FEDERAL RESERVE BANK OF RICHMOND

1963 ANNUAL REPORT

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OF
RICHMOND
FORTY-NINTH
ANNUAL
REPORT

MAJOR TRENDS AND PROBLEMS
IN THE
POSTWAR ECONOMY

FEDERAL RESERVE BANK OF RICHMOND

TO OUR MEMBER BANKS:

It is a pleasure to present the 1963 Annual Report of the Federal Reserve Bank of Richmond. This year's report features major trends in the national economy since World War II. Also included in the report are comparative financial statements, a brief summary of our operations, and a current list of officers and directors of our Baltimore, Charlotte, and Richmond offices.

On behalf of our directors and staff, we wish to say thank you for your cooperation and support throughout 1963.

Sincerely yours,

Edwin Hyde
Chairman of the Board.

Edw. A. Wayne
President.

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MAJOR TRENDS AND PROBLEMS

In recent years the performance of the American economy has come under increasing scrutiny and criticism. Economic literature is heavily sprinkled with analyses of, and speculation about, economic growth and the factors which promote or retard it. The need to stimulate growth was a major issue in the 1960 Presidential campaign. More recently, the question has been debated extensively in connection with the proposed Federal tax reduction.

At times the discussion has concentrated on the whole economy, while at others it has dealt with certain major components. The time period covered has been sometimes long and sometimes short. This has meant that frequently the issues were not clearly joined and the different discussants were not always talking about the same things.

Almost two decades have passed since the end of World War II. In those two decades the environment and the behavior pattern of the United States' economy have been considerably different from those prevailing before the war. Perhaps, therefore, the present may be an appropriate time to take a long and broad look at the behavior of the whole economy and of its major components in the postwar period. Such is the purpose of this report. Among its other uses it may, as was its original purpose, serve as

IN THE POSTWAR ECONOMY

An Introductory Note

a general framework or background to afford some perspective for discussions of the short-range business outlook.

After a brief look at the general postwar environment of the economy, the first operation will be to examine a number of statistical series, a few of which deal with the economy as a whole, but most of which show the behavior of certain major economic sectors. In each of these, particular attention will be devoted to the rate of growth. Following that, consideration will be given to a few of the more important developments of the period in an attempt to provide some explanation as to why they occurred. Next, a complex of the more troublesome current problems will be discussed and an attempt made to show their interrelationships and causes. Finally, some recent changes which seem to be evolving will be noted and evaluated.

There are a great many statistical series which to some extent measure the behavior of the whole economy or its many parts. It is not easy to select a small number of series which will give the kind of composite picture needed here. All of the major series are interrelated in some fashion and changes in any one of them are to some extent both cause and effect of changes in others. For the present purpose, 12 major series have been selected. These are data which are well known and readily available. No attempt has been made to refine or adjust them, since the purpose here is to paint the picture in broad strokes. The original data used show official index numbers, current dollar values unadjusted for price changes, or other appropriate units of measurement. The one exception to this is the figure for Gross National Product which is shown in both current and in constant (1954) dollars.

The charts are based on quarterly averages; where the data appeared originally as monthly figures, quarterly averages have been computed. Where appropriate, the figures are seasonally adjusted and in many cases they are stated in terms of annual rates. On the charts, annual growth rates appear as superscriptions above the lines representing the data.

The year 1947 was chosen as the starting point since 1946 was too much affected by transition from war to be representative. To indicate changes from prewar conditions, a 1939 or 1940 figure is plotted on most of the charts as a reference point. The material charted extends through the third quarter of 1963, the latest data available at this writing.

The original intention was to treat the whole postwar period together, but early study of the data revealed that substantial and fairly persistent changes of trend took place about 1957 in most series. For that reason, it seemed that in computing rates of growth the data would yield more useful information if the whole period were broken into two subperiods with 1957 as the dividing year, and rates of growth computed for each subperiod. The choice of time periods for such comparisons always raises the troublesome problem of comparability of terminal years. For the first subperiod—1947-1957—there is no great problem since both years were years of high-level economic activity. For the second subperiod, the comparison is between 1957, which marked the peak of a business cycle, and 1963. It is impossible at this time to say whether 1963 also recorded a cyclical peak, but it was almost as far from the previous cyclical trough as was 1957. In this respect it would seem that 1963 is reasonably comparable with 1957.

The annual rates of growth were computed by converting annual averages to logarithms and determining the line of best fit for those values. This method avoids giving undue weight to extreme or untypical values occurring in terminal years. Figures for 1963 were estimated from data for the first three quarters.

The Setting

As a preliminary it may be helpful to note briefly the broad and general characteristics which have marked the economy since World War II. In this connection there were two important developments which did *not* occur.

No Major Depression Contrary to all past experience following major wars, there was no broad, general deflation with its accompanying depression. In fact, the economy has not had a sharp business decline nor a major depression in 25 years—since 1938. This is the longest such period in the past century. The late Per Jacobsson, for many years managing director of the International Monetary Fund, thought that the absence of a postwar deflation was due largely to relatively effective wage and price controls during the war and to the very high degree of liquidity, relative to wages, prevailing in the immediate postwar period.

No Major Tax Reduction The other thing which did *not* happen was a major reduction in Federal taxes. There was a substantial reduction in 1948 but this was followed by a sharp increase after the outbreak of the Korean War in 1950. In the case of the corporate income tax, the standard rate (that applying to income above $25,000) was raised far above the highest rate of World War II—from 38 to 52 per cent—an increase of over 35 per cent. This top rate has continued until the present. There was a general tax reduction in 1954, but it was relatively small and there was no reduction in the higher brackets of the individual income tax. Within the past two years substantial relief in the form of more liberal allowances for depreciation and an investment tax credit has been granted. For the past year and a half there has been widespread discussion of a general tax reduction which might amount to as much as $10 or $13 billion. This has been greatly delayed and at this writing the outcome is uncertain, but even if it is adopted it, plus earlier reductions, would still fall far short of the major reductions which have followed other major wars.

Korean War Among the major features of the period was the Korean War, which lasted from 1950 until 1953. This provided a considerable stimulus to economic activity and probably had an appreciable effect in raising rates of growth for the 1947-1957 period.

Population Growth Population recorded a vigorous and accelerated growth throughout the period, following a period of slow growth in the 1930's. The annual rate of growth varied between 1.7 and 1.9 per cent. Over the whole period from 1947 to 1963 the total population, including the numbers gained by the admission of Alaska and Hawaii, increased by approximately 31 per cent.

Money and Liquid Assets The country inherited from the war a greatly swollen money supply and tremendous amounts of other liquid assets, both of which received another boost during the Korean War. In recent years the money supply has expanded rather slowly as the economy "grew up" to the initial oversupply.

Other Characteristics Other important features may be noted more briefly. First, residential mortgages and consumer credit increased by more than $200 billion during the period. This amount supplemented consumer incomes in the purchase of homes and durable consumer goods. Second, at the beginning of the period there was an enormous demand for homes and durable goods, built up during the Great Depression and the war. During the period that backlog was worked down steadily and fairly rapidly until it may be said to have disappeared in recent years. Third, the period was marked by the continuation and strengthening of the practice of granting annual wage increases. Fourth, there was a steady and rapid rise in the costs of government, caused by the Korean War, the cold war, rapid urban growth, enormously increased needs for schools and highways, greatly expanded welfare programs, and many, many other factors. Finally, foreign competition increased greatly, especially after 1958, primarily as a result of rapid industrial growth in Europe and Japan and the stabilization of a number of major currencies.

A Theme In a nutshell, the American economy since World War II has functioned at a high and rising level of production and consumption. It has been by a considerable margin the most productive economy the world has ever known. It has been marked by four recessions which became progressively shorter; they also became milder except for the increase in unemployment. For the first ten-year period, the rate of economic growth was quite high, partly because of accumulated demand and the Korean War. Since 1957 the rate has been somewhat lower.

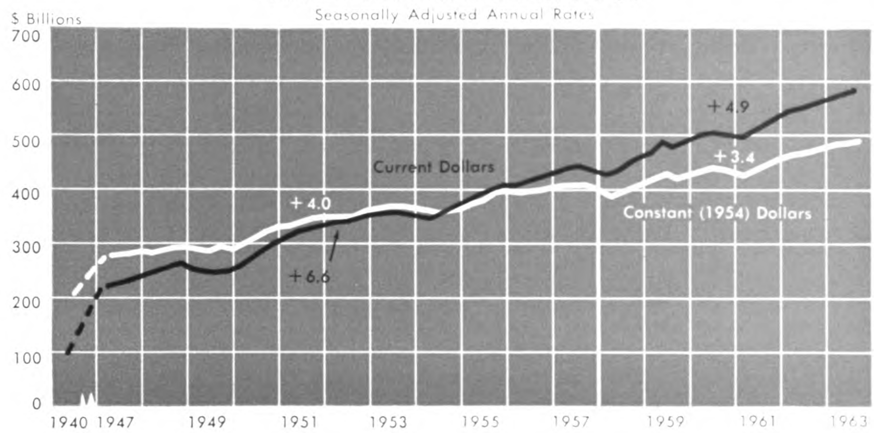
The Trends

Gross National Product The fluctuations of GNP outline the behavior of the economy as a whole and provide a backdrop for the examination of the other series, many of which are components of GNP. An accompanying chart shows the growth of GNP over the whole period in both current and constant (1954) dollars. On either basis it is evident that the recessions were short and mild. The downswings usually did not last more than six to nine months, and in all cases GNP had surpassed its previous high not later than 18 months after the downturn. In no case did the maximum decline amount to more than 5 per cent and usually it was much less. The 1960-1961 decline was less than 1 per cent—hardly more than a brief leveling-off in the advance. Based on current dollars, the annual growth rate in the 1957-1963 period was about one fourth less than in the previous ten years. Over the whole period, GNP in current dollars grew by about 150 per cent; from $234 billion to about $585 billion.

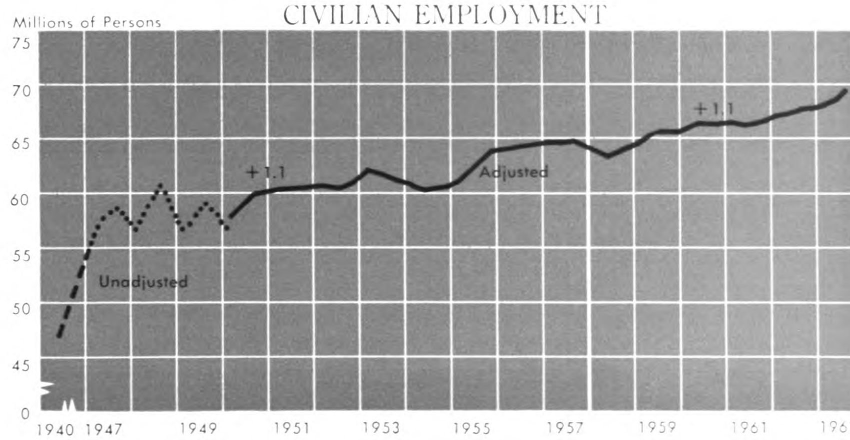
Based on constant dollars, the growth for the entire period was approximately 74 per cent, indicating that one half of the growth in current dollars was due to rising prices. On the same constant dollar base, the annual growth rate in the 1957-1963 period was about 3.4 per cent, or 0.6 percentage point less than in the preceding ten years.

Employment and Unemployment Between 1947 and 1963 civilian employment rose from 57.8 million to about 69 million—an increase of 11 million, or 19 per cent, in 16 years. At first glance that would appear to

GROSS NATIONAL PRODUCT



CIVILIAN EMPLOYMENT



be a healthy and adequate increase. Yet unemployment was the cause of widespread and growing concern during much of the period. The reason, of course, was that the labor force was growing faster than the number of available jobs.

As noted above, the population increased by 31 per cent over these 16 years. The civilian labor force expanded from 60.2 million to approximately 73 million—an increase of only some 22 per cent. The primary reasons for this comparative lag in the growth of the labor force were two: (1) much of the population increase was concentrated in the younger age groups which still were not in the labor force in 1963; and (2) a larger proportion of the young people aged 14 to 25 were staying in school longer. Both of these facts mean that the numbers entering the labor force in the years immediately ahead will be increased greatly.

The comparatively small difference between an increase of 22 per cent in the labor force and an increase of 19 per cent in employment was responsible for the growth and persistence of the unemployment problem. Employment grew by only a little more than 1 per cent per year from 1947 to 1957 and showed little change after that despite a somewhat more rapid growth in the labor force. As a consequence, both the number of the unemployed and the rate of unemployment in relation to the labor force rose in the latter period. The annual rate of increase in the number of unemployed since 1957 was more than three times the rate for the previous ten years. This is one of the trends which will be examined in greater detail later, with an attempt to isolate some of the causes.

Industrial Production The index of industrial production is a broad measure of physical production in the economy and as such is less affected by changing prices than many of the other series. It is a relatively volatile index but, even so, the fluctuations during the period under study were quite mild. The largest decline from peak to trough, based on quarterly averages, was about 12 per cent and the typical decline was 7 or 8 per cent. The decline in the rate of growth in this area after 1957 was not as large as it was in some other areas or in GNP. The total increase in the index over the whole period was 89 per cent. In comparison with the population increase of 31 per cent, this gives some indication of the increase in per capita consumption of physical goods.

In manufacturing, which accounts for the great bulk of industrial production, employment increased by only a little more than 10 per cent. Compared with the increase of 89 per cent in output, this reflects the great strides which have been made in increasing productivity in this field. It also suggests one of the major causes of the unemployment problem. Out of the increase of about 13 million in the labor force, manufacturing has employed only a little more than a million and a half since 1947. Thus, the burden of providing employment for the great bulk of the increase in the labor force has fallen on the nonmanufacturing area. The burden has been accentuated by the tendency of wages in the nonmanufacturing area, where increases in productivity have been relatively low, to rise at the same rate as wages in manufacturing, where increases in productivity have been relatively high.

New Plant and Equipment Expenditures Business expenditures for new plant and equipment constitute the largest component of gross private domestic investment. Currently the proportion is nearly one half. These expenditures serve as a good indicator of the vigor of economic growth, especially in the industrial area.

As a rule investment expenditures are likely to fluctuate more widely and more erratically than most other economic series, especially those more closely connected with consumer spending. This is particularly true of expenditures for new plant and equipment. On several occasions they have reversed direction within a general upswing or downswing. When the movements were connected with movements in the economy as a whole, they tended to lag somewhat behind most other indicators. During the whole period these expenditures registered quarter-to-quarter declines 23 times compared with 12 such declines shown by GNP. In the four postwar recessions plant and equipment expenditures declined by amounts ranging from 7 to 20 per cent. The largest decline came in 1957-1958 and the smallest in 1960-1961.

Along with industrial production, these expenditures grew by about 90 per cent over the entire period, but their rate of growth was considerably higher in the first ten years and much lower thereafter. As the chart shows, they reached a peak in 1957, declined sharply in 1957-1958, and failed to reach the 1957 peak in the 1958-1960 upswing. The failure of this important indicator to equal its former peak has often been cited as evidence of the sluggishness of business investment and of the abortive or incomplete nature of the 1958-1960 recovery.

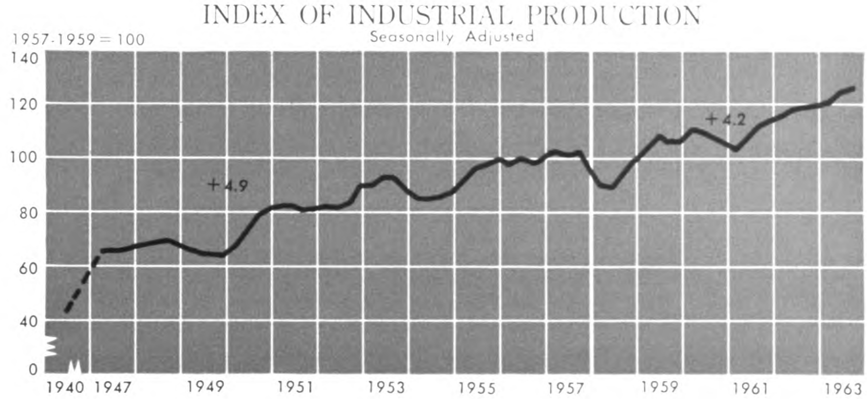
The chart shows also that, over the period, expenditures for new plant and equipment as a per cent of GNP fell from 8.8 in 1947 to 6.7 in 1963. This indicates that this important and strategic part of private investment has not been keeping pace with the economy as a whole.

VALUE OF NEW CONSTRUCTION The series giving the value of new construction put in place covers nearly all types of new construction and major alterations—residential, industrial, commercial, and governmental. The industrial and commercial segments overlap the expenditures for new plant and equipment discussed above. Residential construction is the largest single component of new construction, usually comprising 55 per cent or more of the total. In recent years total construction has made up more than 10 per cent of GNP.

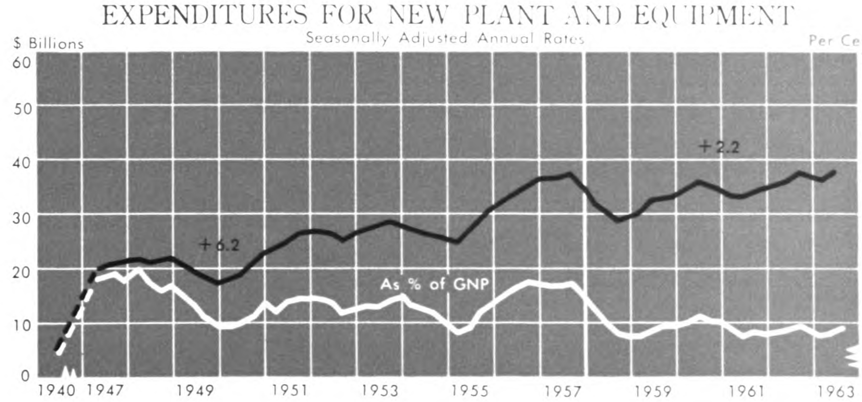
Construction activity was very low during the Great Depression and World War II and consequently a very large accumulated demand had built up by the end of the war. This was further accentuated by the rapid population growth of the past 20 years and by the great migration to urban areas. Especially in the residential area, activity has been further stimulated by extensive new arrangements for financing home ownership. Strengthened and sustained by all these forces, construction activity scored a greater advance than any other major series examined here. The total gain was 260 per cent and the annual growth rate in the first period was nearly 10 per cent. The sharp drop in the growth rate since 1957 reflects the working down of the accumulated backlog and a small drop in the rate of family formation.

A brief look at the major components of this series shows the rapid increase of construction activity by

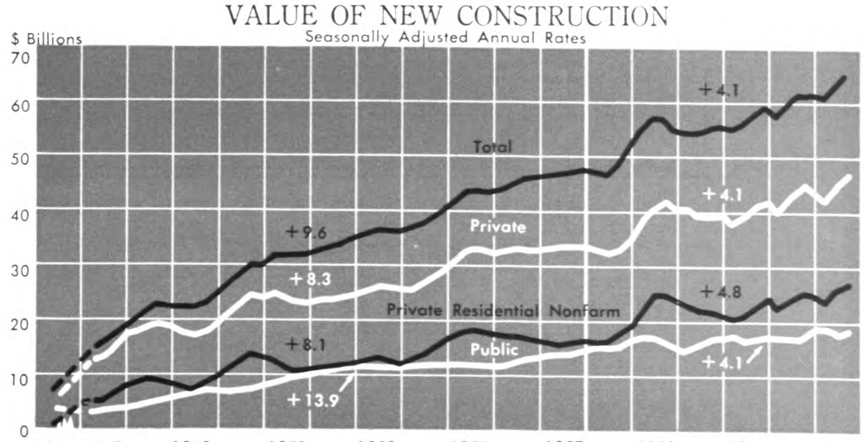
INDEX OF INDUSTRIAL PRODUCTION



EXPENDITURES FOR NEW PLANT AND EQUIPMENT



VALUE OF NEW CONSTRUCTION



public authorities during this period. Despite the pressing need, public construction was a little slow getting started after the war and consequently the figures start from a comparatively low base in 1947. But over the whole period the value of total public construction increased by 464 per cent compared with an increase of 214 per cent in total private construction and 256 per cent in private nonfarm residential construction. In the past six years, however, the annual growth rate of public construction has been the same as that for private construction despite heavy outlays for the Interstate Highway System and other major undertakings.

Personal Income Personal income serves two purposes as an economic indicator. On the one hand, it indicates fairly accurately the compensation individuals receive for participating in economic activity, although some of its minor elements are not closely related to production or indeed, as in the case of unemployment insurance, may have an inverse relationship. On the other hand, it measures fairly well the flow of consumer purchasing power available for spending although, again, there are exceptions; taxes, debts, and other similar arrangements may drain off income before it can be spent for goods or services.

Personal income has risen quite steadily in recent years. As the chart shows, the only significant decline was in 1948-1949. In 1953-1954 and 1957-1958 the maximum declines were less than 1 per cent, while in 1960-1961 the quarterly averages showed no decline at all, although the advance was slowed to 1.1 per cent over a period of three quarters. The annual growth rate for personal income has been very close to that for GNP. Over the entire period the total grew from $191.6 billion to about $462 billion—an increase of 141 per cent.

The major components of personal income show considerable variations in their behavior. Labor income is by far the largest component, comprising over two thirds of the total. Quite naturally, it fluctuated closely with the total, although occasionally it may move slightly in the opposite direction as it did in the fourth quarter of 1960. Its increase over the whole period was about 160 per cent.

The component "Proprietors' and Property Income" is the sum of five separate series comprising such items as rent, dividends, interest, and farm and professional income, which make up altogether a little less than one fourth of the total. To some extent fluctuations in the individual items offset each other so that the total at times shows an erratic behavior pattern. Over the period the composite total increased by about 99 per cent.

Transfer payments make up the smallest but the most rapidly growing of the three components. They comprise such items as unemployment insurance, OASI payments, other social security benefits, military pensions, and similar income, most of which are related only indirectly, if at all, to current economic activity. Until 1950 they showed wide and generally countercyclical fluctuations, probably because of the dominance of unemployment insurance payments. From 1950 until the middle of 1963, however, they rose steadily and fairly rapidly, showing small declines in only three widely separated quarters, probably because of the dominance of the steeply rising OASI payments. They increased from $11.8 billion in 1947 to about $37 billion in 1963—an increase of approximately 209 per cent.

Per capita personal income naturally showed a considerably slower rise than the total because of the steady population growth. The per capita figure rose from $1,329 to about $2,440—an increase of 84 per cent. This was somewhat more than twice the increase in the index of consumer prices during the same time.

Personal Consumption Expenditures The figures for personal consumption expenditures show broadly what consumers did with their income. A glance at the chart shows two dominant features: a remarkably stable and relatively high growth rate, and a steady and fairly rapid increase in the importance of services. The increase for the entire period was from $165 billion to about $393 billion—or approximately 125 per cent.

Expenditures showed even smaller fluctuations than did personal income. Interestingly enough, the largest fluctuations were caused by the panic buying near the beginning of the Korean War. In the third quarter of 1950 and the first quarter of 1951 expenditures jumped by approximately 8 and 6 per cent, respectively, and in the ensuing quarters fell by about 2 and 3 per cent, respectively. Except for these aberrations, the total did not decline by more than 1 per cent at any time during the 16 years, and in all cases the declines lasted only one or two quarters.

The rate of growth was comparatively high in the 1947-1957 period, and the drop thereafter was quite moderate. Since prices rose somewhat less after 1957, the difference in real terms was even less than that shown by the figures on the chart.

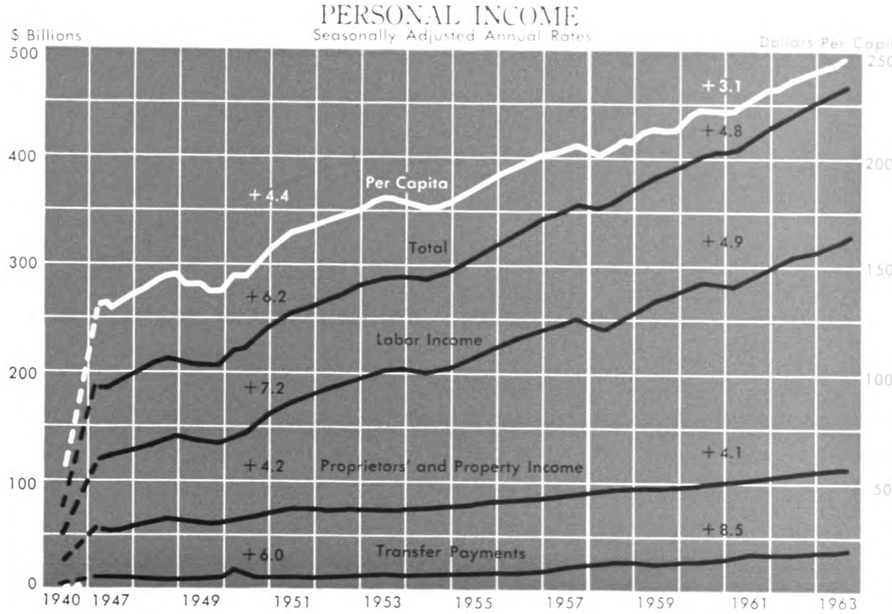
Outlays on durable goods did not change greatly in relative importance, but purchases of nondurable goods declined from over 56 per cent of the total to less than 46 per cent. The difference, of course, was accounted for by services, which rose from 31 per cent to over 41 per cent of the total. The approximate increases for the entire period were: nondurable goods, 79 per cent; durable goods, 146 per cent; and services, 200 per cent. The figures for services made the remarkable record of showing an increase for every quarter during the 16 years. During the entire period they grew a little more than twice as fast as the total for durable and nondurable goods combined.

The rates of increase shown here indicate that consumer expenditures were a sustaining, and not a restraining, force in the economy as a whole. After allowances for the effects of the Korean War and the smaller price rise since 1957, the growth rate during the past six years compares quite favorably with the rate for the 1947-1957 period.

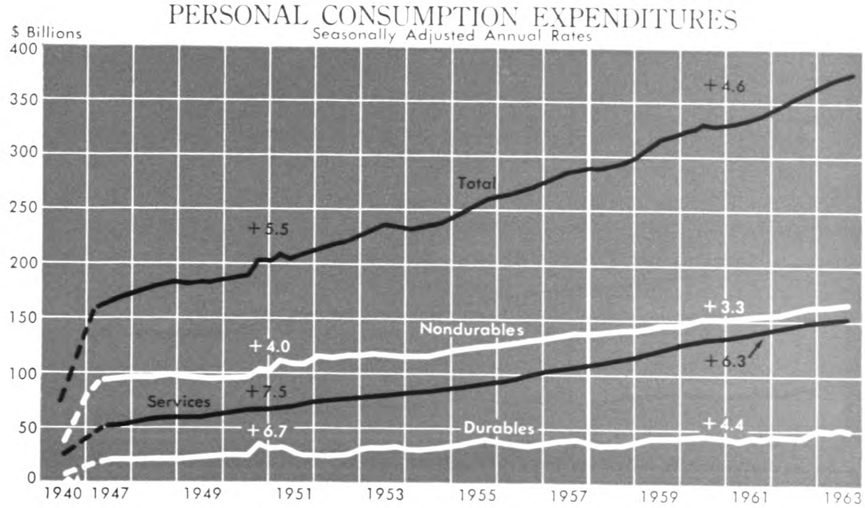
CORPORATE PROFITS In the free enterprise economy of today corporate profits play a strategic role. Profits, or the prospect for profits, exert a dominant influence on corporate investment which, in turn, is a major factor affecting economic growth.

Corporate profits after taxes represent the earnings available to corporate owners—the return to the owners of corporate equity capital. Conceptually, profits are made up of three distinct elements. First, there is implicit interest on the equity capital; this would be computed at the "pure" or "riskless" rate of interest. Second, there is the premium for riskbearing—a rate which would vary from firm to firm depending on the risk involved. Finally, there is the reward for business leadership and management—some-

PERSONAL INCOME



PERSONAL CONSUMPTION EXPENDITURES



thing approaching the economist's concept of "pure profit." All of these vary from time to time but the last two especially are subject to wide and erratic fluctuations and can, of course, be negative.

The concept of corporate profits which is used in practice is neither precise nor stable. One of the most uncertain and changeable factors affecting it is the allowance to be made for depreciation. First, a value must be placed on the capital goods, and then a time period must be set during which it will be used up or become obsolete. Both of these quantities are subject to considerable variation. The allowances permitted by tax laws have a considerable effect on practice. In the past 15 years depreciation allowances permitted by Federal tax laws have been increased two or three times, the last time in 1962. Also in 1962 there was allowed a credit against taxes for certain types of investments which also affects the amount of after-tax profits. In the early part of the period covered here, corporate profits were probably overstated to some extent, while in the past two years they have been stated more accurately or perhaps understated in some instances. These changes have been partially responsible for the slow growth of profits noted below and have accentuated the decline in profits as a percentage of equity capital.

In the period covered by this study, corporate profits showed wide fluctuations from year to year, with only a moderate upward trend despite very large amounts of new investments in the corporations covered, in the form either of retained earnings or new capital brought in by the sale of stock. In several cases downward fluctuations occurred when the economy as a whole was moving up and the declines associated with recessions usually lasted longer than did the declines in GNP or in most other economic series. The following tabulation shows most of the quarters during which corporate profits declined and the approximate extent of the declines:

1948-1949	4 quarters	29 per cent
1950-1951	3 quarters	36 per cent
1952	3 quarters	10 per cent
1953	2 quarters	24 per cent
1956	3 quarters	10 per cent
1957-1958	4 quarters	31 per cent
1959	2 quarters	12 per cent
1960-1961	4 quarters	20 per cent

Altogether, profits showed a quarter-to-quarter decline 30 times between the first half of 1947 and the middle of 1963. Over the whole period profits increased by about 49 per cent, which is approximately one-third of the increase registered by personal income. The annual growth rate of profits in the first subperiod was quite low. The somewhat higher rate for the second subperiod was due largely to the higher earnings in 1962 and 1963; before those years there had been very little increase over 1957.

As a per cent of GNP, total corporate profits have declined persistently and substantially. The rate in 1947 was 7.8 per cent; in the past two years it has been near 4.5 per cent. This represents a decline of over 40 per cent, despite the sharp improvement of total profits in recent years. The more significant figure of corporate profits as a return on equity will be discussed later.

GOVERNMENT RECEIPTS The figures in this series include the revenue receipts of Federal, state, and local governments, adjusted to eliminate duplications. On the one hand, such receipts indicate roughly the level of governmental activity and, on the other, they reflect the burden of taxes and other similar payments on the economy.

No single statistical series on public finances is entirely satisfactory for measuring the impact of public activities on the economy. Quite often public purchases of goods and services, a major component of GNP, are used for this purpose, but they are very inadequate as indicators of the tax load and they omit entirely the large and rising total of transfer expenditures. The series used here emphasizes private payments to governments, a cost factor, and understates governmental activity to the extent that deficits are incurred, or overstates it by the amount of any surpluses. These figures include some payments received by governments for goods and business-type services, but they are relatively minor.

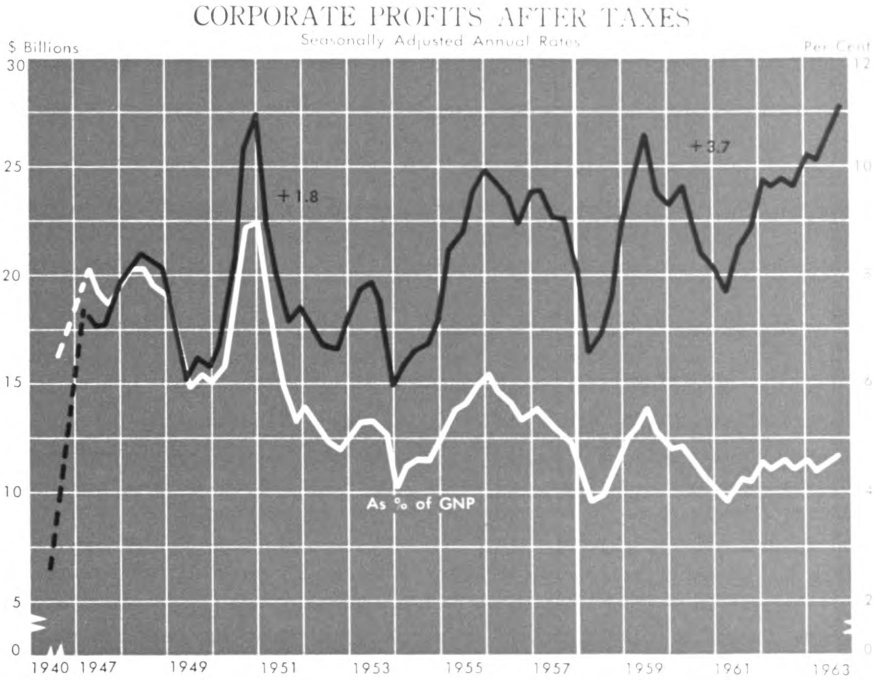
Two dominant trends are evident from a glance at the chart. The first is that total receipts have increased steadily and fairly rapidly over nearly the whole period. The second is that state and local receipts have increased faster than Federal despite large Federal expenditures for the Korean War, the cold war, space explorations, and other major projects. Actually, the contrast is even greater than shown here, because Federal grants-in-aid to state and local governments were subtracted from the state and local totals in the process of eliminating duplication. Those grants have been increasing rapidly in recent years.

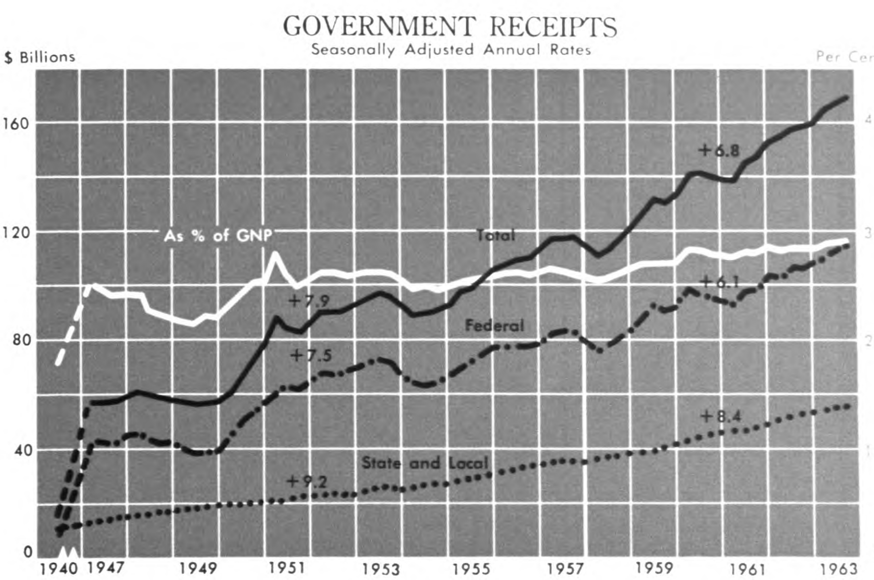
Total public receipts almost tripled during the 16 years. This was the result of an increase of about 160 per cent in Federal receipts and a rise of approximately 300 per cent in state and local receipts. Annual rates of growth were only moderately lower after 1957 despite the fact that the Korean War was included in the earlier period and despite smaller price rises and somewhat slower rates of economic growth in the past six years.

During the first three years—1947-1949—there was no significant change in total receipts. This was the result of a substantial decline of Federal receipts offset by the slowly but steadily rising total of state and local receipts. The decline in Federal receipts was caused by the repeal of the excess profits tax, the 1948 tax reduction, and some decline in economic activity. Beginning in 1950 the Federal total zoomed upward for three and a half years for an increase of over 85 per cent because of the Korean War. The tax reduction of 1954 and an economic recession brought a decline of 13 per cent. Since the third quarter of 1954 Federal receipts have moved up with only a few interruptions and the total is now approaching twice the 1954 low point. State and local receipts have moved upward at varying rates but in no quarter of the 16 years did they show a decline.

As a per cent of GNP, total receipts have risen irregularly but substantially —from 24.4 to 28.8 per cent. This represents a rising and inflexible cost factor on business units and consumers and, as has been increasingly recognized in the past two years, exerts a drag on economic growth.

Prices Prices are major indicators of the health of an economy, because





substantial price changes may seriously affect both the production of goods and services and the distribution of income. Further, large price movements are likely to be in considerable measure the result of improper fiscal and/or monetary policies. As the reference points on the chart show, the really large price changes took place before 1947, most of them in 1946 following the release of inflationary forces pent up during the war.

Wholesale prices showed only four significant movements during the period. After a moderate decline during the recession of 1948-1949, they rose sharply by nearly a fifth during the early part of the Korean War and then lost about a third of the advance by the middle of 1953. For about two years thereafter they were comparatively stable. From the middle of 1955 until early 1958 they rose by about 8 per cent; since the latter date they have fluctuated within a range of about 1 per cent—perhaps the longest period of such stability in our history. The total increase for the whole period was about 23 per cent.

There have been wide variations in the behavior of different groups of wholesale prices. To a considerable extent this was due to the fact that the price structure in 1947 still retained much distortion caused by the war, since some prices require much more time than others to adjust to changed conditions. Farm products as a group declined by about an eighth between 1947 and 1963, while processed food prices were rising by about 10 per cent and the prices of other, mainly industrial, products were rising by a third.

Consumer prices showed smaller fluctuations but a larger total advance during the period. After a small decline in 1948-1949, they moved up by more than 13 per cent during the first two years of the Korean War. They did not decline appreciably thereafter but were quite stable for about four years. After a significant rise from early 1956 to the latter part of 1958, they hesitated briefly and then began a slow, steady rise which has continued to the present. Since early 1959 no quarter has registered a decline and the total has advanced by about 6 per cent. The advance for the whole period was about 37 per cent.

As was true in the wholesale field, different groups of consumer prices behaved differently. Commodities other than food showed the smallest rise—about 23 per cent. Food prices rose by about 29 per cent, while services increased by about two thirds.

In recent years consumer prices have risen somewhat more than wholesale prices for three principal reasons. First, the consumer price index is fairly heavily weighted with prices for services, which, as noted above, have had the greatest rise. Many of the service prices are closely geared to wages which have risen steadily. Second, commodities at retail are more highly processed and therefore embody more labor than commodities at the wholesale level. They are thus more sensitive to rising wages. Third, the process of producing and distributing goods is subject to many taxes (other than specific sales taxes). Goods sold at retail are subject to more such taxes, which have been rising. Generally, taxes are costs of production, so it was inevitable that, in whole or in part, they would be shifted to the retail prices of the commodities.

Interest Rates The level of interest rates is a major factor affecting economic activity and growth. Since 1947 both the structure and level of interest rates have experienced three distinct periods of change in addition to the usual cyclical changes.

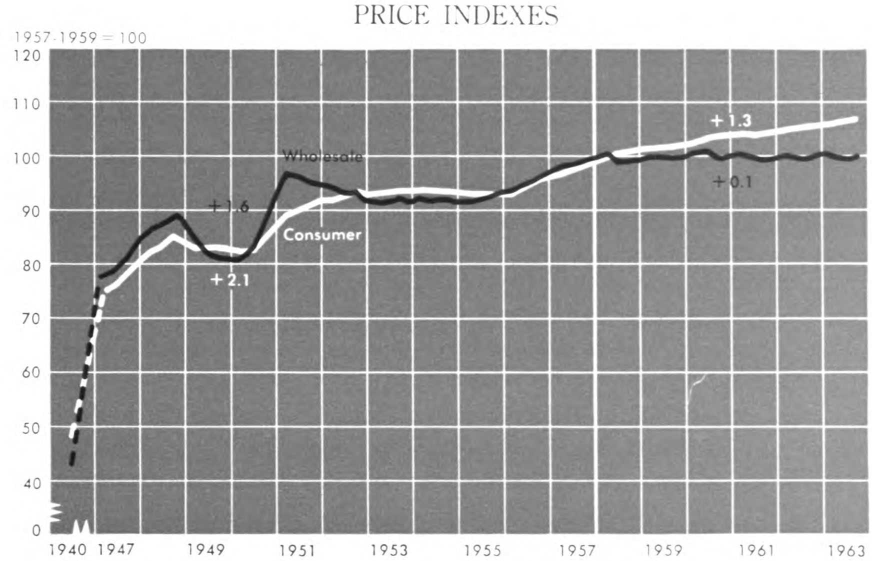
Until early 1951 interest rates were strongly affected by the Federal Reserve's policy, continued from the war period, of supporting the prices of Government securities. This policy was modified somewhat with the passage of time, but it remained a major market force. About the middle of 1947 the specific support price for Treasury bills was removed and that accounted for the steep rise in the yields on bills for the next year and a half. Long-term rates, however, showed no significant trend from 1947 through 1950.

After the Treasury-Federal Reserve Accord of 1951, all rates began a slow and irregular advance, restrained somewhat by the terms of the Accord and the need to finance the Korean War. The recession of 1953-1954 brought a general decline in rates, but this was followed by an extensive rise, lasting until the latter part of 1957. During the 1957-1958 recession there was a significant but rather short decline in rates, lasting only about three quarters. In the last half of 1958 and throughout 1959 rates moved up sharply, reaching, in the latter part of 1959 and early 1960, the highest levels in about 30 years. Several factors, especially the 4¼ per cent interest ceiling on Government bonds, caused short-term rates to rise faster and farther than long-term rates, and for a brief time the yield on Treasury bills was above the yield on long-term Government bonds. Generally, the whole period from 1951 to early 1960 saw a movement in both the structure and level of interest rates back toward a "normal" situation such as prevailed before 1930.

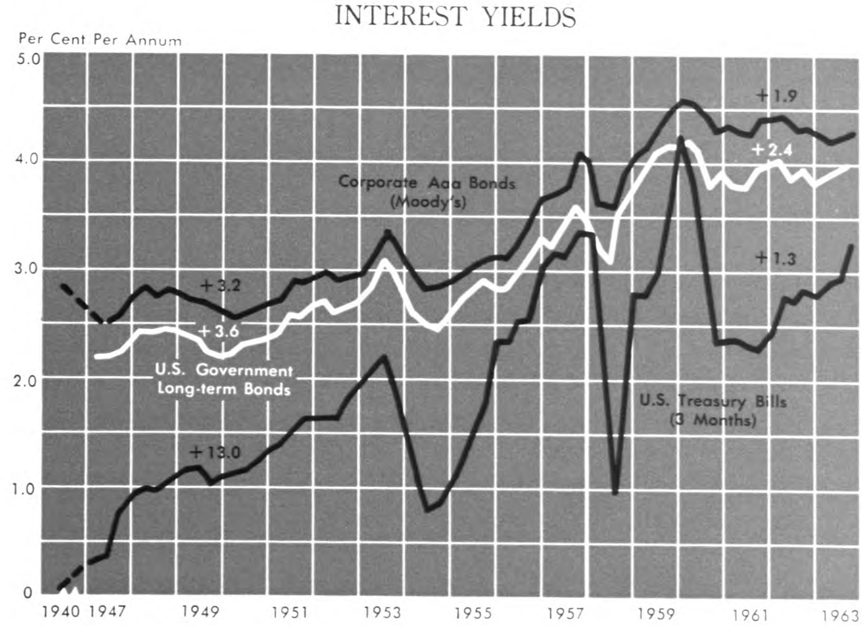
The third distinctive period of interest rate developments began about the middle of 1960 as the economy moved into a mild recession and the balance-of-payments problem became acute. The distinguishing feature of this period was a conscious effort by fiscal and monetary authorities to influence interest rates. They wished to prevent short-term rates from falling to such a low level that they would have encouraged an outflow of short-term funds, thus increasing the deficit in the balance of payments. At the same time, in order to stimulate the domestic economy, they wished to make credit freely available and hoped that long-term rates would hold steady or decline. Several devices were used in the effort to realize these twin goals. The Treasury substantially increased the use of short-term securities in its financing. The Federal Reserve System reduced certain reserve requirements of member banks, allowed them to count vault cash as reserves, and began purchasing longer-term securities in its open market operations. Increased supplies of savings and a relatively slow growth in the demand for investment funds also helped to hold down or lower long-term rates.

These efforts met with a considerable measure of success. The yield on the critical three-month Treasury bill did not fall below 2.1 per cent, whereas in previous recessions it had dropped well below 1 per cent. By late 1963 it had risen above 3.5 per cent. While this was going on, the yield on high-grade corporate bonds first rose moderately and then eased off somewhat so that by late 1963 it was only very slightly above the low point reached in early 1961.

PRICE INDEXES



INTEREST YIELDS



Balance of International Payments Probably no other economic development of recent years has received more attention in this country than the deficit in the United States' balance of international payments. Many technical and complex factors enter into a country's balance of payments. All that can be done here is to note briefly the movements of a few major factors in the balance of the United States in the postwar period. Later an attempt will be made to ascertain some of the causes.

The international exchange of goods and services is responsible for the largest sums involved in the balance of payments. In addition to trade in merchandise or commodities, this category includes also income from investments and payments for shipping services, insurance, tourists' expenditures, and many other such services. In the case of the United States it includes also military expenditures abroad, which recently have been running at a rate of about $3 billion per year. The balance for all of these items is the "balance on goods and services."

Since 1947 the United States has consistently had a surplus on its goods and services account, although in 1953 and 1959 the amounts were negligible. In most years it has varied between $2 billion and $5 billion per year. For the three years 1960-1962 it averaged $4.7 billion.

Another important component of the balance of payments is the movement of private capital. In each year since World War II Americans have made investments abroad in amounts rising from about $1 billion in the early years to well over $3 billion in several recent years. The 1960-1962 average was $3.8 billion, but in the first half of 1963 the figure zoomed to an annual rate of $5.2 billion. These exports of capital reduce a surplus or increase a deficit in the balance of payments.

The third major factor in the payments account of the United States is made up of government loans and grants under the foreign aid program. These items also reduce a surplus or increase a deficit. From $6.1 billion in 1947 the figure for this factor dropped to around $2 billion in the middle 1950's and then rose slowly to nearly $3 billion. The 1960-1962 average was $2.8 billion, but in the first half of 1963 the figure rose sharply to an annual rate of $4.1 billion.

In addition to these three major items, there is always a residual item in the balance of payments labeled "errors and omissions" or "unrecorded transactions." This is the amount required to make the two sides of the account balance. It represents errors of estimation and also transactions which are not covered by the system of reporting. It is generally believed that most such transactions represent movements of capital, especially of short-term funds. During the 1950's the figure was positive, indicating some inflow of capital. In the past four years, however, the trend was sharply reversed and large negative figures appeared, indicating that there was probably a considerable outflow of funds in addition to those officially recorded. The 1960-1962 average of all unrecorded transactions was $871 million.

The movements of the above factors produce a surplus or a deficit on "regular transactions." This is the balance resulting from normal, recurring transactions. From time to time, however, there may be special, essentially nonrecurring, transactions such as the advance and nonscheduled payment of some part of a debt by a foreign debtor. Such a payment reduces the deficit for a particular period but could be misleading if it were interpreted to be a normal, recurring development. Thus, it has now become customary to show the balance of payments on "regular transactions" and also after (some or all) special transactions. Unless otherwise noted, the concept used here is for regular transactions. It is now in order to trace briefly the course of the surpluses and deficits.

A large surplus of $4.6 billion in 1947 almost disappeared by 1949, primarily because of a sharp drop in the trade balance. A deficit of $3.6 billion ensued in 1950 as the trade balance fell even more sharply because of the Korean War. Except for a very small deficit in 1951 and a large one in 1953, the latter caused by another sharp drop in the trade balance, deficits fluctuated around $1 billion through 1956, despite a rising outflow of capital. In 1957 there was a small over-all surplus because of the large trade surplus resulting from the Suez crisis.

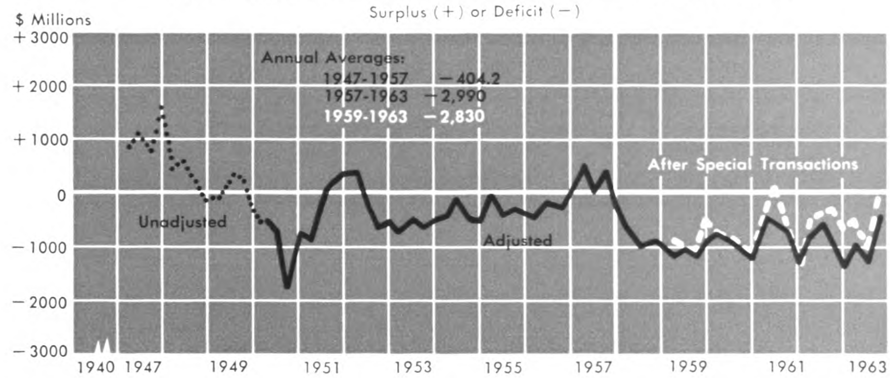
The comparatively small deficits of these years were not a cause of widespread concern. The United States had a very large gold reserve, the dollar was a scarce currency, and the claims against this country created by the deficits were used to build up the liquid reserves of many countries. Consequently, although the deficits between

1950 and 1957 amounted to over $10 billion, very little gold was lost.

In 1958 the first of the large and continuing deficits appeared. Receding from the high level caused by the Suez crisis, the trade balance fell sharply in both 1958 and 1959. Deficits of more than $3.5 billion on all regular transactions were incurred in both years and there were substantial outflows of gold. In 1960 the balance on goods and services recovered sharply but at the same time outflows on both government and private capital accounts rose by large amounts and the deficit showed only a small improvement. In 1961 the balance on goods and services improved further and the deficit declined significantly but the gold outflow, though reduced, remained substantial. In 1962 the trade and services balance declined moderately, government grants and loans rose a little, and recorded capital outflows were off substantially, but unrecorded transactions were quite large. As a result, the deficit on regular transactions rose from $3 billion to $3.6 billion. Gold losses were about $900 million. In the first half of 1963 the trade and services balance was up, but there were sharp increases in both government grants and loans and in the outflow of private capital. In July the Federal Reserve System increased the discount rate and President Kennedy proposed the interest equalization tax to curb the outflow of long-term capital and other measures to reduce the deficit. The outflow of capital was reduced sharply in the second half of 1963 but at this writing it appears that the deficit for the year 1963 will be substantial.

U. S. BALANCE OF PAYMENTS, BY QUARTERS

Surplus (+) or Deficit (−)



PERCENTAGE INCREASES, 1947-1963

Expenditures for New Construction	260
Government Receipts	195
Gross National Product, Current Dollars	149
Personal Income	141
Personal Consumption Expenditures	125
Index of Industrial Production	89
Expenditures for New Plant and Equipment	89
Gross National Product, Constant 1954 Dollars	74
Corporate Profits After Taxes	49
Consumer Price Index	37
Wholesale Price Index	23
Civilian Employment	19

ANNUAL RATES OF GROWTH, 1957-1963

	(per cent)
Government Receipts	+6.8
Gross National Product, Current Dollars	+4.9
Personal Income	+4.8
Personal Consumption Expenditures	+4.6
Index of Industrial Production	+4.2
Expenditures for New Construction	+4.1
Gross National Product, Constant 1954 Dollars	+3.4
Hourly Earnings in Manufacturing	+3.1
Expenditures for New Plant and Equipment	+2.2
Civilian Employment	+1.1
Corporate Profits as Return on Equities*	−2.6

*1957-1962

A SUMMARY OF TRENDS The trends discussed above show that since World War II the American economy has functioned at a high level. The tabulation on the preceding page shows the percentage increases in the major series from 1947 to estimated 1963, arranged in descending order.

In recent years the rate of growth has slowed in all segments—substantially in some and quite moderately in others. The period has been marked by recurring recessions which have become progressively shorter and milder except for the behavior of unemployment. Each recovery has peaked out with a higher rate of unemployment, and probably a larger amount of unused resources, than the one before it.

Some sectors of the economy have been affected more than others by the declining growth rate. The accompanying table shows rates of growth for the period from 1957 to 1963 for certain significant indicators, arranged in descending order. (Two of these indicators will be discussed later.)

The top six series all show annual growth rates above 4 per cent. The three series at the bottom show very small growth rates or a decline. Employment and expenditures for new plant and equipment are closely related to the behavior of corporate profits. These series would seem to be the ones which are exerting a drag on the growth of the economy and the behavior of corporate profits appears to be a significant key to that behavior.

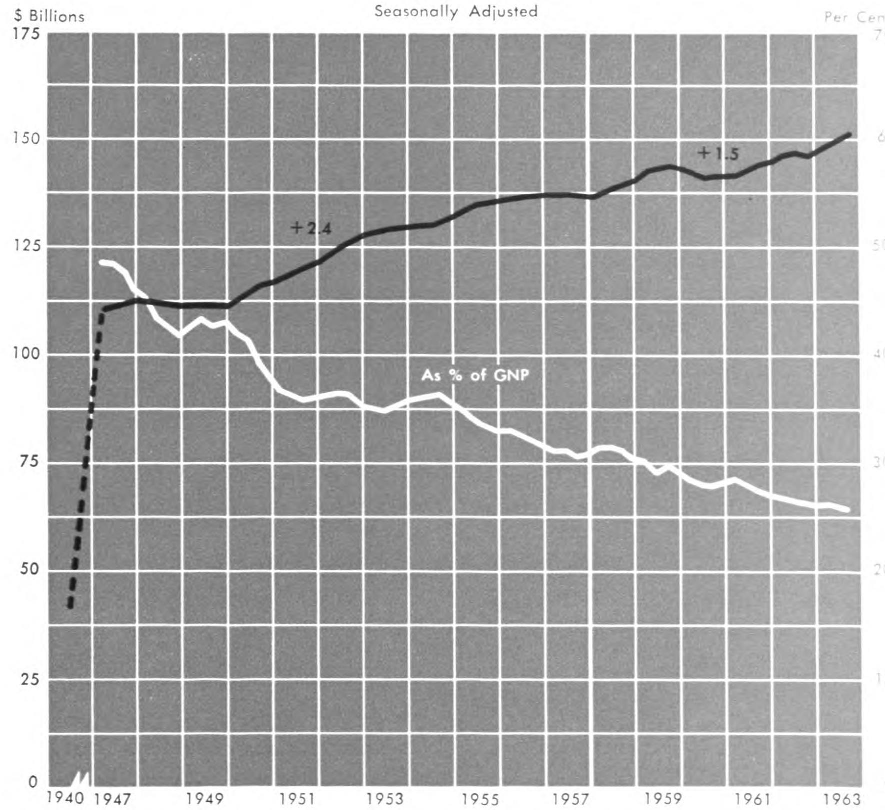
Two Major Developments

At this point two major developments of the postwar period deserve brief attention. They represent combinations of various elements of the trends discussed above. They are the decline of inflation and a significant change in the length and configuration of business cycles.

THE DECLINE OF INFLATION Measured by wholesale prices, inflation definitely waned over the postwar period. Indeed, for the past six years it may be said to have disappeared entirely. Further, this happened without any significant deflation appearing at any time, whereas a general and substantial deflation had come to be regarded as almost inevitable in any period following a major war. These developments excite little interest today and the American people apparently regard them as normal events of recent history. But in the light of historical developments and of conditions around the world today they represent a very significant change in the economic environment. Such a degree of price stability is a rare exception rather than the rule.

It would seem that four factors were primarily responsible for this price behavior. First, the money supply was brought under better control after a very sharp rise during the war. An accompanying chart shows the variations in the money supply and its low rates of annual growth during the period. These low rates were closely connected with the large oversupply of money existing at the start of the

MONEY SUPPLY
Seasonally Adjusted



period and the steady rise in its velocity or rate of turnover. These aspects are discussed further below.

A second factor was the gradual reduction in the accumulated backlog of consumer demand for houses and durable goods. As those demands were reduced total demand pressed less insistently on the available supply and the pressure on prices was reduced. Closely related to this was a third factor—a great increase in the productive capacity of American industry. Many billions of dollars were invested in new plant and equipment and great advances were made in technology. One recent study has computed the new investment in manufacturing alone between 1947 and 1957 at a little over $100 billion or about $10 billion per year. The result of this additional investment and technological progress was a tremendous increase in the capacity of industry to produce the goods consumers wanted.

A fourth factor was increased foreign competition, especially in recent years. Automobiles provide an outstanding example of this. The principal causes of the increased competition were the recovery and modernization of European and Japanese industries and the convertibility of major European currencies after 1958.

THE MONEY SUPPLY During the postwar period GNP rose more rapidly than the money supply and consequently the ratio of the money supply to GNP declined steadily from 48 per cent to about 26 per cent. The money supply grew slowly but it experienced only a few small declines. It fell nearly 2 per cent in 1948-1949. But after 1949 it did not, except for an occasional small drop for one quarter, show another decline until 1957. There was a drop of less than 1 per cent in 1957 and another of a little more than 2 per cent in 1959-1960.

The failure of the money supply to grow as fast as GNP has been cited as evidence that the money supply grew too slowly and thereby exerted a deflationary influence and discouraged economic growth. But it is clear that the efficiency or effectiveness of the money supply depends on the velocity or speed with which it circulates as well as on its total amount. The turnover of the demand deposit component of the money supply—which is by far the larger component—is fairly well indicated by the turnover of demand deposits in 343 of the country's largest cities, excluding New York City. That rate approximately doubled between 1947 and 1963.

MONEY ACTIVITY In order to show more clearly the effects of rising velocity a computation was made which incorporated changes in both the money supply and the rate of turnover of deposits. An index of the rate of turnover of demand deposits in the 343 cities was computed. The demand deposit component of the money supply was then multiplied by this index. To this figure was added the currency component of the money supply. For want of a better term, this total is called "money activity."

An accompanying chart shows that after 1949 this total rose at a steady and fairly rapid rate. It declined at the same times as the money supply, but, except in 1960, those declines were shorter although larger than the declines in the money supply, both absolutely and relatively. In contrast with most other series, the growth rate did not decline appreciably after 1957. Over the whole period the increase was about 143 per cent compared with increases of 33 per cent in the money supply, 149 per cent in GNP, and 89 per cent in industrial production. As a per cent of GNP money activity declined slowly until 1952 but has been relatively stable around 42-45 per cent since that time. It showed a small upturn in 1962 and 1963.

THE CHANGING BUSINESS CYCLE As previously noted, postwar cycles have tended to become shorter and, in most respects, milder. These features are shown clearly in the accompanying table. The present cycle has broken the trend on the upside since by late 1963 it had already run well over 30 months.

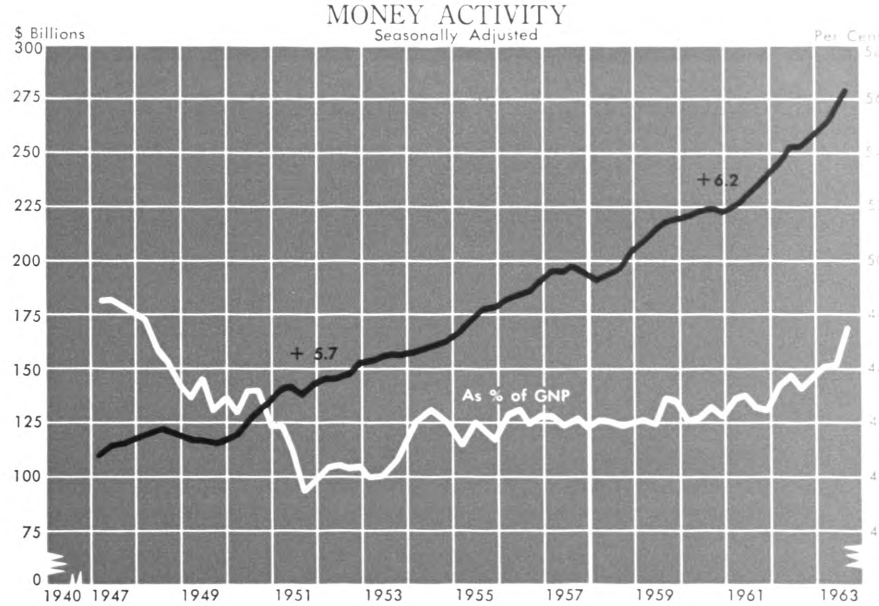
The 1949-1954 cycle undoubtedly was lengthened somewhat by the Korean War. Without it, the table might have shown a perfectly smooth trend. It will be noticed that the upswings have been shortened somewhat more than the downswings, and this has aroused some concern with respect to the possibilities of economic growth. It has given rise to claims that in the upswings the "brakes" were applied with more force than was used in applying stimulation in the downswings.

Professor R. A. Gordon has listed a number of factors which have caused the changed behavior of the cycle: (1) Generally, inventory investment began to taper off before the peak in general business. (2) Residential housing usually tapered off early in the upswing and turned up well before the low point. (3) Wages and prices resisted cyclical declines, incomes were stabilized, and consumer spending was a strong stabilizing force. (4) The volatility of corporate profits in recessions has meant that the decline of undistributed corporate profits and corporate income taxes made a major contribution toward sustaining disposable incomes. (5) Government spending was a much larger portion of GNP and that spending tended to be stable or countercyclical. (6) A larger proportion of workers was employed by governments and in the service industries; in these areas unemployment does not develop as quickly nor go so far as in manufacturing and trade.

Looked at more specifically and from a different angle, there are several reasons for the shorter and milder cycles. First, the secular movements discussed below have curtailed the forces which normally push business activity up sharply in boom periods. On the other hand, in periods of recession deflationary forces have been cushioned by easy money policies, by the operation of automatic stabilizers, and by the absence of speculative excesses.

Inventories and Unfilled Orders Among the strictly cyclical forces, probably the most important factor has been a significant change in inventory policy. The accumulation and liquidation of inventories have always been important causes of cyclical fluc-

MONEY ACTIVITY

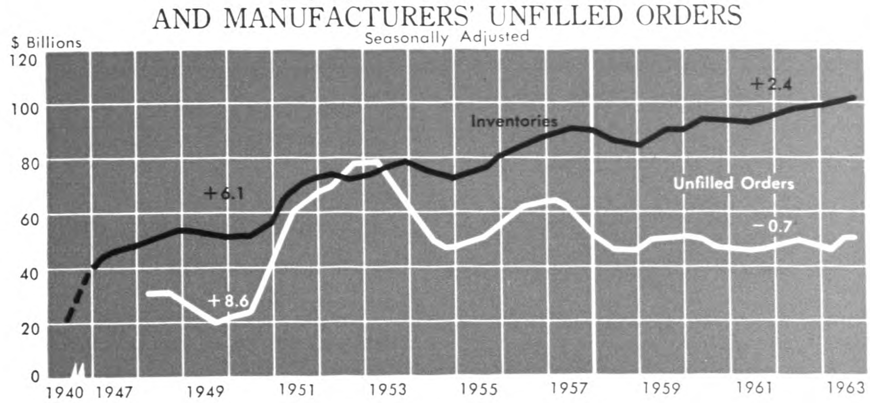


THE POSTWAR BUSINESS CYCLE

	Length in Months			Percentage Changes in GNP**	
Period	Complete Cycle*	Upswing	Down-swing	Upswing	Down-swing
1945-49	48	37	11	***	—3.3
1949-54	58	45	13	+43.5	—2.7
1954-58	44	35	9	+24.9	—3.4
1958-61	34	25	9	+16.4	—0.7

*Measured from trough to trough.
**Measured from highest and lowest points reached by GNP and not necessarily from reference points of the cycles.
***Not computed since upswing started before 1947.

BUSINESS INVENTORIES
AND MANUFACTURERS' UNFILLED ORDERS



tuations. This was especially true in the ten years immediately after World War II when, despite two declines, the book value of manufacturing and trade inventories grew at an annual rate of 6 per cent. Indicative of the change which has occurred, the annual growth rate dropped to 2.4 per cent in the past six years. The chart on the preceding page shows the fluctuations in these inventories and in the closely related series of manufacturers' unfilled orders. The reduction in the amplitude of the swings in these two series is most striking.

There are a number of reasons for the reduced fluctuations of these series. As noted earlier, prices have been noticeably more stable in recent years, and this has reduced the inclination of manufacturers and merchants to speculate in inventories or to hedge against price increases. This tendency has been encouraged by the appearance of excess capacity in manufacturing plants and the development of faster and more flexible transportation facilities which have insured the prompter delivery of orders and thus made it feasible to maintain a given level of sales with smaller inventories. Still another factor promoting lower levels of inventories has been better methods of inventory control, many of them based on the use of electronic equipment and new statistical techniques. These permit businessmen to know more accurately what inventories they have, to get the information more promptly and thus to maintain the amounts they desire. In some cases these new methods have shown that certain slow-moving models or designs were not necessary or not worth their costs.

Several minor factors also have had their effects on the levels of inventories. Interest rates have been higher and this has meant an increase in costs for those units which borrow to carry inventories. Conversely, for those companies which provide their own funds for carrying inventories there has been the opportunity to earn more in the money market on any funds freed from investment in inventories. In some cases the savings on labor and rent made possible by lower inventories were not insignificant. Also, in some states and localities the taxation of inventories has been a factor tending to keep them to the lowest feasible level.

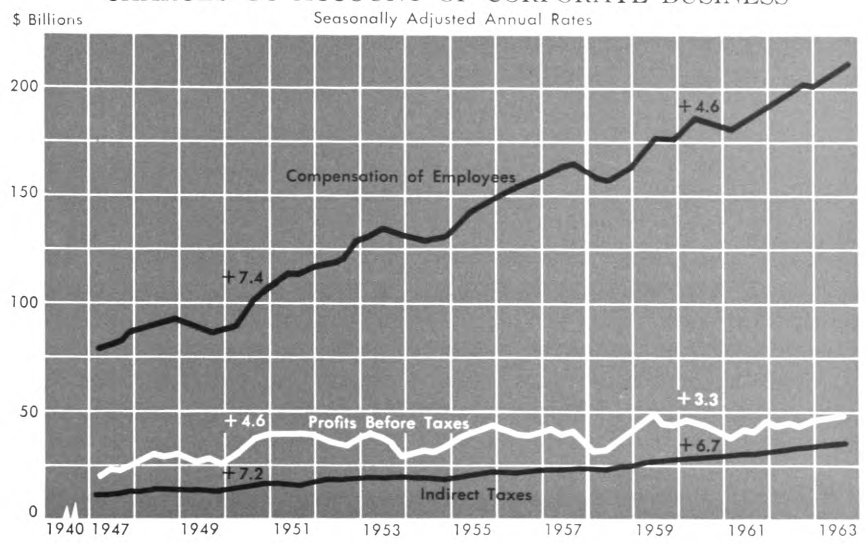
Finally, the movement toward lower inventories has tended to feed on itself. As businessmen have come to anticipate more moderate swings in the cycle, they have not stocked up on inventories as much as formerly, and this in turn has contributed to milder cycles. An exception to this, however, has been the extensive stockpiling of steel and certain other commodities in anticipation of strikes. But this is not a cyclical phenomenon except to the extent that such actions generate cycles.

The Slow-Growth Complex

The preceding analysis and discussion lead up to the hard core of the group of economic problems which beset our economy. For convenience this may be labeled "the slow-growth complex." It includes a moderately slow rate of economic growth, a relatively high rate of unemployment, and large deficits in the balance of payments. There are differences of opinion as to whether the rate of economic growth is unduly low in comparison with previous peacetime periods. It is true that the growth rate of the past three years is not greatly below the rate which prevailed in such previous periods but it is also true that it is appreciably below the rate of which the economy is capable. In the same way, there are questions about the accuracy of the measurements of unemployment and about the economic significance of such unemployment as does exist. As noted below, that significance is sometimes exaggerated. But after allowance for these qualifications it is still true that unemployment is a persistent problem, and that the rate is higher than it need be.

The elements in this complex are interrelated and are, in turn, related to rising production costs, declining corporate profits, and the low rate of business investment. These interrelationships do not constitute a full explanation of the present economic dilemma, but they are among the important causes. An examination of the complex may well begin with a consideration of corporate profits.

CHARGES TO ACCOUNT OF CORPORATE BUSINESS



CORPORATE PROFITS Total corporate profits in this country have not shown a vigorous growth rate since World War II. Despite tens of billions of dollars of new business investment, total profits, whether before or after taxes, have risen only slowly and erratically, and have lagged well behind the growth rate of the economy as a whole. The chart on the preceding page shows, for all U. S. corporations, the allocation of corporate gross product as between compensation to employees, indirect taxes, and profits before income taxes. The latter is a total figure and reflects the very large additional investment in corporate enterprises made during these years.

More significant figures, of course, are those which show earnings or income per unit of capital. Another chart shows corporate profits after taxes as a return on equity capital. For a comparison of trends, another line on that chart shows average hourly earnings of employees in manufacturing. These latter figures do not include most of the large and growing amount of fringe benefits. A recent study estimated those benefits at a figure of about $20 billion, somewhat more than the total of corporate dividends.

Despite the importance of the subject, there are no satisfactory data on corporate profits related to equity capital. As Professor George Stigler has stated: "Considering how often our economic system is described as 'capitalistic' or 'the profit system,' it is paradoxical that we have relatively little information on the stock of capital or the rate of profits it yields in various industries." The data used here to show corporate profits as a return on equity were compiled by The First National City Bank of New York. (These are annual data and the 1962 figures are the latest available.) They are based on a sample of large corporations and, in the words of the Bank's publication, ". . . are biased in favor of success, embracing practically all of the largest and most successful corporations." Even so, the figures show that since 1947 the rate of return has declined steadily and significantly, falling from 12.3 per cent in 1947 to 9.1 per cent in 1962.

In a study of profits in the manufacturing field, Professor Stigler was able to examine data from corporations of all sizes since they were derived from income tax returns. The rates of return he found reflect the inclusion of smaller and less successful corporations and hence were substantially below those noted above but the trend and pattern were much the same. He computed rates which declined fairly steadily from 10.38 per cent in 1947 to 6.29 per cent in 1957. The declining rates of return shown in both of these series are all the more significant because they occurred at a time when interest rates were rising substantially and, as noted above, the total of corporate profits necessarily includes a large element of implicit interest cost.

The chart on hourly earnings and rates of return shows dramatically the divergent movement of the compensation of employees and the compensation of capital. In the 1957-1962 period, while hourly rates were growing at an annual rate of more than 3 per cent, the rate of return on equity was declining by 2.6 per cent per year. This followed a ten-year period in which the divergence had been even greater.

Reasons for the Trend A number of factors have been responsible for the relatively low levels of corporate profits. As the economy moved toward stability in the general price level, the artificial and unhealthy stimulus to demand afforded by inflation disappeared. This, together with the increase in producing capacity noted earlier, intensified domestic competition at the same time that competitive pressure from abroad was being stepped up. Meanwhile, costs—especially those occasioned by rising taxes and wage increases in excess of productivity—continued to move up steadily. Consequently, producers found themselves in a tight squeeze between relatively stable prices and rising costs.

In the tax area, indirect taxes (which here mean all those other than income taxes) have increased more rapidly than corporate revenues. There have been some increases in state taxes on corporate income, but the chief increase was in the Federal tax. As noted earlier, the principal rate in the Federal tax was raised in 1950 to a level 30 per cent above the highest rate reached during World War II and it has remained there since that time. This made the standard rate 52 per cent and, as President Kennedy noted in January 1963, made the Federal Government the "senior partner in business profits."

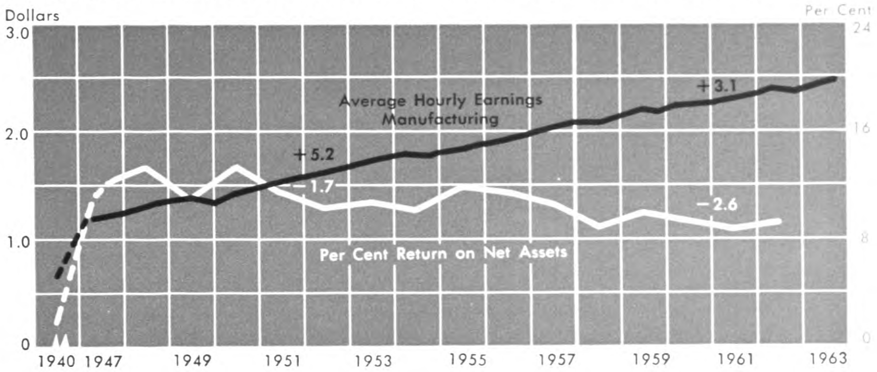
This profit squeeze in turn took its toll upon the economy by holding down employment in the face of a growing labor force, by pushing up the rate of unemployment, by discouraging business investment, and probably by adding to the deficit in the balance of payments. In short, the sort of situation developed in which mere stimulation of demand was not enough to cure the nation's economic ills. In addition the economy needed structural changes to restore a more normal relationship between costs and prices of final goods in view of the vital role played by business profits in the economic process.

Unemployment — Some Connotations Today, the unemployment problem—though serious wherever it hits—is fortunately quite a different matter from what it was during the Great Depression. Some indication of how conditions have changed is afforded by the following statement in a report on certain aspects of unemployment in 1961 by the U. S. Department of Labor: "The government's statistics on unemployment . . . have never been intended as a measure of financial need or hardship. Although unemployment is a serious matter for many families, it cannot be assumed that every unemployed person is in dire financial straits."

To a large extent the relatively better positions of the unemployed today as compared with those of their predecessors 30 years ago stem from five factors. First, unemployment today exists against the backdrop of an extensive and comprehensive system of unemployment insurance, supplemented in a growing number of cases by similar systems financed by employers. In addition, various forms of public assistance are available, including direct or general relief. Second, as noted earlier, the recessions of the past 20 years have been quite mild and short and there are some grounds for hoping that this will continue to be the case.

Third, in today's society a great many families have two or even three members employed, so that if the head of the family loses his job there is often a regular wage or salary check coming in. The extent of this condition is shown by the Department of Labor's study of unemployment in 1961 mentioned above. Of the 9.6 million who were unemployed for five weeks or more in 1961, 8.8 million were in fam-

HOURLY EARNINGS AND RETURN ON CORPORATE EQUITIES



ilies and the median income of those families was $4,413. The head of the family was the one unemployed in 5.3 million cases, and those families had a median income of $4,148, of which the head contributed about three fifths despite the fact that on an average he was unemployed for four months. In 3.4 million cases the head received unemployment compensation which offset about two fifths of the loss of family income caused by unemployment.

Another reason why conditions are different today is that more families have built up reserves in the form of insurance, liquid savings, an equity in a home, or in other forms. The above study showed that 46.9 per cent of the families involved used savings, the median amount of which was $396. Finally, more of the unemployment today is discretionary in the sense that there are jobs of some kind which the unemployed could fill, even if those jobs are below the level to which they are accustomed.

UNEMPLOYMENT—SOME CAUSES Unemployment in a nation may result from many complex factors. Technological change is sometimes one of the most important. At one end of the scale, technological change destroys jobs, often in large numbers, while at the other end it may create more jobs than can be filled because of the lack of necessary training. Such forces are quite evident today in the persistent shortages of workers in a wide range of technical skills at the same time there are large pools of unemployed, unskilled workers and workers with obsolete skills.

Another important cause is geographical and industrial immobility—the reluctance of workers to leave their home communities or the industry in which they are experienced. If husband and wife are working in different industries they may especially be reluctant to move, since both may not be able to find employment in the new environment.

Improper monetary policies can also result in unemployment. If, for example, monetary policy is too "tight," it will contribute to a slowdown in the economy. Conversely, if it is too "easy," it will foster an inflationary build-up which may burst and result in declining business activity and reduced employment.

Similarly, unwise fiscal policies can contribute to unemployment. A growing high-employment economy requires not only wise expenditure policies but also a reasonable tax structure. If taxes weigh too heavily on the consumer, they may result in insufficient demand to remove goods from the market, thereby cutting the demand for labor. Conversely, if taxes unduly discourage investment in business plant and equipment, similar employment effects may occur.

Unwise wage policies and practices and social legislation can also add to unemployment problems. The adoption of overly generous minimum wages can, for example, effectively exclude from the labor force those whose productivity is below the minimum wage. Similarly, fringe benefits that vary with the number of workers rather than with the number of hours can lead to a "stretch out" of workweeks at the expense of employment.

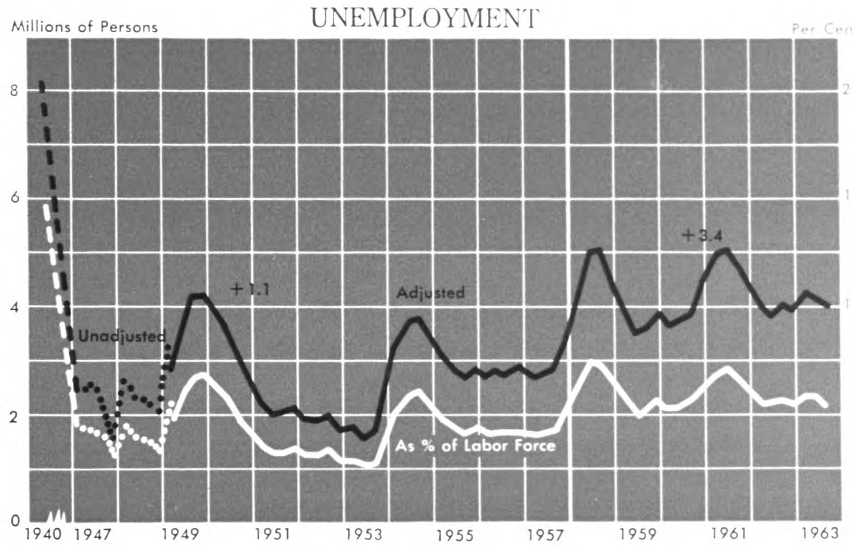
The level and trend of wages may also be causes of unemployment. As business profits narrowed in recent years, employers naturally searched for methods of reducing costs. It is an elementary and basic principle of economics that when one factor of production is relatively more costly than others, producers will economize in the use of that factor. Labor has been a relatively costly factor in recent years. Faced with that condition, employers have been under pressure to reduce wherever possible the amount of labor they use.

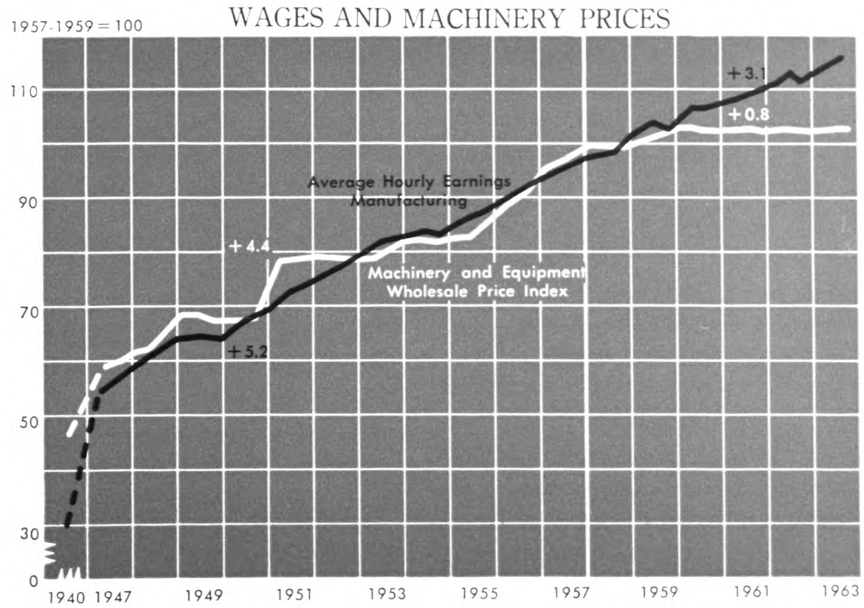
They have usually accomplished this saving of labor by improving techniques or by using more machinery, or both. In this respect producers have been favored during the past five years by relatively stable machinery prices. An accompanying chart shows that from 1947 to 1957 average hourly earnings in manufacturing and prices of machinery and equipment moved up roughly together. But since 1957 hourly earnings have risen at an annual rate of over 3 per cent while machinery prices have flattened out; over the six-year period as a whole, machinery prices have risen at an annual rate of less than 1 per cent, and for the past three years they have been almost completely stable. With this increasingly favorable ratio between wages and machinery, it would be only natural to expect that producers would favor production techniques that use a maximum of machinery and a minimum of labor.

BUSINESS INVESTMENT In the first ten years after the war expenditures for new plant and equipment increased at an annual rate of about 6 per cent. In the four years from 1957 to 1961 there was a net decline and only within the past two years has the total risen above the 1957 figure. The net advance for the whole six years has been only a little more than 6 per cent. Further, a large majority of the expenditures in the past six years was for replacement and modernization rather than for expansion of capacity. The 1962 issue of McGraw-Hill's survey of business investment plans stated: "Perhaps one of the most striking findings of this survey is that once again manufacturing firms plan to devote 70% of their investment to replacement and modernization. This is roughly the same proportion they have devoted to such purposes every year since 1958."

Apparently the pressure of rising wages forced producers to install cost-cutting equipment in order to economize on labor. This had the effect of restraining the increase in, or actually reducing, employment. To create new jobs to take care of some part of the growing labor force, substantial new investments to expand capacity would have been necessary. But the profit outlook was not sufficiently encouraging to induce producers to make such investments. So a large part of the investments made was defensive, negative, and cost-reducing in character rather than positive and expansionary.

Beyond this immediate effect, new business investment plays a strategic role in the economy as a whole. It is ordinarily a principal channel through which savings are put to work and through which the income multiplier operates. In this light, the low rate of growth in new plant and equipment in the past six years appears as one





of the major reasons for the relatively slow growth in the economy as a whole.

BALANCE OF PAYMENTS The problem presented by the balance of payments is another complex and difficult one. As in the case of unemployment, this one must be discussed in summary fashion. It may be profitable first to note some relationships among the different accounts in the balance of payments and then to look for some causes.

First, it is pertinent to note that the deficit is *not* caused by an unfavorable balance on the trade and services accounts. As noted earlier, surpluses in that area have usually run between four and eight billion dollars per year. Second, Government outlays abroad have been a major factor affecting expenditures abroad. Military expenditures in foreign countries and Government loans and grants have been running at a level of six to seven billion dollars per year. It is not correct to say that these outlays are *the* cause of the deficit since they are only a part of total spending and lending abroad. It *is* pertinent to observe, however, that these outlays are relatively inflexible, and that they are determined almost entirely by political considerations. Both of these features mean that these items are less affected by the normal operations of economic forces than are private spending and lending. In recent years the effect of economic aid to foreigners on the balance of payments has been reduced significantly by the practice of "tieing" the aid to American sources; that is, by requiring that the aid be taken in the form of goods and services rather than in dollars. In this way the money is spent in this country and the dollars cannot get abroad to increase the liquid claims of foreigners on this country.

The discussion of foreign aid is frequently conducted on the implicit assumption that if all aid could be tied the amount would be of little or no importance. This overlooks two considerations. First, the amount would still be a matter of some importance in the domestic budget and the problem of holding down the increase in expenditures in that budget is now a matter of major concern. Second, the above assumption means that if aid were cut off the present recipients would not use dollars earned elsewhere to purchase goods and services now being received as aid. Undoubtedly this latter is true to a large extent but probably not entirely.

The third and final major area of the balance of payments account is that of private capital movements. In recent years outflows of long- and short-term capital funds have fluctuated widely but have usually been between two and four billion dollars per year. Again, it is not correct to say that these movements are *the* cause of the deficit, although in a given period they may be responsible for most or all of the changes which take place. Last August Secretary Dillon stated that the recent increase in the deficit ". . . is due almost entirely to the accelerating outflow of long-term portfolio capital into new foreign issues . . ." and cited figures to show that this was true for 1962 and the first half of 1963.

It is now possible to point out a significant relationship between the developments described above and the deficit in the balance of payments. Domestically we have had a rather low rate of economic growth, relatively high unemployment, and a low level of capital investment. To counteract those forces and to foster a more vigorous rate of growth, we have followed a relatively easy money policy. But that policy has not been as easy, particularly in the area of short-term interest rates, as it would have been except for the balance-of-payments problem. During the past three years, when the international problem has been most acute, interest rates in the United States have been low relative to those in Europe. This difference in interest rates, coupled with the fact that this country has the world's largest, best organized, and only really unrestricted capital market, has led to outflows of both long-term and short-term funds. Those outflows have been a major factor in the balance of payments. In a nutshell, the American market has been a good one in which to borrow because of favorable interest rates, but it has not been a good one in which to invest because of a low and declining rate of profits. So both Americans and foreigners have borrowed here and invested abroad.

Some Recent Signs of Change

Eventually almost all trends change and the changes may go far toward diminishing or wiping out troublesome problems created by earlier trends. In the past two or three years there have been signs that some of the trends discussed above are slowly changing. It is the purpose of this final section to comment briefly on some of those signs of change.

WAGES Recently there have been two important developments affecting wages. The first was official recognition that over most of the postwar period wage increases were too great to permit economic growth without inflation. This was accompanied by an announcement of guideposts to indicate what increases are believed to be economically correct. Second, the rate of wage increases has declined and has approached the rate of increase in productivity.

In its 1962 *Annual Report* the Council of Economic Advisers presented figures showing that from 1947 to 1961 increases in hourly compensation (wages and salaries plus most supplements or fringe benefits) of all employees had consistently exceeded increases in output per man-hour, frequently by 100 per cent or more. After an extended analysis of the relationships among prices, wages, corporate profits, and economic growth, the Council arrived at its central guidepost for wage increases which was: "The general guide for non-inflationary wage behavior is that the rate of increase in wage rates (including fringe benefits) in each industry be equal to the trend rate of over-all productivity increase." This goal, to be attained through collective bargaining rather than legislation, was endorsed by the President in his *Economic Report*.

The Council presented data showing that from 1955 to 1961 the annual increase in average hourly earnings and average hourly compensation declined steadily, with the over-all decline amounting to about 50 per cent. In October 1963 the Bureau of Labor Statistics reported that "General wage changes under major collective bargaining agreements have tended to become smaller in recent years." The amount of the decline was from about ten cents per hour in the mid-fifties to about seven or eight cents in the past two years. Other studies have shown similar trends. Also, several reports have shown that the rate of wage increases in the United States has been substantially lower than in Western Europe. For example, one study covering the year from July 1962 to July 1963 showed that gross hourly wages increased by the following percentages: United States, 2.7; Great Britain, 3.4; West Germany, 5.7; France, 9.5; and Italy, 11.0. If these differences continue they will be of considerable significance to the balance of payments.

The recent pattern of wage behavior, together with steps taken by employers to control labor costs, has had a distinct and favorable effect on labor costs per unit of output. In the first two upswings of the postwar period those costs rose substantially. But in the upswings of 1958-1960 and 1961-1963 those costs, after two and a half years of recovery, were significantly *below* the levels prevailing at the troughs.

TAXES There have also been major developments affecting taxes. Here, too, there has been official recognition that the burden of taxes is a hindrance to full employment and a drag on economic growth. This was accompanied by a three-pronged program, two parts of which have already been accomplished, to reduce the tax load.

In 1962 the Treasury put into effect a new and substantially more liberal depreciation schedule to be used in computing income for tax purposes. Also in 1962 Congress enacted a provision allowing a limited tax credit for new investments made by taxpayers. It is estimated that these two changes reduced corporate tax liabilities for 1962 by about $2¼ billion.

The third component of the program is a broad and substantial reduction in Federal taxes on personal and corporate incomes. The proposal has been pushed vigorously for more than a year and a bill to accomplish it was passed by the House of Representatives in September 1963, but at this writing its fate is uncertain. As passed by the House, the measure would reduce personal tax liabilities by an average of 18.7 per cent, with larger reductions in the lower brackets and smaller reductions in the higher brackets. Also, certain new features would give additional relief to the lower brackets, while changes in the provision allowing the exclusion of certain dividends and tax credits against others would reduce the relief in the higher brackets. The effect of these changes would be generally to reduce the rates of the personal tax to a level well below the peak rates reached during World War II. The measure would reduce corporate tax liabilities by an average of 9.8 per cent, which would leave the rates substantially above the peak rates of World War II. Further, corporations would not realize the full benefits from the reduction during a transition period of about five years; the date for paying taxes would be advanced each year until corporations would be on a current basis.

CORPORATE PROFITS The slowdown in wage increases, the more favorable tax provisions, the prospect of more tax relief to come, and a relatively high level of business activity all combined to boost corporate profits in the past two years. They rose to a new high level in 1962 and registered significant additional gains in 1963. The gains were general and widespread, with only a very few industries failing to participate in the advance. It was the first time in ten years that profits had shown significant gains for two consecutive years. The profits were, of course, computed after taking advantage of the enlarged allowances for depreciation. Computed without these allowances, the profits would have been considerably larger.

EXPENDITURES FOR NEW PLANT AND EQUIPMENT Larger corporate profits and a more favorable tax environment have been important factors in stimulating the increased spending for new plant and equipment which began in the third quarter of 1961. During the recovery of 1958-1960 plant and equipment expenditures did not regain the level of $37.7 billion reached in the third quarter of 1957. But this figure was surpassed in the third quarter of 1962. Then, after declining moderately for two quarters, the total moved up again and was expected to pass $41 billion in the fourth quarter of 1963. This would be an increase of about 23 per cent in two and a half years. The rise has been accompanied by a slow but steady rise in the rate of utilization of manufacturing capacity. This indicates that the increase in plant and equipment has been justified and affords some grounds for expecting that the rise will continue for a while into the future.

Spending for plant and equipment is significant for several reasons. As pointed out earlier, it constitutes perhaps the most important channel through which savings are translated into investment, thus permitting the income multiplier to work in the private economy. It is also an important indicator of the confidence of businessmen in the prospects for the intermediate future. Finally, it lays the groundwork for greater and more efficient production in the future. Domestically this could bring higher wages and/or larger profits. Internationally, it could mean more effective competition with other countries and perhaps some improvement in the balance of payments, both by increasing the surplus on trade and services account and by reducing capital outflows because of an improved business outlook.

THE LENGTHENING CYCLE As noted earlier, postwar business cycles, especially the periods of expansion, have shown a definite tendency to become shorter. The current cycle has proved to be an exception to that generalization and may mark a change in the trend. Contrasted with periods of 35 months and 25 months for the two previous cycles, the current upswing has continued for more than 30 months and if it lasts until February 1964 it will reach 36 months. Undoubtedly many factors have contributed to this change, but three which appear to be among the more significant are the rise in corporate profits, a change in the pattern of residential construction, and a booming automobile industry. These were supported by a continuing policy of relatively easy money which, in turn, was facilitated by the relatively slow rise in wage rates.

In 1954-1955 corporate profits reached their peak only five quarters after the cyclical trough. In 1958-1959 the peak was reached after only four quarters. In the current cycle profits continued to rise, with only minor interruptions, for nine quarters and if, as appears likely, they continue to show gains to the end of 1963, the run will have been extended to 11 quarters. It seems quite likely that the more favorable profits picture has had a fairly direct and beneficial effect on expenditures for plant and equipment, employment, volume of output, and other phases of economic activity. In these ways the larger profits have contributed to the lengthening of the period of business expansion.

In earlier cycles rising interest rates exerted a restraining effect on residential construction fairly early in the periods of business expansion. This caused residential construction to "peak out" and turn downward early in the cycle. The opposite happened near the troughs of the cycles, and these effects probably contributed to the shortening of the cycles. In the current cycle the rise in interest rates generally has been quite gentle and moderate. In the case of mortgage loans, several special factors have been at work to hold interest rates down or push them lower. These include an abundance of savings, competition of commercial banks for mortgage loans, and official efforts to hold down all long-term interest rates. As a result, after two and a half years of business expansion interest rates on residential mortgages were, in most parts of the country, significantly lower than they were at the trough of the cycle.

Responding to these lower interest rates and a generally favorable environment, residential construction has moved up throughout the current period of business expansion. In the third quarter of 1963 expenditures for residential nonfarm construction stood at the highest point on record and in September and October 1963 housing starts moved up sharply to new highs. The volume of expenditures involved here necessarily made a contribution toward the extension of the period of relatively high business activity.

Finally, the automobile industry, for whatever reasons, has had two consecutive years of very high production and sales, with favorable prospects for a third good year to come. The two years which are past have already helped to lengthen the present period of business expansion. If the third boom year is realized it will be a new pattern for the industry and also a major contribution toward a further lengthening of the upswing.

It is, of course, too early to say whether these three developments will continue and help to change the pattern of future cycles. But the cyclical pattern is continually changing as the net result of a multitude of developments and it would not be unreasonable to expect that for a while the trend might be toward longer cycles.

SUMMARY OF OPERATIONS

The year 1963 was characterized by significant increases in many of the operating functions of the Richmond Reserve Bank. The number of checks cleared reached an all-time high of 326,339,000—25 million more than in 1962—and the dollar value rose to a record $115.6 billion. Currency shipments and receipts climbed to more than $5.6 billion, up 5 per cent from the 1962 figure. Wire transfers of funds totaled almost $141 billion, 18 per cent more than the previous year. In response to a slightly less easy monetary policy, member banks stepped up their borrowing at the discount window to $5.95 billion, more than double the volume in 1962.

A significant decrease was experienced in one area of operations—the handling of coins. Outgoing shipments and receipts totaled $156 million, down about $5 million from 1962. The drop is attributable to the nationwide coin shortage that has been growing more acute each of the last several years. Among the factors apparently contributing to the shortage are an increase in coin collecting, rising business activity, and more extensive use of vending machines, parking meters, and similar devices.

Net earnings before payments to the U. S. Treasury rose $7 million to a record $62,842,503.34. Member banks received 6 per cent statutory dividends of $1,391,692.85, and the Bank's surplus account (surplus is twice the paid-in capital) was increased $5,037,000.00 to bring it to $49,139,300.00. The net earnings which remained, amounting to $56,413,810.49, were paid to the Treasury as interest on Federal Reserve notes.

Capital stock rose to $24,569,650.00 as a result of an increase in the capital and surplus of District member banks.

Publications and statistical reports of the Bank continued to be popular and were widely distributed during the year. Approximately 140,000 copies of our *Monthly Review* were sent to bankers, businessmen, educators, students, and other interested individuals; and over 281,000 copies of other publications were distributed by the Bank.

In addition to the annual college survey, in which suitable publications and films are offered for classroom use to professors of economics and related subjects, the Bank conducted its second high school survey to encourage the teaching of economics at that level. Over 800 high schools in the Fifth District requested publications in response to the survey.

Early in 1963 our traveling money exhibits were refurbished and furnished with new cases and easels. Two new counterfeit exhibits were added to bring the total number of displays to eleven. The exhibits, which are borrowed for one-week periods, remain quite popular with District member banks.

Our annual Operations and Policy Seminar was held in April of 1963. It was attended by 230 bankers, representing 146 District member banks and branches.

New Federal Reserve Notes

On November 26 the Bank, along with other Reserve Banks, began issuing one-dollar Federal Reserve notes. These notes will replace one-dollar silver certificates, which are being retired to conserve the silver for coinage. The new notes, like other Federal Reserve notes, are secured primarily by gold certificates and U. S. Government securities.

Check Collection

By April 1963 all three of our offices were equipped with high-speed check handling equipment on a rental basis. Richmond installed a Burroughs B-270 in November 1962, and a second Burroughs high-speed system was installed in November 1963. Baltimore and Charlotte acquired IBM 1412 equipment in March and April respectively, and both offices plan to replace this equipment with a higher-speed document handling system, the IBM 1420, early in 1964.

At the Richmond office about four hundred thousand country items—approximately 80 per cent of the average daily volume of country items received for collection—are processed in the high-speed unit each day. Plans are being made to process Government card checks and postal money orders on the high-speed equipment early in 1964.

At the Baltimore Branch, where an IBM 1419 Reader-Sorter replaced the original IBM 1412 in November 1963, about 145,000 country items—approximately 60 per cent of the daily average volume of country items received for collection—are processed each day. At the Charlotte Branch, where the IBM 1412 is still in use, 60,000 country items—approximately 30 per cent of the average daily volume of country items received for collection—are processed each day.

At all three offices low-speed encoding equipment is utilized to qualify items in the amount field for electronic processing. It is contemplated that some units of the encoding equipment, as well as some of the conventional proof machines, will be released as the number of incoming items qualified for high-speed handling increases.

New Member Banks

Twelve newly-formed Fifth District banks entered the Federal Reserve System during the year, and three former nonmember banks converted to System membership. Member banks opening for the first time during 1963 were:

January 24—First National Bank of Hillandale, Silver Spring, Maryland.

June 5—National City Bank of Baltimore, Baltimore, Maryland.

July 1—First National Bank of Boone, Boone, North Carolina.

July 1—Security National Bank of Roanoke, Roanoke, Virginia.

July 23—Public National Bank, Washington, D. C.

August 5—Horry County National Bank, Loris, South Carolina.

August 16—Commonwealth National Bank of Arlington, Arlington, Virginia.

September 5—Peoples National Bank of Prince Georges County, Suitland, Maryland.

September 25—The Colonial National Bank of Alexandria, Alexandria, Virginia.

November 13—The National Bank of Rosslyn, Arlington, Virginia.

December 2—Madison National Bank, Washington, D. C.

December 16—National Bank of Commerce of Fairfax County, Falls Church, Virginia.

The Farmers and Merchants Bank of Craig County, New Castle, Virginia, joined the System on May 15; Citizens National Bank of Southern Maryland, Lexington Park, Maryland, formerly Citizens Bank of St. Mary's, joined on May 27; and the First National Bank of Smithfield, Smithfield, North Carolina, formerly the Johnston County Bank, became a member on September 16.

Changes In Official Staff

The year 1963 brought about one official promotion and the appointment of three new officers. Welford S. Farmer, formerly General Counsel, was named Vice President and General Counsel in December.

Edward L. Bennett, R. Henry Smart, and Chester D. Porter, Jr., were appointed to the position of Examining Officer also at the end of the year.

COMPARATIVE STATEMENT OF CONDITION

ASSETS:	December 31, 1963	December 31, 1962
Gold certificate account	$ 845,296,215.72	$ 894,629,406.31
Redemption fund for Federal Reserve notes	117,529,535.00	100,516,830.00
TOTAL GOLD CERTIFICATE RESERVES	962,825,750.72	995,146,236.31
Federal Reserve notes of other banks	38,672,250.00	36,860,300.00
Other cash	9,012,572.85	25,644,066.01
Discounts and advances	2,854,000.00	995,000.00
U. S. Government securities:		
Bills	289,926,000.00	165,733,000.00
Certificates	494,678,000.00	894,553,000.00
Notes	1,241,139,000.00	727,296,000.00
Bonds	325,206,000.00	280,729,000.00
TOTAL U. S. GOVERNMENT SECURITIES	2,350,949,000.00	2,068,311,000.00
TOTAL LOANS AND SECURITIES	2,353,803,000.00	2,069,306,000.00
Cash items in process of collection	588,826,970.10	572,259,096.25
Bank premises	5,106,576.07	5,116,166.03
Other assets	24,272,087.52	22,311,118.99
TOTAL ASSETS	$3,982,519,207.26	$3,726,642,983.59
LIABILITIES:		
Federal Reserve notes	$2,703,309,890.00	$2,525,031,750.00
Deposits:		
Member bank—reserve accounts	706,662,802.47	761,009,058.90
U. S. Treasurer—general account	79,381,427.35	27,944,548.68
Foreign	7,520,000.00	11,700,000.00
Other	8,073,593.22	10,181,264.10
TOTAL DEPOSITS	801,637,823.04	810,834,871.68
Deferred availability cash items	398,382,082.78	320,368,007.44
Other liabilities	5,480,461.44	4,254,904.47
TOTAL LIABILITIES	3,908,810,257.26	3,660,489,533.59
CAPITAL ACCOUNTS:		
Capital paid in	24,569,650.00	22,051,150.00
Surplus	49,139,300.00	44,102,300.00
TOTAL LIABILITIES AND CAPITAL ACCOUNTS	$3,982,519,207.26	$3,726,642,983.59
Contingent liability on acceptances purchased for foreign correspondents	$ 4,319,300.00	$ 3,784,500.00

COMPARATIVE STATEMENT OF EARNINGS AND EXPENSES

	1963	1962
EARNINGS:		
Discounts and advances	$ 563,964.68	$ 238,006.42
Interest on U. S. Government securities	75,645,680.58	67,479,037.72
Foreign currencies	95,994.62	157,607.00
Other earnings	17,251.30	13,387.64
TOTAL CURRENT EARNINGS	76,322,891.18	67,888,038.78
EXPENSES:		
Operating expenses (including depreciation on bank premises) after deducting reimbursements received for certain Fiscal Agency and other expenses	12,281,791.59	11,541,987.12
Assessments for expenses of Board of Governors	358,300.00	301,900.00
Cost of Federal Reserve currency	896,476.88	684,468.53
NET EXPENSES	13,536,568.47	12,528,355.65
CURRENT NET EARNINGS	62,786,322.71	55,359,683.13
ADDITIONS TO CURRENT NET EARNINGS:		
Profit on sales of U. S. Government securities (net)	20,748.73	130,618.22
All other	36,890.59	33,988.44
TOTAL ADDITIONS	57,639.32	164,606.66
DEDUCTIONS FROM CURRENT NET EARNINGS	1,458.69	67,425.28
Net additions	56,180.63	97,181.38
NET EARNINGS BEFORE PAYMENTS TO U. S. TREASURY	$62,842,503.34	$55,456,864.51
Dividends paid	$ 1,391,692.85	$ 1,272,977.39
Paid U. S. Treasury (interest on Federal Reserve notes)	56,413,810.49	50,222,987.12
Transferred to surplus	5,037,000.00	3,960,900.00
TOTAL	$62,842,503.34	$55,456,864.51

SURPLUS ACCOUNT

	1963	1962
Balance at close of previous year	$44,102,300.00	$40,141,400.00
Addition account of profits for year	5,037,000.00	3,960,900.00
BALANCE AT CLOSE OF CURRENT YEAR	$49,139,300.00	$44,102,300.00

CAPITAL STOCK ACCOUNT

(Representing amount paid in, which is 50% of amount subscribed)

	1963	1962
Balance at close of previous year	$22,051,150.00	$20,070,700.00
Issued during the year	2,552,250.00	2,049,450.00
	24,603,400.00	22,120,150.00
Cancelled during the year	33,750.00	69,000.00
BALANCE AT CLOSE OF CURRENT YEAR	$24,569,650.00	$22,051,150.00

FEDERAL RESERVE BANK OF RICHMOND

Directors (December 31, 1963)

	Edwin Hyde	Chairman of the Board and Federal Reserve Agent
	William H. Grier	Deputy Chairman of the Board
CLASS A		
	David K. Cushwa, Jr.	President, The Washington County National Savings Bank Williamsport, Maryland (Term expires December 31, 1965)
	Addison H. Reese	President, North Carolina National Bank Charlotte, North Carolina (Term expired December 31, 1963) Succeeded by: Robert T. Marsh, Jr. Chairman of the Board First & Merchants National Bank Richmond, Virginia (Term expires December 31, 1966)
	J. McKenny Willis, Jr.	Director, Maryland National Bank Easton, Maryland (Term expires December 31, 1964)
CLASS B		
	Robert Richardson Coker	President, Coker's Pedigreed Seed Company Hartsville, South Carolina (Term expires December 31, 1964)
	Robert E. L. Johnson	Chairman of the Board, Woodward & Lothrop, Inc. Washington, D. C. (Term expires December 31, 1966)
	Raymond E. Salvati	Chairman of the Board, Island Creek Coal Company Huntington, West Virginia (Term expires December 31, 1965)
CLASS C		
	Edwin Hyde	President, Miller & Rhoads, Inc. Richmond, Virginia (Term expires December 31, 1964)
	William H. Grier	President, Rock Hill Printing & Finishing Company Rock Hill, South Carolina (Term expires December 31, 1966)
	Wilson H. Elkins	President, University of Maryland College Park, Maryland (Term expires December 31, 1965)
MEMBER FEDERAL ADVISORY COUNCIL		
	Robert B. Hobbs	Chairman of the Board The First National Bank of Maryland Baltimore, Maryland (Term expired December 31, 1963) Succeeded by: John F. Watlington, Jr. President Wachovia Bank and Trust Company Winston-Salem, North Carolina

FEDERAL RESERVE BANK OF RICHMOND

Officers

Edward A. Wayne
President

Aubrey N. Heflin
First Vice President

Robert P. Black
Vice President

J. Gordon Dickerson, Jr.
Vice President

Welford S. Farmer
Vice President and General Counsel

Donald F. Hagner
Vice President

Edmund F. Mac Donald
Vice President

Upton S. Martin
Vice President

John L. Nosker
Vice President

Joseph M. Nowlan
Vice President and Cashier

B. U. Ratchford
Vice President and Senior Adviser

Raymond E. Sanders, Jr.
Vice President

John G. Deitrick
Assistant Vice President

Stuart P. Fishburne
Assistant Vice President

H. Ernest Ford
Assistant Vice President

William B. Harrison, III
Assistant Vice President

John C. Horigan
Chief Examiner

James Parthemos
Assistant Vice President

Victor E. Pregeant, III
Assistant Vice President and Secretary

Joseph F. Viverette
Assistant Vice President

J. Lander Allin, Jr.
Assistant Cashier

Clifford B. Beavers
Assistant Cashier

Edward L. Bennett
Examining Officer

John E. Friend
Assistant Cashier

Robert L. Miller
Assistant Cashier

Arthur V. Myers, Jr.
Assistant Cashier

Chester D. Porter, Jr.
Examining Officer

R. Henry Smart
Examining Officer

Wythe B. Wakeham
Assistant Cashier

G. Harold Snead
General Auditor

Roger P. Schad
Assistant General Auditor

BALTIMORE BRANCH

Directors (December 31, 1963)

Joseph B. Browne	President, Union Trust Company of Maryland Baltimore, Maryland (Term expires December 31, 1965)
E. Wayne Corrin	President, Hope Natural Gas Co. Clarksburg, West Virginia (Term expires December 31, 1965)
Leonard C. Crewe, Jr.	President and Treasurer Maryland Fine and Specialty Wire Company, Inc. Cockeysville, Maryland (Term expires December 31, 1964)
Harry B. Cummings	Vice President and General Manager Metal Products Division, Koppers Company, Inc. Baltimore, Maryland (Term expires December 31, 1966)
Harvey E. Emmart	Senior Vice President and Cashier Maryland National Bank Baltimore, Maryland (Term expires December 31, 1964)
Martin Piribek	Executive Vice President The First National Bank of Morgantown Morgantown, West Virginia (Term expires December 31, 1964)
J. N. Shumate	President, The Farmers National Bank of Annapolis Annapolis, Maryland (Term expired December 31, 1963) Succeeded by: John P. Sippel, President The Citizens National Bank of Laurel Laurel, Maryland (Term expires December 31, 1966)

Officers

Donald F. Hagner
Vice President

A. A. Stewart, Jr.
Cashier

B. F. Armstrong
Assistant Cashier

E. Riggs Jones, Jr.
Assistant Cashier

A. C. Wienert
Assistant Cashier

CHARLOTTE BRANCH

Directors

(December 31, 1963)

George H. Aull	Consulting Economist The South Carolina National Bank (Term expired December 31, 1963) Succeeded by: James A. Morris, Dean School of Business Administration University of South Carolina Columbia, South Carolina (Term expires December 31, 1966)
Wallace W. Brawley	President The Commercial National Bank of Spartanburg Spartanburg, South Carolina (Term expires December 31, 1964)
J. C. Cowan, Jr.	Vice Chairman of the Board Burlington Industries, Inc. Greensboro, North Carolina (Term expires December 31, 1965)
W. W. McEachern	President, The South Carolina National Bank Greenville, South Carolina (Term expires December 31, 1966)
G. Harold Myrick	Executive Vice President and Trust Officer First National Bank Lincolnton, North Carolina (Term expires December 31, 1965)
Joe H. Robinson	Senior Vice President Wachovia Bank and Trust Company Charlotte, North Carolina (Term expires December 31, 1964)
Clarence P. Street	President, McDevitt & Street Co. Charlotte, North Carolina (Term expires December 31, 1964)

Officers

Edmund F. Mac Donald
Vice President

Stanhope A. Ligon
Cashier

Winfred W. Keller
Assistant Cashier

Fred C. Krueger, Jr.
Assistant Cashier

E. Clinton Mondy
Assistant Cashier