, a surplus is likely to bring a net reduction in disposable income and total demand below what it would have been

* *There could be some net reduction in total demand if holders of the redeemed securities were less eager spenders than the taxpayers.*

only when accompanied by some monetary restraint.

It is equally important to note that the stimulating effect of a deficit depends on how it is financed. If financed by additional taxes or by selling securities to nonbank buyers, there is a shift of funds but no change in the public's disposable income. The deficit results in an increase in total spendable funds only if the borrowing results in creation of new funds; i.e., if purchased directly or indirectly by the Federal Reserve and commercial banks; or if it activates funds which otherwise would have been idle. If purchased by commercial banks, more reserves would be required to support the newly created deposits; less reserves would be available for extending credit to other borrowers. Therefore, for a deficit to have a stimulating effect the support of monetary policy is also required.

Secondary. The direct effects are only the initial impact of the Government's financial operations on disposable income and aggregate demand. The initial rise in income would touch off more spending. Improved sales swell the flow of new orders to manufacturers. Manufacturers buy more supplies and use more labor. Higher levels of production and employment generate more income, which in turn touches off another rise in total demand and business activity. A reduction in disposable income would set in motion a contraction in demand and output.

The chain reaction to an initial rise or fall in disposable income does not continue forever. There are leakages, so that the secondary effects are similar to the waves created by throwing a rock into a pond—they spread in ever-widening circles but with diminishing intensity. Some of the increase in income, for example, may be used to repay outstanding debt; taxes will siphon some back to the Treasury; and a part may be offset

by reduced unemployment benefits. As leakages divert funds from the income-spending stream, secondary effects gradually fade away.

The secondary response of consumer expenditures to an initial increase in disposable income is fairly prompt and predictable. The ratio of consumer spending to disposable income has moved within a narrow range of 92 to 95 per cent for almost two decades. Some have estimated that the major part of the effect on consumer expenditures occurs within the first quarter following the initial impact on disposable income.

Business investment is likely to be more sensitive to economic conditions. Rising retail sales may be met for a while out of topheavy inventories. If so, only after inventories have been reduced to desired levels will the larger flow of new orders be matched by a rise in production. Likewise, rising production may be met for a while by using existing productive facilities. Excess capacity, profit expectations, and availability and cost of financing are among the factors that will influence the secondary effect on investment.

Selective effects

Fiscal policy has considerable potential for influencing the composition as well as the aggregate demand for goods and services. The direct impact can be varied somewhat by altering the tax structure and composition of federal expenditures.

Tax structure. Tax changes can be designed so as to put most of the direct effect on consumption or investment.

The direct impact of raising or lowering the personal income tax will fall mainly on consumer income and expenditures. The effect on consumption may be greater if tax changes are concentrated in the lower income brackets. People with lower incomes are likely to spend a larger

proportion on consumer goods and services. There are limitations, however. Those with a taxable income of less than \$5,000 account for about one-third of total individual tax returns but less than 10 per cent of total personal income tax receipts. Individuals with taxable incomes under \$10,000 account for less than one-half of total receipts.

Tax changes can also be formulated to concentrate the direct effect on investment. Changes in the corporate income tax affect net earnings and the supply of internal funds available for investment. They also alter net profit margins and incentive to invest. Changing individual tax rates on high- instead of low-bracket incomes is more likely to affect the flow of personal savings into investment. Investment tax credits and depreciation allowances are other methods of altering the inducement to invest.

Only the initial impact of a tax change can be directed toward certain parts of the economy. Once new dollars injected by fiscal policy get into the hands of consumers and businessmen they lose their identity. They will be spent like any other dollar. The secondary effects, therefore, will reflect consumer and investor preferences—not necessarily those of fiscal authorities.

Composition of expenditures. Projects can be selected so that payments will go mainly to lower-income groups. For example, old-age and retirement benefits, unemployment benefits, public assistance and relief, and housing subsidies are likely to go mostly to people with below-average incomes. In effect, such payments redistribute income from higher to lower income groups. But it should be noted that expenditures of this type are usually determined largely by considerations other than cyclical stabilization.

Some types of expenditures are more closely related to business investment. Government ex-

penditures for research and development may well create opportunities for private investment. Expenditures for education and job training improve the quality and skill of the labor force. Investment in human resources, as well as plant and equipment, tends to increase productivity.

Taxes vs. spending. Effectiveness in achieving selective effects is one important consideration in choosing between taxes and spending. Another factor that should not be overlooked is the allocation of resources between private and public use.

The restrictive effect of a surplus can be achieved either by a reduction in Government spending or an increase in taxes or both. A reduction in Government spending tends to divert resources from public to private use. A larger portion of total output goes to satisfy private wants and preferences, unless the surplus results in a proportionate decline in private output. Raising taxes to create a surplus does the opposite. It diverts resources from private to Government use. The choice at stake is how much of our income we want to spend ourselves and how much we want the Government to spend for us.

MECHANICS OF MONETARY POLICY

Tax and expenditure changes directly enlarge or reduce disposable income; monetary policy influences use of credit to supplement current income.

Credit is a means of drawing on future income to pay for today's purchases. The effect on total demand depends mainly on whether borrowing results in the creation of new funds. If the lender advances to the borrower funds collected from savers, as in the case of savings institutions, the net effect is a transfer from saver to borrower. There is no increase in total amount of spendable funds. Total demand is not increased unless some borrowed funds would have been held idle

otherwise. If the lender puts newly created funds at the disposal of the borrower, as in the case of commercial banks, there is a net increase in checkbook money.

Monetary policy impinges directly on bank reserves and the capacity of commercial banks to create new deposits. Open market operations supply or withdraw reserves; a change in the discount rate makes it more or less expensive for banks to borrow additional reserves; and a change in reserve requirements alters the amount of reserves banks are required to hold against deposits. In short, Federal Reserve tools enable the System to alter the cost and supply of reserves, which in turn affects both ability and willingness of commercial banks to create new deposits by making loans and investments. The Federal Reserve can restrict deposit creation by making reserves less readily available and more expensive; it encourages credit and deposit expansion by increasing the supply of reserves and making borrowed reserves less expensive.

The impact of monetary policy extends beyond bank credit and money supply. Monetary restraint may cause banks to sell securities and compete more aggressively for new deposits. Declining securities prices and possibly a reduced inflow of savings may cause nonbank as well as bank lenders to be more cautious and selective in extending credit. Rising interest costs and less favorable terms discourage borrowing. Thus monetary policy, by altering the cost, supply, and availability of credit, may encourage or discourage borrowing for consumer and investment expenditures.

Federal Reserve actions, except for authority to establish margin requirements on stock market credit, influence the total quantity of credit and spendable funds. Even though general monetary instruments may have an uneven impact, mone-

tary authorities can do little to regulate how funds are allocated among competing borrowers. The impact is usually greater, however, where cost and availability of credit are more important in spending decisions. Housing and business fixed investment, for which financing is usually long-term, are likely to be more sensitive to interest rates and monetary policy.

In short, the operation of monetary policy has several significant features. First, Federal Reserve actions operate mainly on use of credit to supplement current income. They do not directly affect the level of *existing* income available for expenditure; however, unfavorable credit terms may encourage borrowers to use current income to repay outstanding indebtedness instead of to purchase goods and services. Second, the Federal Reserve can make additional reserves and deposits available in a period of economic slack, but there is no increase in total demand unless someone is willing to spend. Third, the instruments of monetary policy primarily affect the price of credit and total supply of spendable funds. The possibility of using existing general monetary tools to attain certain selective effects is limited; however, such use should be explored more fully.

PROBLEMS OF IMPLEMENTATION

Successful use and blending of fiscal and monetary policies require enough flexibility so that actions can be adapted to changing economic conditions. Federal Reserve authorities can take action promptly once the need is recognized. One of the advantages of monetary policy is its flexibility.

Inflexibility is a serious weakness of fiscal policy. It is one of the main reasons this potentially powerful and useful stabilization tool has been used little in actual practice. Whether the problem can be solved or at least mitigated will

have an important bearing on successful use of the fiscal-monetary mix.

Inflexibility of fiscal policy

Preparation and enactment of the federal budget is currently a time-consuming process. Formulation of the budget for the fiscal year beginning July 1, 1967, for example, has been under way several months. The President submits his budget recommendations to Congress in the latter part of January. Congressional committees conduct hearings and then the budget recommendations are debated on the floors of the House and Senate. Action on all budget items is usually not completed until shortly before the beginning of the new fiscal year.

When the budget is being formulated and considered by Congress no one can tell what economic conditions will be during the coming fiscal year. It is impossible to determine so far in advance whether the budget will or should show a surplus or a deficit, much less how large a surplus or deficit should be. At present we cannot approach the forecasting accuracy required much of the time so that enactment of the budget may include such changes as are needed for purposes of economic stabilization.

The time required for fiscal actions, once taken, to affect disposable income and the flow of federal expenditures varies. An income-tax change that does not alter collection procedures may affect disposable income in a short time. This is especially true for withheld taxes. There is usually a considerable time lag between Congressional action on expenditure projects and the flow of payments to the public. The time lag is less for actions altering expenditures such as social security and unemployment benefits. It is likely to be much longer for major defense and public works projects. Preliminary planning and

awarding of contracts may consume considerable time before new orders are placed. For heavy durables and large construction projects, several more months may elapse before payments start to flow in substantial volume.

The time lag between monetary actions and the impact on spending and demand also varies according to economic conditions; however, it is likely to be several months before the bulk of the impact is felt.

Automatic stabilizers

Inflexibility inherent in the budget process has long been recognized. A partial solution is to build into the budget, items that automatically respond to changes in production and employment.

Progressive income-tax rates and employment taxes exercise a stabilizing influence on disposable income. A decline in total income and employment results in more than a proportionate decrease in income and employment tax receipts. The declining tax bite cushions the effect of a recession on disposable income. In periods of expansion, rising business activity and income bring more than a proportionate increase in tax receipts. The slower rise in disposable income acts as a drag on business expansion.

Some Government expenditures also respond automatically in a stabilizing manner. Unemployment benefit payments, for example, rise as employment declines; they decrease as business activity and employment expand.

Automatic stabilizers, although helpful, are only part of a solution to the problem of implementing an effective fiscal policy. Some have estimated that currently automatic stabilizers offset about 30 cents of each dollar rise or fall in G.N.P.

Strengthening the automatic stabilizing effects,

however, would create other problems. Built-in stabilizers become restrictive as soon as an upturn in business activity begins. They tend to choke off expansion long before manpower and other productive resources are being fully utilized. More potent automatic stabilizers would increase the fiscal drag on expansion and growth.

More flexible discretionary action

Built-in stabilizers are only a partial solution to the problem of better timing of fiscal policy. Greater flexibility in discretionary actions is also needed.

On the tax side, a recent proposal is that Congress give the President standby authority to make tax changes of limited amount. For example, the authority might be limited to a 5 per cent across-the-board increase or decrease in individual and corporate income taxes. Congress would retain complete control over tax reform. Even with such safeguards, however, Congress seems reluctant to delegate limited standby authority to the President.

Another proposal that would avoid delegation of authority is for Congress to plan in advance so that a tax change could be enacted more promptly. In anticipation that tax action might soon become desirable, a bill could be drafted and hearings held by the appropriate Congressional committees. If possible, agreement should be reached on the type and perhaps the amount of a tax change so that only a joint resolution of Congress would be required to put the change into effect. Such advance legislative preparation would enable Congress to act promptly once the need for a tax change became reasonably clear. There is a natural reluctance, however, to spend time preparing legislation for some presumed future need of uncertain magnitude.

It is also difficult to achieve much flexibility

on the expenditure side of the budget. A major part of total expenditures is determined largely by non-economic objectives. For instance, defense expenditures, interest on the debt, and veterans' benefits can hardly be deferred or expanded in order to exert a stimulating or restrictive effect on the economy. For various reasons, only a small portion of the total is amenable to variation in accordance with changing economic conditions. And even this small part may not be flexible as to timing.

WHAT KIND OF MIX?

Different features and a close interrelationship offer opportunities to employ a varying fiscal-monetary mix in order better to meet the needs of a particular economic situation. A few of the more common recent proposals are used to illustrate both the advantages and limitations of altering the fiscal-monetary mix.

Selective effects

In recent months, there has been considerable discussion of a tax increase which would make possible a less restrictive monetary policy. The intention is a change in mix, not in the over-all degree of restraint. Monetary restraint in the face of vigorous credit demands helped lift interest rates to levels that had not been reached for many years. High rates and reduced availability of credit hit certain sectors of the economy, such as housing, especially hard. A tax increase combined with less monetary restraint would ease some of the pressure on these sectors and possibly spread the impact more evenly over the economy.

The fiscal-monetary mix has often been suggested as a method of altering distribution of expenditures and resources between consumption and investment. In an inflationary situation powered mainly by strong consumer demand with

only a sluggish rise in fixed investment, a relatively heavy dose of fiscal restraint on consumer income and expenditures could be combined with monetary policy and possibly some fiscal actions, designed to encourage a more rapid rise in investment and in productive capacity. If, on the other hand, an investment boom is threatening to create excess capacity, corporate tax changes could be coordinated with a more restrictive monetary policy to curb the rise in investment expenditures.

In periods of recession and economic slack, the mix could be heavily weighted toward fiscal action to lift the level of private disposable income. A rise in consumer income and spending would, by absorbing unused resources, help create an environment more favorable to an increase in investment. Fiscal policy, as we have seen, can directly increase consumer disposable income both by personal income-tax reduction and carefully selected increases in Government expenditures. The stimulative effect is likely to be considerably greater than making credit more readily available at low rates. Consumers and business firms are reluctant to borrow as long as employment and profit prospects are uncertain. As consumer expenditures and business activity rise, excess capacity will be reduced. With improving profit prospects and a dwindling margin of unused resources, policies designed to encourage investment will be more fruitful. As recovery proceeds, and especially if investment lags, the mix could gradually be shifted more toward stimulating investment.

A mix heavily weighted toward fiscal action to stimulate consumption is also especially suitable for recession when a country is confronted with a balance-of-payments problem. Fiscal action to swell disposable income probably puts less downward pressure on short-term rates and hence is

less likely to stimulate an outflow of short-term capital. Financing a deficit primarily by issuing short-term securities would tend to increase the market supply and help keep short-term rates up.

Limitations on selective use

There is a wide range of combinations in which monetary and fiscal policies conceivably could be employed. We should recognize, however, that there are limitations on what can be accomplished by changing the policy mix. For instance, combining fiscal restraint and monetary ease in such a way as to divert resources from consumption to investment may be hard to accomplish in practice.

First, because of the mobility of funds and close interrelation between fiscal and monetary policies, it is difficult to effect a restrictive fiscal policy with monetary ease. In theory a fiscal policy directed toward curbing consumer expenditures will release resources, and an easy money policy will encourage their use in investment. But in practice these results may not be achieved.

A fiscal surplus is not necessarily restrictive, as we have seen. To be restrictive, the surplus must be employed in such a way that excess receipts are not returned to the public or replaced by new funds created by credit expansion. If used to redeem securities held largely by commercial banks, an easy money policy would permit banks to use the reserves released to extend credit and bring deposits up to the former level. There is no net reduction in funds available for expenditure unless monetary policy is restrictive enough to prevent creation of new funds to replace the excess receipts siphoned from taxpayers.

Second, curbing consumer demand sufficiently to release resources for the production of additional capital goods may weaken the incentive to invest. A slump in consumer spending is soon felt by merchants and manufacturers. Adverse

effects on current and prospective profits would make them less willing to invest. Curbing consumer demand might diminish inducement to invest as much as or more than an easy money policy would increase it.

A third limitation is that only the direct effects of either fiscal or monetary policy can be slanted toward a certain type of economic activity such as consumption or investment. Dollars injected either by fiscal policy or monetary policy are just like any other dollars to those who receive them. The secondary response initiated by the direct effects cannot be regulated. Policies designed to alter the proportion of total income used for consumption and investment are unlikely to be successful unless accompanied by a corresponding shift in preferences between consumption, and saving and investment.

Short- vs. long-run stabilization

Hazards involved in forecasting together with the inflexibility of fiscal policy have led to proposals that we should rely primarily on automatic stabilizers and monetary policy to smooth out short-term fluctuations in business activity. Automatic stabilizers, which respond promptly to changes in production and income, exert considerable cushioning effect. Monetary policy, which can be quite flexible as to timing, could be used to supplement automatic stabilizers.

Discretionary fiscal actions could then be directed toward longer-run stability and sustained growth. Such actions would be taken mainly to help keep total demand in balance with expanding productive capacity instead of being directed mainly toward counteracting business fluctuations.

Two guides have been developed in recent years to facilitate implementing this type of fiscal policy. The "high or full employment sur-

plus” represents the excess of receipts over expenditures that the existing tax structure would yield with the economy operating at capacity. The “production gap” is the difference between actual G.N.P. and G.N.P. at full employment.

The production gap shows how far below potential capacity the economy is actually operating. It serves as a useful guide as to how much additional stimulus may be needed. The surplus that would be produced at full employment is a useful indicator of whether the current tax structure is likely to be too restrictive or too expansionary. A large surplus means the tax structure becomes restrictive before full employment is reached. There is fiscal drag on continued expansion and sustained growth. A sizable deficit, on the other hand, means the tax structure would continue to provide a stimulus even after full employment is reached. A tax increase would likely be needed as the economy approached full employment to avoid excess demand and rising prices.

A semi-automatic, long-range budget policy was suggested a few years ago by the Committee for Economic Development. Government expenditures, which determine allocation of resources between public and private use, should be established at the level society prefers. The tax structure should then be adjusted as necessary so as to yield a moderate surplus when productive capacity and resources are being fully utilized. It was believed that over a span of years such a policy would provide some net surplus for debt retirement.

This longer-range type of fiscal policy was expected to contribute to stability and growth with only limited discretionary action. The policy would also retain some of the discipline imposed by the goal of an annually balanced budget. New expenditures would require additional taxes in order to maintain the planned surplus at full

employment.

It seems likely, however, that considerable discretionary action would still be needed to maintain the desired surplus at full employment. The tax structure required would vary with changing conditions and could not be accurately determined far in advance. Changes in the level and composition of income, for example, would affect income-tax yields. Population growth and innovations might create a need for more Government services and a higher level of expenditures than anticipated. War and international tension might require large increases in Government expenditures.

CONCLUDING COMMENTS

It would be a marked step forward if both fiscal and monetary policies could be timed and coordinated toward our general economic goals of full employment, sustained growth, and price stability. Both tools, impersonal and indirect in their operation, are especially suitable in a democratic free enterprise society.

Greater flexibility is a prerequisite for more effective use of fiscal policy. Proposals to improve flexibility have some disadvantages, but these are small compared with the loss arising from not being able to time fiscal actions properly.

The next step, once we have improved flexibility, is use of fiscal policy to help curb inflationary pressures as well as to stimulate expansion in periods of economic slack. Coordinated fiscal-monetary actions to curb excessive demand and rising prices are more effective than either used alone and probably result in a more even distribution of the burden among sectors of the economy.

Altering the fiscal-monetary mix in order to meet more effectively the needs of a particular

situation is a further refinement in implementation. But the results that can be achieved are limited. This refinement is of considerably less

importance than overcoming the more fundamental weaknesses of inflexibility and failure to use fiscal policy as an instrument of restraint.

BUDGET CONCEPTS

The evolution of ideas as to how the federal budget should be used has been accompanied by a growing number of budget concepts—administrative, consolidated cash, national income, and high-level or full employment. Most of us are probably not interested in the technical details involved in the different concepts, but it is useful to see how they have been designed to serve different purposes.

Summary of Administrative, Cash, and National Income Accounts Budgets—1965 (Fiscal year; in billions)

Federal Receipts	
Administrative budget receipts	\$ 93.1
Trust fund receipts	31.0
Deduct: Intragovernmental transactions	4.4
Total, cash receipts from the public	119.7
Add: Adjustment from cash to accrual basis	— 0.9
Deduct: Receipts from loans, property sales, and other adjustments	1.9
National income accounts receipts—Federal sector	120.6
Federal Payments	
Administrative budget expenditures	96.5
Trust fund expenditures	29.6
Deduct: Intragovernmental transactions and other adjustments (net)	3.7
Total, cash payments to the public	122.4
Add: Adjustment from cash to accrual basis	2.6
Deduct: Disbursements for loans, land purchases, and other adjustments	6.7
National income accounts expenditures—Federal sector	118.3
Excess of Receipts (+) or Payments (–)	
Administrative budget	–3.4
Receipts from and payments to the public	–2.7
National income accounts—Federal sector	+2.3

Administrative budget

The administrative budget is the oldest concept. It is the one submitted to the Congress each January. Prior to 1921, each Executive department of the Government in its budget request dealt di-

rectly with the appropriate committees of Congress. No over-all budget was prepared and each departmental request was acted on individually. Effective budget control was practically impossible under such a piecemeal procedure.

The Budget and Accounting Act of 1921, establishing essentially the present budget procedure, was designed to provide much better control over the budget. The Act directed the President to prepare and submit to Congress, annually, proposed budget receipts and expenditures for the coming fiscal year. In addition, the Act authorized creation of the Budget Bureau in the Executive Branch to assist the President in preparing the annual budget. It also provided for establishment of the General Accounting Office which, acting on behalf of Congress, was to audit and control expenditures in accordance with the appropriations made by Congress.

The administrative budget is primarily an instrument for management and control of federal expenditures and receipts. It does not include all transactions between the Federal Government and the public, and therefore is not a good indicator of the impact of the Government's financial operations on the economy.

Cash consolidated budget

Social legislation, especially in the thirties, established a number of trust funds and Government-sponsored agencies and enterprises. Some of the larger trust funds are: the Federal Old Age and Survivors Insurance Trust Fund, the Unemployment Trust Fund, and the Highway Trust Fund. Government-sponsored enterprises include the Farm Credit Administration, Federal home loan banks, and the Federal Deposit Insurance Corporation.

Receipts and expenditures of the trust funds and Government-sponsored enterprises are not included in the administrative budget. A growing volume of transactions not included impaired ef-

fectiveness of the administrative budget as an indicator of the economic impact of the Federal Government's operations. In fiscal 1966, for example, net trust receipts and expenditures totaled nearly \$35 billion each.

The cash consolidated budget was designed to overcome these deficiencies of the administrative budget. It shows cash receipts from and payments to the public during a given period—the public referring to all economic units other than the Federal Government, its trust funds, and sponsored enterprises. The cash budget records receipts and payments when the funds are received or paid out.

National income accounts budget

A weakness of the cash budget is that it does not reflect promptly changing private economic activity. In the national income accounts budget, receipts—other than withheld income taxes—are recorded on an accrual basis instead of when cash is actually received; expenditures are recorded when goods are delivered instead of when payment is made. Net loans and other credit transactions of Government agencies are excluded.

In periods of economic expansion, tax liabilities rise more rapidly than the Treasury's cash tax receipts. To illustrate: corporate income-tax receipts recorded in the national income budget

for fiscal 1965 totaled \$27.8 billion, as compared to \$26.1 billion in the cash budget. An important advantage of the national income budget is that it reflects the impact of changing economic conditions more quickly than the cash budget.

Full or high employment budget

A budget surplus or deficit, regardless of which concept is used, reflects two things: discretionary fiscal actions with respect to taxes and expenditures, and effects of changes in the volume of business activity. Tax receipts as well as some expenditures automatically rise and fall with levels of income and output.

The full employment budget shows estimated receipts and expenditures (on a national income accounts basis) assuming the economy is operating at capacity, and under the existing tax structure and expenditure programs.

If tax receipts rise too rapidly during a period of business expansion, a growing surplus may exert so much restraint that the uptrend is halted before full employment is reached. A large full-employment surplus indicates a substantial fiscal drag on expansion and growth. A large deficit indicates the opposite—a substantial fiscal stimulus, which with resources about fully utilized would probably generate excessive demand and rising prices.

1967: A NEW SPENDING MIX

by Kevin G. Woelflein

As 1967 begins, the economy is set to start another year in the longest expansion in our economic history. This statement sounds much like ones made at the start of 1966. But important changes have occurred which may make continued prosperity more difficult to achieve. These changes are wrapped up in the spending mix.

For better or worse, the present expansion shifted gears in 1966. Because of these changes, policymakers have an unusual challenge to prolong prosperity by selecting an appropriate combination of measures that will make the transition a smooth one.

From 1961 through 1965, businesses and individuals increased spending at a slightly faster pace than government. Thus, increasing percentages of GNP growth were rooted in the private sector of the economy. But during 1966, U.S. involvement in Vietnam accelerated, imposing additional demands on a bustling economy. The increase in government spending was double the 1965 advance, outpacing the percentage rise in both private investment and consumer spending. As a result, the relative importance of Federal Government outlays in total expenditures, which declined for four years, rose in 1966, as the top portion of Chart 1 shows.¹

This development is likely to continue as business, government, and bank forecasters predict

increased government spending will account for a larger portion of GNP growth in 1967.² These published forecasts take for granted further increases in defense spending. Uncertainty focuses on the question how much more. But in the private sector, many signs of weakness have developed. This combination—rising government and slowing consumer spending—will produce a basic shift in the spending mix, a basic shift in underlying forces providing upward thrust to the economy in 1967.

Government spending shifts are under way

The fresh upward thrust of government spending in 1966 was caused by increased spending by the Federal Government. This was a new development, since Federal Government expenditures had not increased so rapidly as outlays by state and local governments for four years in this expansion—1961, 1963, 1964, and 1965. (See middle section of Chart 1.)

A large portion of these expenditures by state and local governments has gone for education—new schools as well as increased outlays for teacher salaries. Recent studies show that the rate of increase of education outlays—especially new schools—will slow down. But increased spending is needed for urban renewal, reducing air and water pollution, improving transportation services, and creating new recreation facilities.

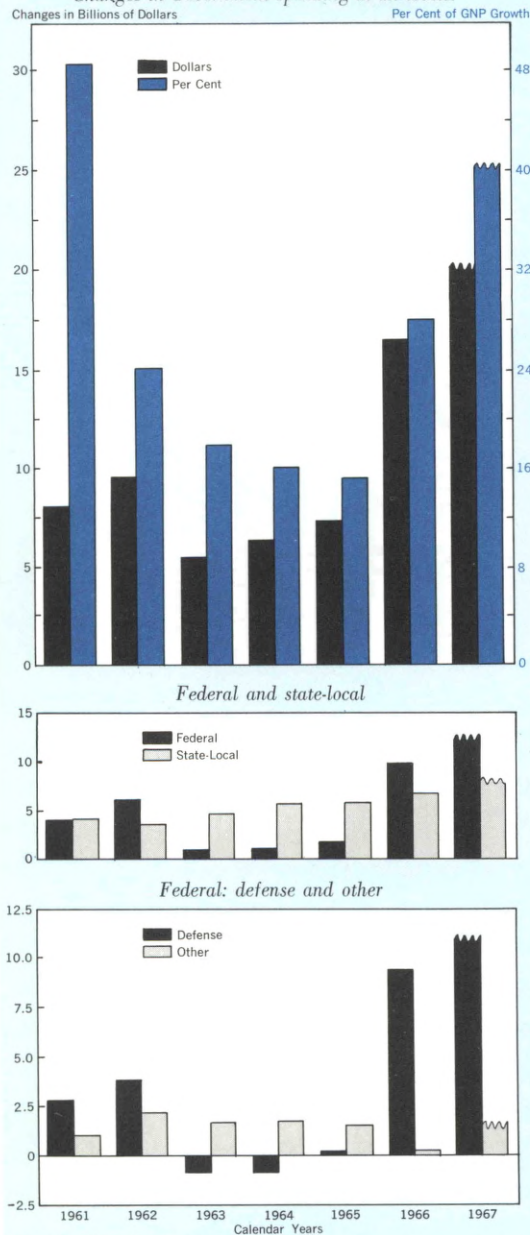
¹ *The Federal Government also increased payments for social security, Medicare, veterans' benefits, interest on the national debt, and grants to states, but these expenditures only show up in GNP accounts when consumers, businessmen, and local governments spend the money.*

² *This statement and others in this article concerning 1967 forecasts are based on a consensus of published forecasts compiled by the Federal Reserve Bank of Philadelphia.*

CHART 1

**THE GROWING ROLE OF GOVERNMENT
IN THE EXPANSION OF AGGREGATE DEMAND**

*Changes in Government spending at all levels.**



*For goods and services as shown in GNP accounts.

This type change can be made gradually without sudden disturbing effects.

The change in government spending that is having more serious economic impact is rising federal outlays. Federal spending for goods and services provided firm support, but it was not an important expansionary force until 1966 when defense spending shot up over \$9 billion, 16 per cent of 1966 growth in GNP.

This rapid rise of defense buying in 1966 came on top of brisk private spending for durable goods, especially aircraft, machinery, non-ferrous metals and fabricated metals. And a bigger armed force also siphoned young men from the labor force and helped empty caches of food; furthermore, the nature of the Vietnam war has required a shift in procurement from sophisticated missile systems to conventional arms—rifles, ammunition, helicopters, and tactical airplanes.

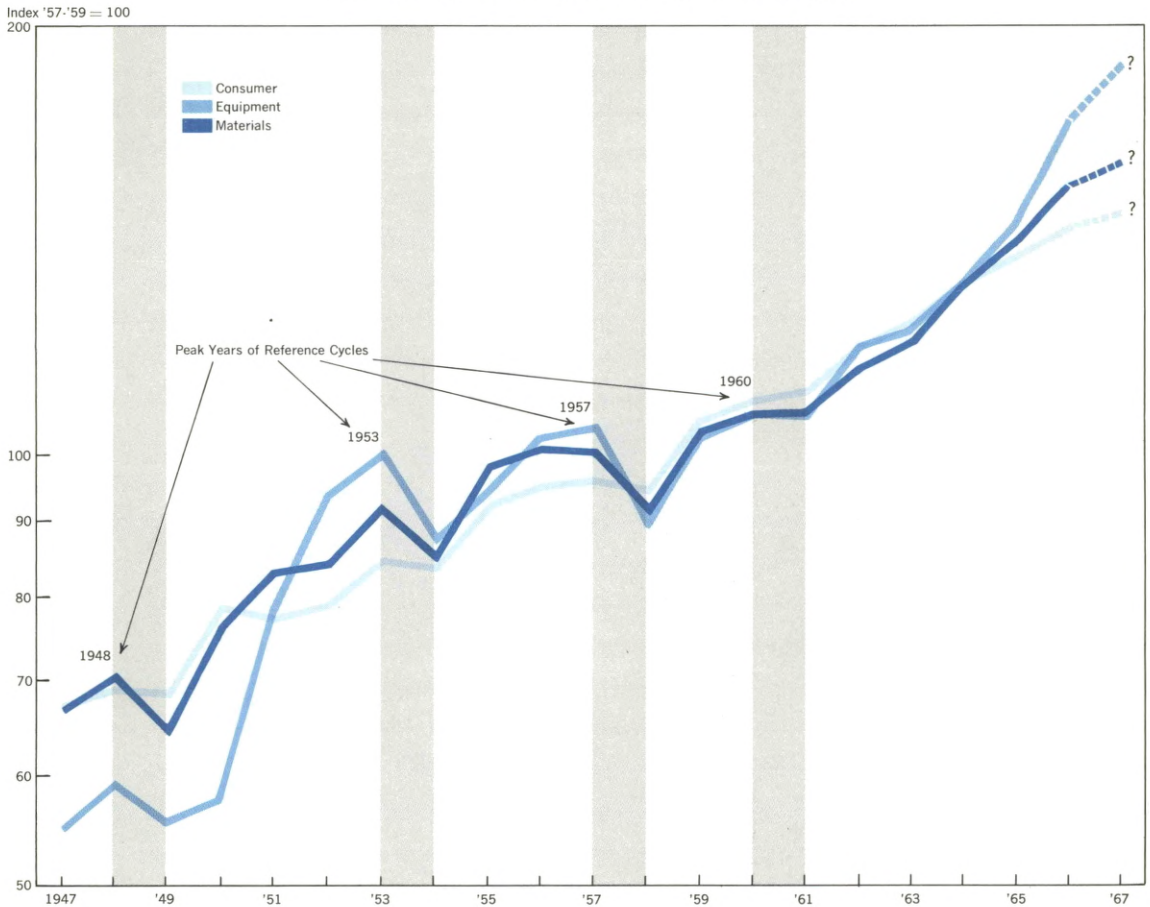
The 1967 forecasts assume that projected increases in defense spending will offset slowness in the private sector of the economy. But the resources needed to produce these very different goods have not, in the short run, been readily shifted from consumer goods production to defense. Adjustments like plant modifications take time. Retraining and relocating workers is a formidable practical problem also. And if new facilities are needed, businessmen will have to gear up. This also takes time. The net economic effect of all this is not clear. It is safe to say, however, that equilibrium is disturbed. Where high levels of activity have prevailed—as in defense industries—immediate response has not been possible. Further increases in defense spending in 1967 will complicate the adjustment.

Also in 1966, increased defense needs coincided with burgeoning capital expenditures in most major industries. Thus, pressure built up in

CHART 2

THE WIDENING GAP BETWEEN EQUIPMENT AND CONSUMER GOODS PRODUCTION

*FRB index of industrial production by market category**



capital goods industries at the same time consumer buying slowed. Producers of consumer goods slowed production after mid-1966, trying to hold inventory in line with sales. But equipment production boomed upward, widening the gap with consumer goods production as shown in Chart 2. If prevailing forecasts turn out to be right, the gap will widen further in 1967.

In the postwar period, all our recessions have

been preceded by this sort of imbalance. Will history repeat itself in 1967? Or can government spending rise enough to offset declines in the private sectors of the economy?

Private spending pauses

A year ago businessmen viewed the outlook optimistically. The economic expansion was widespread and demand from all sources advanced

with no significant changes apparent. Plans for increased capital expenditures in 1966 were made. And throughout most of the year, leading indicators—new appropriations, new orders, profits, margins, and the ratio of price to unit labor cost—all showed favorable trends. There was little indication that consumer buying patterns were about to change.

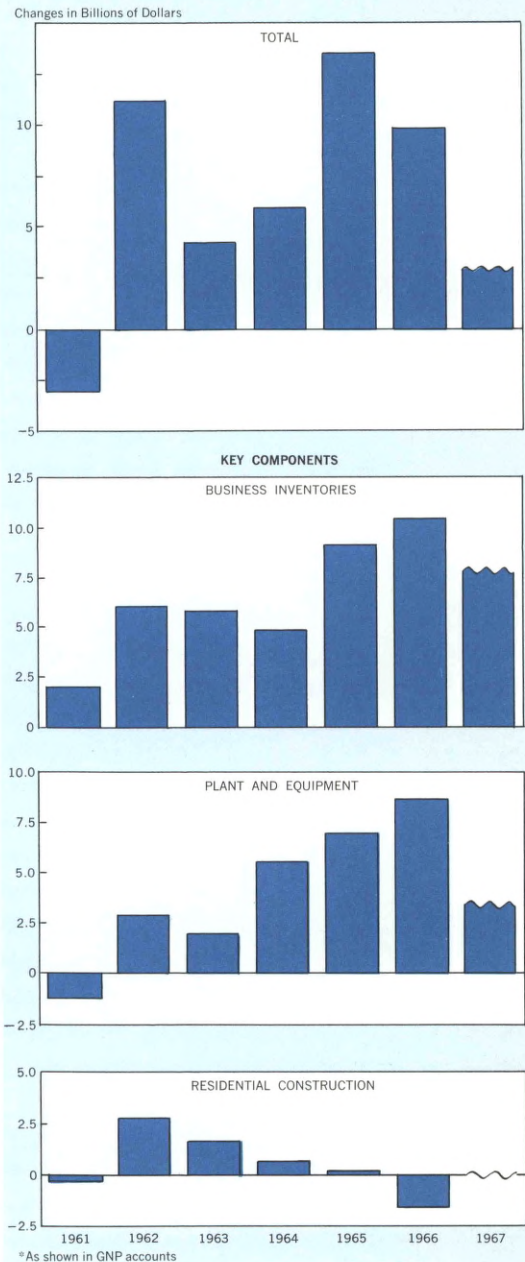
Inventory accumulation, one of the most important forces in this expansion, kept pace with rising sales throughout most of 1966. The change in business inventories in 1966, when adjusted for building of defense goods, was only slightly higher than 1965.

Nevertheless, by year-end, signs of change appeared. Some manufacturers were laying off workers, others were cutting overtime. Still, inventory-to-sales ratios moved higher in the fourth quarter. Thus, forecasters predicted a slowdown in the rate of increase for inventory in 1967. (See Chart 3.)

And the *investment climate* for 1967 became less certain as businessmen saw each major investment consideration cloud up. As consumer optimism sagged, market opportunities went with them. Thus, the possibility of passing along rising costs as higher prices in 1967 also diminished with signs of softening demand. By fall 1966, new capacity coming on stream eased pressure on capacity utilization, showing that demand was no longer building up faster than ability to produce. Besides that, suspension of the investment tax credit took effect in the fourth quarter, thus reducing another incentive to invest.

Operating costs began to rise faster than prices late in the year; the ratio of labor cost per unit of output started rising in September. But profits had already leveled off. And new appropriations for capital expenditures peaked in the second quarter.

CHART 3
THE DECLINING FORCE OF BUSINESS SPENDING
*Changes in Gross Private Domestic Investment**

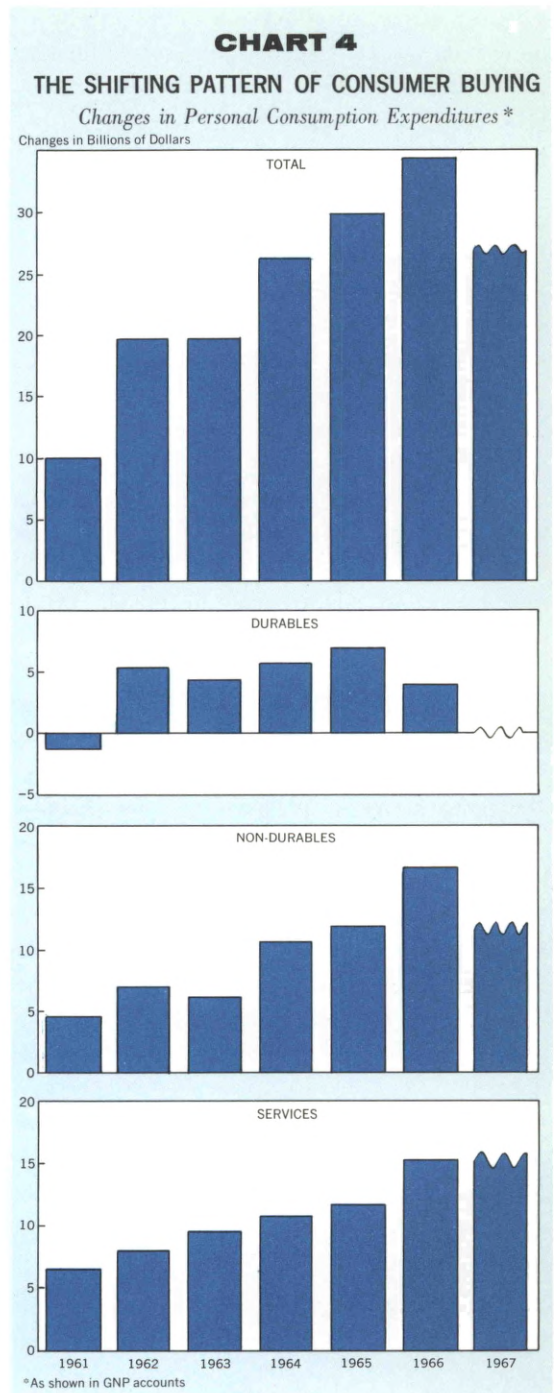


Surveys of 1967 investment intentions show far less enthusiasm than they did at this time a year ago. The forecasts we reviewed cluster around a gain of 6 per cent in 1967 which will advance GNP \$3-4 billion. (See Chart 3). Analysis of the investment plans in greater detail shows that increased investments are planned by those industries affected by rising defense orders. Industries supplying consumer goods plan less capital outlays than they made in 1966. Thus, the changing investment climate means fewer industries will participate in the 1967 capital goods expansion.

In 1962 and 1963 about \$4.4 billion was added to GNP by increased outlays for *housing*. (See bottom section of Chart 3). Housing starts peaked early in 1964 largely because apartment units were overbuilt. Nevertheless, the modest declines in starts did not prevent expenditures from advancing a little in 1964 and 1965 due to a combination of higher prices and better quality. But as credit tightened in 1966, mortgage funds were first to feel the impact of monetary policy. Housing starts fell sharply after the first quarter, reaching 20-year lows by fall.

Hope for the industry in 1967 hinges on greater availability of mortgage funds. Strength of potential demand seems certain because of rising family formations, family income, and falling vacancy rates. But it is questionable that mortgage funds, even if much more readily available, could have a significant impact on actual starts or on construction activity before mid-1967. Thus, few forecasters assume any expansionary thrust from residential construction for the year taken as a whole.

Consumers spend about 92 cents of every after-tax income dollar. To predict total spending, therefore, is not difficult given estimates of income and taxes. What proves formidable is fore-



casting shifts in spending patterns and their economic impact. In 1966 more-than-usual amounts of extra income were spent for nondurables and services, less on durables. If present trends continue into 1967, the economic driving force derived from consumer spending will come only from nondurables and services. (See Chart 4).

Consumer psychology will play an important role in economic activity. If the income and employment outlook appears drab, consumers will go to the laundromat and make the family car last a little longer. Further outlays for defense without any fundamental change in the war are unlikely to alter consumer attitudes in the year ahead. But if the war escalates and we endure some military setbacks, fear of shortages might develop as it did during the Korean War. No such fear of shortages exists now. Consequently, consumers are likely to follow the normal pattern of holding back on durable goods purchases, spending more percentagewise on basic needs until fresh new stimulus appears.

Government outlays the key to 1967

As 1967 begins, much of the upward thrust in the private sector therefore is directly tied to rising government spending. Forecasts for the year ahead basically assume that increased government spending will offset weakness in the private sector. But even if total expenditures are maintained,

shifts from private to military demands will be painful and will take time to achieve. Resources, in terms of men and machines, are simply not so flexible as economists sometimes believe. Money not spent on appliances, autos, and housing causes these producers to reduce output and employment. However, such slack in the 1967 economy would not do much to relieve pressure building up in the aircraft, machinery, electronics, and other defense-related industries.

Defense spending may enhance inflationary effects. Eventually spending, unless paid for by increased taxes, tends to outrun supply because defense outlays add to income but not to the stock of consumer goods. To what extent these pressures will build in 1967 is unknown. But life for policymakers would be easier if they could be sure budget estimates will turn out to be right. Furthermore, no one knows how soon increased government spending will stimulate consumers.

A forecast growth of \$40-50 billion in GNP for 1967 is not pessimistic. However, the seeds of economic imbalance were planted in 1966. Consequently the changing spending mix focuses economic policy problems in 1967 on how to water the garden—one important section (housing) is parched, another (business and consumer spending) drying out fast, and a third (defense) nearly saturated.

Third District Business and Banking Conditions During 1966

by Henry A. Watson

Business. Propelled by the escalation in Vietnam, business conditions during 1966 in the Third Federal Reserve District continued to expand. The labor supply was extremely short and the recruiting of skilled and even semi-skilled workers was intensified as help-wanted advertising in the District reached a new all-time peak.

The unemployment problem which had persisted for years was now not one of generating

cost of living, as measured by the consumer price index, rose by 2.8 per cent for the year and food prices threatened to go even higher in 1967. The one weak spot for the District was residential construction which was off by 12 per cent from 1965. It was clear as the year closed that most areas of business activities in the District had experienced pressure and 1967 loomed on the horizon as a year of continued growth and expansion.

Banking. During the first half of 1966 net loans of all District banks forged ahead at a rate comparable to that in the nation. They leveled off during the second half and then expanded at a much slower rate than before. The growth rate at city banks fell somewhat behind that of country banks. To obtain funds for loans, both city and country banks liquidated securities on balance, with short-term Governments hardest hit.

Time deposits in the District banks increased by 13.8 per cent during the year, about the same rapid pace of 1965. Demand deposits, on the other hand, were subject to wide fluctuations and remained approximately at the same level. Total deposits were up about 7 per cent in both the District and the nation.

UNEMPLOYMENT IN MAJOR LABOR MARKET AREAS — THIRD FEDERAL RESERVE DISTRICT

Per Cent of Labor Force Unemployed	Number of Areas		
	October 1966	November 1965	November 1964
1.5 to 2.9%	6	5	2
3.0 to 5.9	6	4	6
6.0 to 8.9	1	4	5
9.0 to 11.9	0	0	0
12.0 or more	0	0	0
Total areas	13	13	13

new jobs, but matching people to jobs. The unemployment rate was down to 2.7 per cent* of the total labor force, the lowest year for the District since 1953. The rate in all 15 of the major labor market areas in the District dropped drastically in 1966 with only five remaining above the national rate of 3.4 per cent.*

Increased productivity and capacity had helped offset the pressure of rising demand for goods and services. But prices continued upward. Factories were working on longer hours with wage incomes of workers increasing due to raises and overtime. Labor cost per unit of output, after remaining relatively stable during 1965, was rising both in the District and nation as the year closed. The

BUSINESS INDICATORS

THIRD FEDERAL RESERVE DISTRICT PER CENT CHANGE 1965 TO 1966*

Manufacturing employment	+ 3
Factory payrolls**	+ 8
Factory working time**	+ 4
Electric power consumed by manufacturers	+10
Construction contracts:	- 0
Residential	-12
Nonresidential	+ 1
Public works and utilities	+22
Consumer Price Index	+ 3
Bank debits (20 cities) (s.a.)	+14

* First 11 months

** First 10 months

* Not adjusted for seasonal variation.

(Continued from Page 2)

even worse job and severely damaging the economy in the process. The market works remarkably well considering all the impediments that have been put in its way. Despite our efforts to learn more about the monetary system, we could not possibly know better than the market.

Nor do those who take this approach necessarily overlook the drift of public sentiment toward intervention in markets. They feel the public is misguided in attempting to provide special supports for certain parts of the economy and trying to channel resources in one direction rather than another. If special support is deemed politically or socially appropriate for some particular part of the economy, say housing, this is better provided directly by means such as subsidies, rather than through monetary policy. Theirs is the purest form of non-interventionist philosophy of monetary policy.

2. *Remove market imperfections.* Since the market is not completely free and perfect, another approach would remove some of the imperfections which help produce uneven impacts.

Examples suggested by recent events naturally tend to cluster in markets for mortgages and savings. Some have proposed that usury laws be changed to permit rates on mortgages to compete with those on alternative investments. Others have suggested that creation of a secondary market would improve the liquidity of conventional mortgages and make them more attractive. Still others have even raised the possibility that rates on outstanding mortgages could fluctuate as rates on other instruments move up and down. Proposals such as these are designed to alter the market mechanism so as to improve the competitiveness of mortgages.

Another field for action is in rates on time and savings deposits. Experience of the past year has

reinforced the view of many that ceilings on such deposits impair the free flow of funds and should be removed. But the past year also has demonstrated the severe disruption of relationships among savings institutions that can ensue from a freer flow of time and savings funds. It is much more painful to *remove* market imperfections to open up competition than simply to *immobilize* imperfections to preserve the *status quo*.

So even though this approach may be designed to make the market better able to do its job without producing severely uneven impacts, it is not so simple as it might seem. Who is willing to face the disruption of existing institutional patterns that can ensue from removing impediments to a free flow of funds?

3. *Deal selectively.* This third approach has been the one most often used. In fact, a review of Federal Reserve history suggests that the selective approach to monetary policy has tended to recur whenever general instruments of policy have been under great pressure. For purposes of illustration:

- “Direct action” in the late 1920’s; designed to deal selectively with the problem of credit flowing into the stock market.
- Margin requirements; imposed in 1934 to deal with the same problem.
- Moral suasion; use of official pronouncements from time to time throughout the past fifty years to encourage or discourage the flow of credit in certain directions.
- Regulations W and X; for the purpose of restraining the expansion of consumer and real-estate credit.
- “Operation twist”; designed in the early 1960’s to influence the structure of rates in order to resolve conflicting objectives of domestic and international policy.
- The September 1, 1966 letter from the Federal

Reserve System to member banks; intended to induce banks to curtail business lending in return for longer accommodation at the discount window.

The case for a selective approach rests firmly on the fact that monetary policy does impinge on the economy selectively. Although general instruments of policy purport only to regulate the total supply of credit and not various uses of credit, they do in fact affect some uses more than others.*

This being the case, why not employ existing instruments of policy, or design new ones, to influence uses of credit in a *desired* manner? In rebuttal to those who say that this would interfere with the free market, proponents of the selective approach reply that operations of the market place are not sacred. In the first place, the market may not take into consideration the public's social priorities. And secondly, experience tells us that the market frequently permits imbalances to arise: consumer credit may be so plentiful as to produce a boom in consumer durables; credit to business may be so readily available as to encourage over-investment.

Monetary policy long since has been accepted as a way of preventing extremes—booms and busts—in over-all economic activity. Shouldn't the next evolutionary step be to influence *parts* of the economy that produce these over-all extremes? We'll never know as much as we'd like about how the economy works, and policy always will require human judgment, so mistakes will be made. But surely, over time, we should learn

* *In the past year, more effective fiscal measures could have enabled monetary policy to have been less restrictive, thus lessening the uneven impact of monetary restraint. But fiscal policy also has its impacts on various parts of the economy. The difference is that in fiscal policy these impacts can be consciously directed toward certain selected areas more readily than in monetary policy.*

more and make fewer mistakes. Hopefully this has been happening in monetary policy up to now.

* * *

Which of these approaches will be taken probably will depend on which has the least disadvantages. Of the three, the selective approach departs most drastically from a philosophy of non-intervention in the market place. Removing impediments to competition—the second approach—would help the market work more freely but would require drastic changes in existing institutional relationships. To take the first approach—tolerating the uneven impacts—would run against the mainstream of public sentiment. The public seems intolerant of the market place if it frustrates their social or economic priorities. The public may be misguided in this attitude, but in a democratic society the public is always “right.” If this continues to be the nature of public sentiment, some action will be needed to deal with uneven impacts of policy.

Perhaps the best approach is a combination of the three. Free markets offer the unquestioned advantage of allocating funds according to demands. The fact that markets generally are relatively free in our economy goes a long way toward explaining the rapid growth and high standard of living we have enjoyed. To the extent possible, therefore, freedom of markets is a desirable base from which to start.

This requires action to remove some market imperfections and impediments to the free flow of funds. However, it is unrealistic to think that this approach can go very far without running into strong opposition. A selective approach may be needed to do the rest of the job.

If this is so, some forward planning may be required. In ordinary circumstances, the impacts of monetary policy are even enough that an over-all approach presents no problem. But in

exceptional periods of restraint, the selective approach has tended to be an *ad hoc* expedient. Perhaps careful consideration of the advantages and disadvantages of the selective approach—

including such troublesome aspects as the administrative burden and exposure of policy to pressure groups—would place us in better position to deal with uneven impacts in the future.

New Release

Forecasts for 1967. The Department of Research has compiled and analyzed a number of predictions made by businessmen, economists, and Government officials. This compilation includes a summary of forecasts for the economy as a whole and particular sectors of the economy. The more important indicators are presented in chart form.

Copies of this release are available on request from Bank and Public Relations, Federal Reserve Bank of Philadelphia, Pennsylvania 19101.

DIRECTORS AND OFFICERS

On March 3, 1966, the Board of Governors of the Federal Reserve System designated Mr. Willis J. Winn as Chairman of the Board of Directors and Federal Reserve Agent of this Bank for the remainder of 1966, succeeding Mr. Walter E. Hoadley who resigned on February 14. Also, on March 3 Mr. Bayard L. England, a Class B Director since January 1, 1965, was appointed a Class C Director by the Reserve Board and was designated Deputy Chairman for the remainder of the year. In a special election, Mr. Philip H. Glatfelter III, President, P. H. Glatfelter Co., Spring Grove, Pennsylvania, was elected by member banks in Electoral Group 1 as a Class B Director, to fill the unexpired term ending December 31, 1967 vacated by Mr. England.

At regular elections held later in the year, Mr. Robert C. Enders, President, Bloomsburg Bank-Columbia Trust Co., Bloomsburg, Pennsylvania, was elected by member banks in Electoral Group 2 as a Class A Director for a three-year term beginning January 1, 1967. He succeeds Mr. Charles R. Sharbaugh. Mr. Edward J. Dwyer, President, The Electric Storage Battery Co., Philadelphia, Pennsylvania, was elected to a like term by member banks in Electoral Group 3 as a Class B Director, succeeding Mr. Leonard P. Pool. Mr. Ralph K. Gottshall, Chairman of the Board and President, Atlas Chemical Industries, Inc., Wilmington, Delaware, resigned as a Class B Director on December 31, 1966.

In December, the Board of Governors reappointed Mr. Bayard L. England as a Class C Director for a full three-year term beginning January 1, 1967. Mr. Willis J. Winn was redesignated as Chairman of the Board of Directors and Federal Reserve Agent, and Mr. England as Deputy Chairman for the year 1967.

The Board of Directors of this Bank selected Harold F. Still, Jr., President, Central-Penn National Bank of Philadelphia, Philadelphia, Pennsylvania, to serve during 1967 as the member of the Federal Advisory Council from the Third Federal Reserve District.

The Board of Directors of this Bank, with the approval of the Board of Governors, reappointed Mr. Karl R. Bopp as President and Mr. Robert N. Hilker as First Vice President, each for a statutory term of five years, beginning March 1, 1966. During the year, three reductions occurred in the officer staff of the Bank: Mr. Bertram W. Zumeta, Economist, and J. C. Rothwell, Jr., Economist, resigned effective July 31 and December 16, respectively, to accept positions in private industry. Mr. Evan B. Alderfer, Economic Adviser, retired on December 31.

DIRECTORS AS OF JANUARY 1, 1967

Group		Term expires December 31
	CLASS A	
1	HOWARD C. PETERSEN Chairman of the Board Fidelity-Philadelphia Trust Co. Philadelphia, Pennsylvania	1968
2	ROBERT C. ENDERS President, Bloomsburg Bank-Columbia Trust Co. Bloomsburg, Pennsylvania	1969
3	LLOYD W. KUHN President, The Bendersville National Bank Bendersville, Pennsylvania	1967
	CLASS B	
1	PHILIP H. GLATFELTER, III President, P. H. Glatfelter Co. Spring Grove, Pennsylvania	1967
2		
3	EDWARD J. DWYER President, The Electric Storage Battery Co. Philadelphia, Pennsylvania	1969
	CLASS C	
	WILLIS J. WINN, Chairman Dean, Wharton School of Finance and Commerce University of Pennsylvania Philadelphia, Pennsylvania	1967
	BAYARD L. ENGLAND, Deputy Chairman Chairman of the Board Atlantic City Electric Co. Atlantic City, New Jersey	1969
	D. ROBERT YARNALL, JR. President, Yarway Corporation Philadelphia, Pennsylvania	1968

OFFICERS AS OF JANUARY 1, 1967

KARL R. BOPP
President

ROBERT N. HILKERT
First Vice President

HUGH BARRIE
Vice President

JOSEPH R. CAMPBELL
Vice President

NORMAN G. DASH
Vice President

DAVID P. EASTBURN
Vice President

DAVID C. MELNICOFF
Vice President

G. WILLIAM METZ
Vice President and
General Auditor

HARRY W. ROEDER
Vice President

JAMES V. VERGARI
Vice President and
General Counsel

RICHARD G. WILGUS
Vice President and Secretary

CLAY J. ANDERSON
Economic Adviser

EDWARD A. AFF
Assistant Vice President

JACK P. BESSE
Assistant Vice President

JOSEPH M. CASE
Assistant Vice President

RALPH E. HAAS
Assistant Vice President

WILLIAM A. JAMES
Assistant Vice President

WARREN R. MOLL
Assistant Vice President

LAWRENCE C. MURDOCH, JR.
Assistant Vice President
and Assistant Secretary

HENRY J. NELSON
Assistant Vice President

KENNETH M. SNADER
Assistant Vice President

RUSSELL P. SUDDERS
Assistant Vice President

WALTER J. BROBYN
Assistant Counsel

JAMES P. GIACOBELLO
Chief Examining Officer

THOMAS K. DESCH
Examining Officer

WILLIAM L. ENSOR
Examining Officer

JACK H. JAMES
Examining Officer

LEONARD E. MARKFORD
Examining Officer

JAMES A. AGNEW, JR.
Assistant Cashier

FRED A. MURRAY
Director of Plant

A. LAMONT MAGEE
Assistant General Auditor

STATEMENT OF CONDITION

Federal Reserve Bank of Philadelphia

(000's omitted in dollar figures)	End of year	
	1966	1965
ASSETS		
Gold certificate reserves:		
Gold certificate account	\$ 698,902	\$ 787,149
Redemption fund—Federal Reserve notes	96,258	93,751
Total gold certificate reserves	\$ 795,160	\$ 880,900
Federal Reserve notes of other Federal Reserve Banks . .	48,058	65,516
Other cash	6,773	6,473
Loans and securities:		
Discounts and advances	545	3,826
United States Government securities	2,289,202	2,114,399
Total loans and securities	\$2,289,747	\$2,118,225
Uncollected cash items	541,950	483,808
Bank premises	2,510	2,587
All other assets	64,123	51,052
Total assets	\$3,748,321	\$3,608,561
LIABILITIES		
Federal Reserve notes	\$2,305,967	\$2,241,279
Deposits:		
Member bank reserve accounts	896,033	858,408
United States Government	505	38,326
Foreign	8,640	8,400
Other deposits	8,599	6,307
Total deposits	\$ 913,777	\$ 911,441
Deferred availability cash items	456,785	387,172
All other liabilities	11,934	9,577
Total liabilities	\$3,688,463	\$3,549,469
CAPITAL ACCOUNTS		
Capital paid in	\$ 29,929	\$ 29,546
Surplus	29,929	29,546
Total liabilities and capital accounts	\$3,748,321	\$3,608,561
Ratio of gold certificate reserves to		
Federal Reserve note liability	34.5%	39.3%

EARNINGS AND EXPENSES

Federal Reserve Bank of Philadelphia

(000's omitted)	1966	1965
Earnings from:		
United States Government securities	\$95,513	\$79,596
Other sources	1,862	1,318
Total current earnings	\$97,375	\$80,914
Net expenses:		
Operating expenses*	8,501	8,571
Cost of Federal Reserve currency	1,295	1,348
Assessment for expenses of Board of Governors	483	473
Total net expenses	\$10,279	\$10,392
Current net earnings	87,096	70,522
Additions to current net earnings:		
Profit on sales of U.S. Government securities (net)	—	—
All other	93	59
Total additions	\$ 93	\$ 59
Deductions from current net earnings:		
Loss on sales of U.S. Government securities (net)	127	(a)
Miscellaneous non-operating expenses	3	5
Total deductions	\$ 130	\$ 5
Net additions	—37	54
Net earnings before payments to U.S. Treasury	\$87,059	\$70,576
Dividends paid	\$ 1,790	\$ 1,753
Paid to U.S. Treasury (interest on Federal Reserve notes)	84,886	68,392
Transferred to or deducted from (—) Surplus	\$ 383	\$ 431

* After deducting reimbursable or recoverable expenses.
(a) Less than \$1 thousand, rounded.

VOLUME OF OPERATIONS

Federal Reserve Bank of Philadelphia

Number of pieces (000's omitted)	1966	1965	1964
Collections:			
Ordinary checks*	276,643	262,900	244,500
Government checks (paper and card)	30,800	29,500	28,700
Postal money orders (card)	18,200	17,800	17,200
Non-cash items	832	836	863
Food stamp coupons	9,766	3,685	3,572
Clearing operations in connection with direct sendings and wire and group clearing plans**	697	679	702
Transfers of funds	233	208	193
Currency counted	297,500	268,400	269,600
Coins counted	403,800	159,400	136,800
Discounts and advances to member banks	1	1	1
Depository receipts for withheld taxes	662	609	606
Postal receipts (remittances)	280	286	309
Fiscal agency activities:			
Marketable securities delivered or redeemed	621	538	539
Savings bond transactions— (Federal Reserve Bank and agents)			
Issues (including reissues)	9,512	8,867	8,759
Redemptions	6,956	6,745	6,334
Coupons redeemed (Government and agencies)	1,072	1,074	1,141
Dollar amounts (000,000's omitted)			
Collections:			
Ordinary checks	\$ 88,836	\$ 79,445	\$ 72,735
Government checks (paper and card)	6,993	6,004	6,097
Postal money orders (card)	254	246	247
Non-cash items	827	563	239
Food stamp coupons	13	5	5
Clearing operations in connection with direct sendings and wire and group clearing plans**	49,908	47,649	44,770
Transfers of funds	192,718	167,181	134,480
Currency counted	2,205	2,003	1,987
Coins counted	45	12	21
Discounts and advances to member banks	1,806	2,086	863
Depository receipts for withheld taxes	3,348	2,593	2,522
Postal receipts (remittances)	914	891	931
Fiscal agency activities:			
Marketable securities delivered or redeemed	14,913	13,845	14,486
Savings bond transactions— (Federal Reserve Bank and agents)			
Issues (including reissues)	464	431	444
Redemptions	381	362	346
Coupons redeemed (Government and agencies)	342	225	146

* Checks handled in sealed packages counted as units.

** Debit and credit items.