MONTHLY

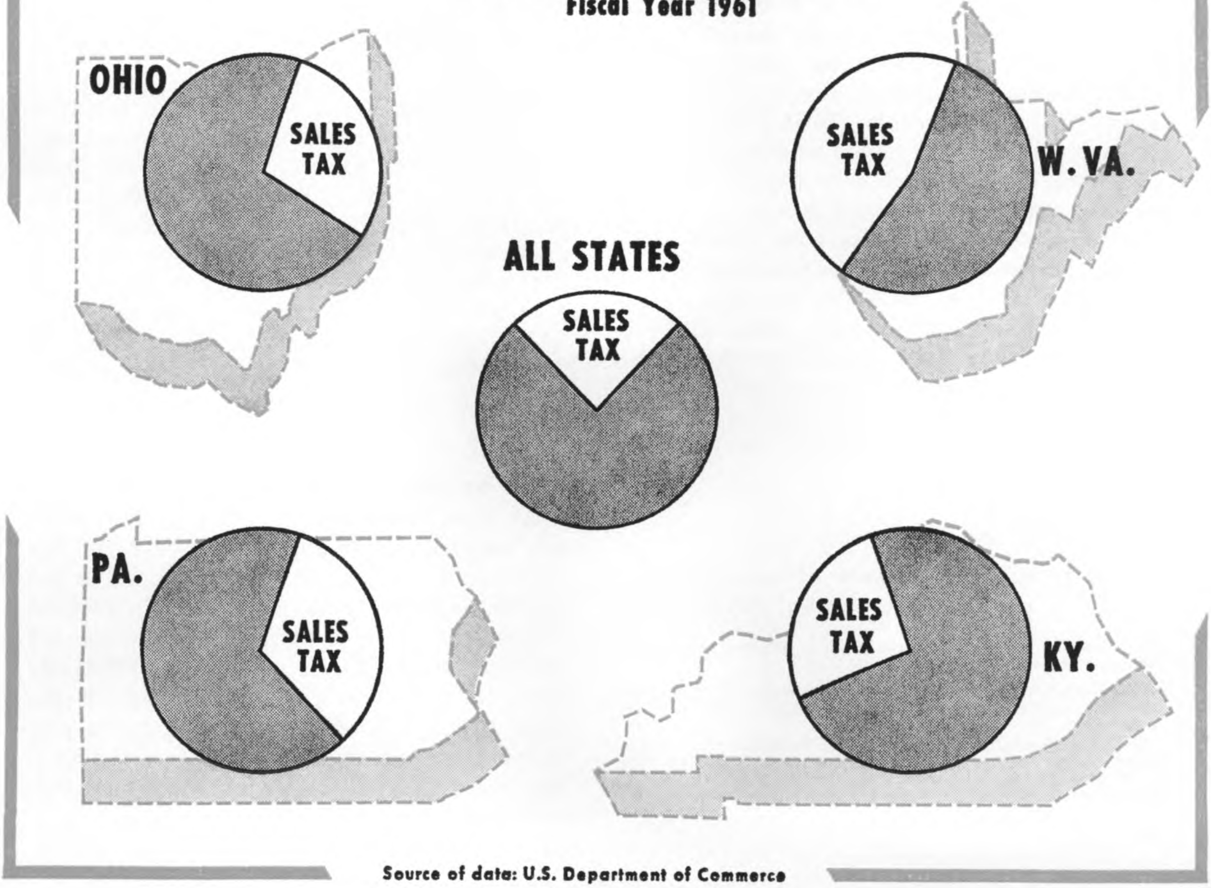
Business Review

FEDERAL RESERVE BANK of CLEVELAND

May 1962

IN THIS ISSUE

STATE TAX REVENUES
Fiscal Year 1961



Source of data: U.S. Department of Commerce

A Look at Sales Taxation

Editor's note: Sales taxes are an important source of state tax revenues. This is especially so insofar as the states of the Fourth Federal Reserve District are concerned. There may be a question as to whether sales taxes can be counted on to provide sufficient revenues to help finance increasing spending by states.

THE sales tax is imposed on purchases for consumption. It is thus usually levied, in various forms, on a broad range of commodities and on a more limited range of services. A sales tax is one member of the family of consumption taxes. However, it is not the same as an excise tax in that the latter usually is imposed on particular commodities, for example, on gasoline or cigarettes.

In the 35 states where it is currently in use,(1) the sales tax is a major source of tax revenues. For example, sales taxes provided about one-third of the tax revenues of the 35 states, taken together, in fiscal year 1961.(2) In fact, sales taxes provided nearly one-fourth of the total tax revenues collected by all states in fiscal year 1961.(3) And this was so, despite the fact that sales taxes were not levied in 15 states. Moreover, sales taxes provided nearly 5 percent more of total tax revenues of all states than did state income taxes in fiscal year 1961. Sales taxes were thus clearly the most important single source of tax revenues to state governments in fiscal 1961, a situation which has existed throughout the postwar period.

A Brief History

The relative significance of sales taxes in the U. S. is a somewhat recent development in that such taxes are essentially an offspring of the 1930's. During that period, when economic activity was deeply depressed, many states were caught up in a need to finance spending from declining revenue bases. By the end of the 1930's, thirty-two states had enacted legislation introducing the sales tax as a new source of state tax revenues. Indicative of the attitude toward sales taxes as a stopgap measure for solving state fiscal problems, ten of the states subsequently repealed the legislation, with only one of these states reactivating the legislation before 1947. Broadly speaking, such actions probably were due to the antipathy of the general public toward sales taxes. In addition, the passing of the 'thirties relieved temporarily some of the fiscal problems of a number of states, thereby reducing the need for revenues from sales taxes.

On the other hand, a majority of the sales taxes introduced in the 'thirties assumed permanent status. Such a development highlighted the fact that sales taxes were producing large revenues and, in most cases, were easily and economically administered. Since 1947, fourteen states either have enacted or re-enacted legislation introducing a sales tax, which reflects at least in part a need to finance the demands of an increasing population for more and better services.

Focus on the Fourth District

As shown on the cover chart of this issue, the sales tax is an important source of tax revenues in each of the states included in the Fourth Federal Reserve District. In fact, as measured by the contribution to state tax revenues, the sales tax has been relatively more important in the District than it has been in the nation. While sales taxes provided approximately 24 percent of the total tax revenues of all states in fiscal year 1961,

(1) Two additional states have recently adopted sales taxes, bringing the total to 37 states.

(2) All data used in this article are from the U. S. Department of Commerce. The figures for fiscal year 1961 are preliminary.

(3) State governments conduct their business on a "fiscal year" rather than on a calendar year basis, with the fiscal year normally running from July 1 through June 30. Four states use a different sequence of months for the fiscal year.

such taxes provided nearly 32 percent of the total tax revenues of the four states included in the District. In this section, the various details associated with the sales taxes of Fourth District States are discussed.

Kentucky. Similar to the majority of states in the U. S., Kentucky levies a "retail sales tax." The sales tax in Kentucky was adopted in 1960. It is levied at a rate of three percent. In addition to being imposed upon goods sold at retail to consumers, the tax is imposed upon certain services, e.g., hotel-room rentals and leases or rentals in place of sales. Kentucky has excluded the sale of goods and equipment used in production from taxation in order to encourage the competitive position of industry in the state. However, the sale of food, which is exempt in some states, is taxed in Kentucky.

West Virginia. This state levies both a retail sales tax and a gross income tax, a situation which exists in no other state. West Virginia was a pioneer in the field of sales taxation, enacting the gross income tax in 1921 and the retail sales tax in 1933. The gross income tax represents a more important source of revenue, providing approximately 28 percent of total tax revenues in fiscal year 1961, while the retail sales tax provided about 19 percent.

The gross income tax is one of the few multi-stage sales taxes in the U. S., i.e., a tax which is levied at more than one stage of the production and distribution process. Levied on the privilege of doing business, this tax is thus applied to nearly all transactions at the various levels of production and distribution. Although sales taxes are usually levied at a flat percentage rate, the gross income tax in West Virginia is imposed according to a highly detailed schedule, with rates ranging from one-quarter of one percent to nearly eight percent, depending on the type of business involved. In some cases, different tax bases are employed, but for most types of businesses the base of the tax is the gross proceeds of sales.

The retail sales tax in West Virginia is levied at a flat rate of 3 percent. The tax applies to all goods sold at retail, as well as to the sale of all services, except those of a professional or personal nature.

Personal services are those compensated by payments of wages, or services rendered without an accompanying sale of goods. Thus, expenditures on amusements, laundries, garages, and TV repairs are taxable; while expenditures on nursing, barbering, or manicuring are not. Similar to Kentucky, sales of producers' goods are exempt from taxation, while food sales are taxed.

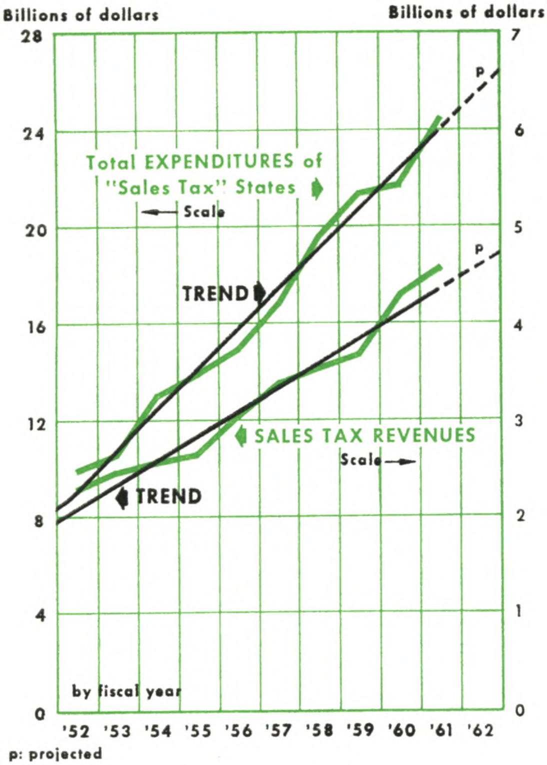
Pennsylvania. Since 1932, Pennsylvania has experimented with sales taxation on three separate occasions, enacting the most recent legislation in 1956. Originally, the sales tax applied only to the retail sales of enumerated classes of goods and to services of utilities. The original 17 taxable categories were so inclusive, however, that the tax was actually similar to a retail sales tax.

With the most recent legislation, the Pennsylvania sales tax has been broadened so that more services and additional goods are now taxable. The rate of taxation currently stands at 4 percent, the highest rate in the nation. Producers' goods are exempted from the tax as is food for home consumption.

Ohio. This state first adopted a sales tax in 1934 as a temporary measure to meet growing revenue needs. One year later, the state legislature proceeded to make the tax a permanent source of state revenues. A constitutional amendment was passed in 1936 prohibiting the taxation of food for home consumption. This step was taken to lessen the regressivity of the sales tax. That is to say, to prevent the tax burden from falling more heavily on lower-income groups.

The sales tax base in Ohio includes the retail sale of most goods and a limited number of services. The sales tax is levied at a general rate of 3 percent, with a special schedule used for sales under $1.00. Until 1961, Ohio was unique in that it utilized prepaid

The computed trend lines show a divergence between sales tax rvenues and state expenditures. When the trends are projected, all things being equal, the divergence becomes even more pronounced.



Source of data: U.S. Department of Commerce.

sales tax stamps. Due to administrative costs this feature was repealed.

Use Tax

Each of the four states of the Fourth District has enacted a tax complementary to the sales tax — the use tax — which is designed to prevent the avoidance of the sales tax by the purchase of goods outside of the state. The use tax is imposed on goods purchased outside the state, which are for use, storage, or consumption within the state. The use tax does not play an important part in revenue production, providing only a small percentage of total tax revenues.

Consumption Patterns and Sales Tax Revenues

There is one important thing that all sales taxes have in common, namely, each is the largest single source of tax revenues for the states where such a tax is imposed.[4] Because of rising expenditures for state governments, the need to maintain stability and steady growth of sales tax revenues thus assumes major significance.

Many observers have suggested that the desired stability and steady growth may not be necessarily inherent in the majority of sales taxes. As shown in an accompanying chart, revenues from sales taxes have failed to keep pace with the expenditures of the states which levy the sales tax. From fiscal year 1952 through 1961, for example, revenues from sales taxes rose 102 percent, while expenditures of sales-tax states rose about 151 percent. In other words, while expenditures were increasing at a rate of about 15 percent per year, sales tax revenues were rising at a rate of only 10 percent. The computed trend line of the two series shows a divergence between sales tax revenues and state expenditures. And when the respective trends are projected, all things being equal, the divergence between sales tax revenues and state expenditures becomes even more pronounced. Looking at the situation another way, from fiscal year 1952 through fiscal year 1961, sales tax revenues declined from 35.6 percent of total tax revenues of sales-tax states to 33.8 percent.

The failure of sales tax revenues to keep pace with expenditures or to hold their own as a proportion of total tax revenues can be accounted for, to some extent, by changes in spending patterns of consumers. For example, in recent years, consumers have devoted a larger percentage of personal income to spending on services. This is in contrast to the period of the 'thirties and World War II, when purchases of services declined steadily as a percent of total consumer spending. And,

(4) This is true for all states, with the exception of *three* states of the 35 which use a sales tax.

it was during the 'thirties that the majority of state sales taxes were enacted, with tax bases, for the most part, stressing durable and nondurable goods, to the exclusion of services.

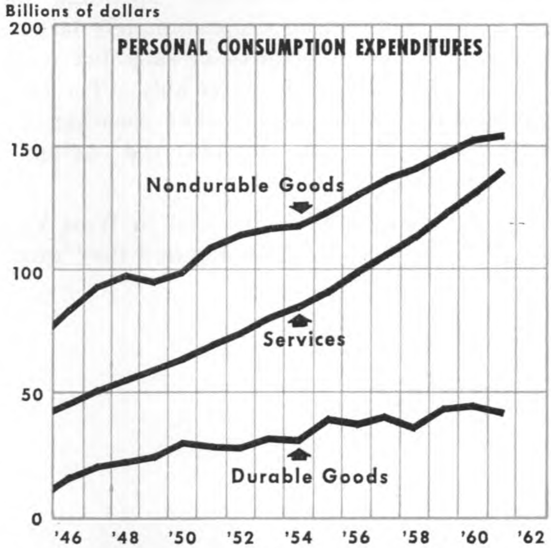
As shown in an accompanying chart, spending on services has risen steadily since 1946, so that by 1961 such spending constituted a larger share of consumer expenditures than in 1929. By the end of 1961, consumer spending on services accounted for 42 percent of total consumer spending,(5) as compared with 41 percent in 1929 and 31 percent in 1947.

It is also found that, in the past few years, spending on services has picked up even more as a proportion of total consumer spending. For example, service spending during the period from 1952 through 1957, increased at an annual rate of 1.5 percent as a proportion of consumer spending. On the other hand from 1957 through 1961, the rate of increase amounted to 2.2 percent per year. These patterns are shown in the chart on consumer spending.

It is reasonable to suggest that if an increasingly larger percentage of consumer expenditures were to be diverted to service spending, a retardation of the growth of sales tax revenues could occur in those states where most service purchases are excluded from the tax base. Most spending on services is excluded in the 32 states which levy a "retail", "general", or "selective" sales tax. Of these states, thirty have used sales taxes during the past decade. An examination of the revenues of the sales taxes of these states shows that such revenues increased at a faster rate in the 1952-57 period than in the 1957-61 period. Revenues from sales taxes rose 7.6 percent per year from 1952 through 1957, but only 4.6 percent per year from 1957 through 1961. Thus the revenues of sales taxes which exclude most services increased at a lesser rate during the period when spending on services as a proportion of total consumer spending was growing more rapidly.

(5) By the end of 1961 non-durables amounted to 45 percent and durables to 13 percent of total consumer spending.

Spending on services has risen steadily since 1946, so that by 1961 such spending constituted 42 percent of total consumer spending.



Source of data: U.S. Department of Commerce.

Five states impose either "gross income" or "gross receipts" taxes, i.e., sales taxes which include many services in the tax base. In four of these states, such taxes have been in force since 1952. In the 1952-1957 period, sales tax revenues from these more broadly-based taxes increased at a rate of 4.1 percent per year, while in the 1957-1961 period such revenues increased at a rate of 6.7 percent per year. The revenues from these taxes thus increased in a manner more in line with total consumer spending patterns.

Fourth District

In the Fourth District, only Ohio and West Virginia have had sales taxes in force since 1952. In some ways, revenues from sales taxes in these states have followed the national pattern.

In Ohio, for example, revenues from the "retail" sales tax fell from 37 percent of total tax revenues in 1952 to approximately 29 percent in 1961. Moreover, sales tax revenues grew at an annual rate of 7.0 percent during the 1952-1957 period, while they increased at an annual rate of only 1.7 percent during the 1957-1961 period. Thus, in the later period when consumer spending on services was becoming proportionately larger, the annual rate of growth of sales tax revenues in Ohio declined appreciably. (The connection is clear assuming that spending by consumers in Ohio follows the national pattern.)

With two sales taxes in effect in West Virginia — the "retail" sales tax and the "gross income" tax — most services are covered. However, the combined revenues of the two sales taxes, as a percent of total tax revenues, declined from 53 percent in 1952 to 46 percent in 1961. Furthermore, an examination of the rate of growth of sales tax revenues shows that in the 1952-1957 period such revenues grew at an annual rate of 3.5 percent, while in the 1957-1961 period the increase amounted to only 1.6 percent per year. Thus, in recent years sales tax revenues in West Virginia have followed, albeit to a lesser degree, a pattern similar to that in Ohio.

Around the Fourth District—

In March, *sales of homefurnishings* expanded considerably at department stores in the Fourth District. Volume rose 16 percent above the February level on a seasonally adjusted basis, and was 14 percent above the year-ago level. Furniture and bedding sales (a subgroup of homefurnishings) were exceptionally strong, up 30 percent from February and 21 percent from a year earlier. In the aggregate, homefurnishings account for approximately one-fifth of annual store sales. Total department store sales increased 9 percent from February.

• • •

Electric power production in Cleveland and northeastern Ohio was sharply reduced in late April and early May. A small part of that decline was seasonal, but the greater part reflected a drop-off in industrial usage of power, particularly at steel mills where activity has slumped.

• • •

Savings deposits continue to set new records in the Fourth District. During the first quarter of 1962, the net increase in savings balances at reporting banks was the largest quarterly increase of record.

(The above items are based on various series of District or local data, which are assembled by this bank and are available to the public in the form of printed releases.)

Banking Patterns In A Year Of Recovery

(Fourth District)

Editor's note: Banking patterns during the first year of the current recovery differed significantly from those during the first year of the 1958-59 recovery. The economic recovery during both 1958 and 1961 influenced importantly the income and expenses of commercial banks.

THE END OF FEBRUARY marked the completion of a full year of economic recovery, following the nation's most recent economic downturn. Banking activity in the 12-month period was influenced largely by various business and financial developments which accompanied the improvement in economic conditions.

Among the more significant developments were the evidence of continued monetary ease, relatively moderate demand for bank loans, and increasing importance of time deposits in the total deposit picture. The combination of these three factors was of paramount importance in shaping the pattern of bank assets and liabilities during the recent recovery year. Furthermore, the substantial variations in banking activity during the recent year of expansion as compared with the first 12 months of the 1958-59 recovery period are due in large part to these three factors.

Bearing in mind the pervasive influence of business and financial developments, let us turn our attention to the banking activity of Fourth District member banks during the latest recovery year; in addition, we will contrast the variations in banking patterns during the recent recovery year with those of the initial 12 months of the previous business upturn.[1]

(1) All data on member bank assets and liabilities used in this article, with the exception of member bank reserves, are seasonally adjusted.

Member Bank Reserves

The level of member bank reserves is one of the prime determinants of the direction and pace of banking activity. During the initial 12 months of the current recovery, total reserves of Fourth District member banks increased 4 percent, as compared with a 1.6-percent advance during the first year of the 1958-59 business expansion.

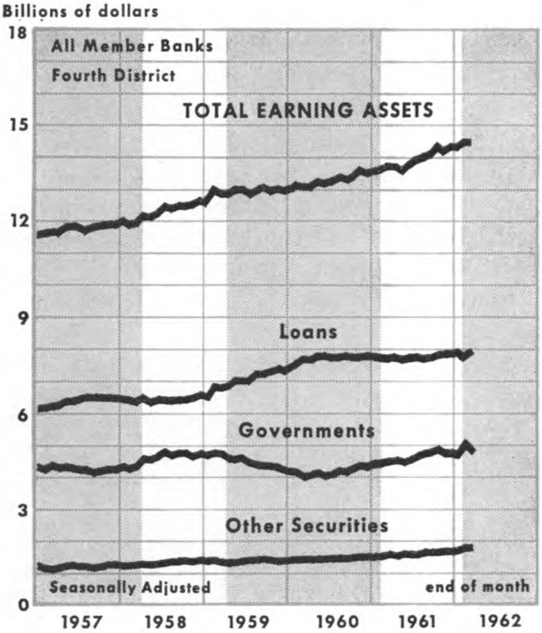
Reflecting the condition of monetary ease, net free reserves of District member banks—reserve balances in excess of required reserves less member bank borrowings from the Federal Reserve Bank—ranged between $40 and $70 million throughout the 12-month period. Conversely, in line with the fact that during the 1958-59 expansion period credit availability was reduced beginning five months after the trough of the recession, net free reserves at District member banks declined from nearly $50 million to less than $1 million during the initial year of recovery.

Bank Credit Developments

In response to the availability of additional reserves throughout the recent recovery year, District member banks increased their total earning assets approximately $734 million. (See the chart on page 8.) The bulk of the expansion occurred in security holdings, as contrasted with the prior recovery year, when additions to investment portfolios accounted for less than 6 percent of the accretion in bank credit.

Moderate Loan Demand. The growth in investments during the recent period was due chiefly to the subdued demand for bank loans. In contrast to the rapid upsurge of loans during the prior expansion period, District member banks experienced a modest 2-

The bulk of the expansion in earning assets of District member banks during the initial twelve months of the current recovery occurred in investments; this contrasted with a sharp upsurge in loan volume during the 1958-59 recovery year. (See white areas.)



percent increase in loans during the recent recovery year.

The absence of a more vigorous demand for bank loans, in turn, has been largely attributable to the sluggish pace of business borrowing. For example, commercial and industrial loans at leading District member banks which report weekly to the Federal Reserve Bank of Cleveland, declined 2.9 percent during the recent period, whereas in the prior 12-month recovery period business loans moved up 2.1 percent.

The somewhat disappointing behavior of business loan demand has been due primarily to three interrelated factors: (1) a relatively high level of corporate liquidity reflecting an increased cash flow from depreciation and retained earnings and a near record sale of corporate securities during 1961; (2) the maintenance of lower levels of inventories as a result of improved inventory control methods, and the presence of general price stability; and (3) the expanded use of nonbank sources of short-term credit to satisfy working capital needs, e.g., trade credit and nonbank held commercial paper and bankers' acceptances. These three factors, coupled with the hesitancy of business investment, which usually characterizes the early stages of a recovery period, have served to soften the demand for bank credit in the recent period.

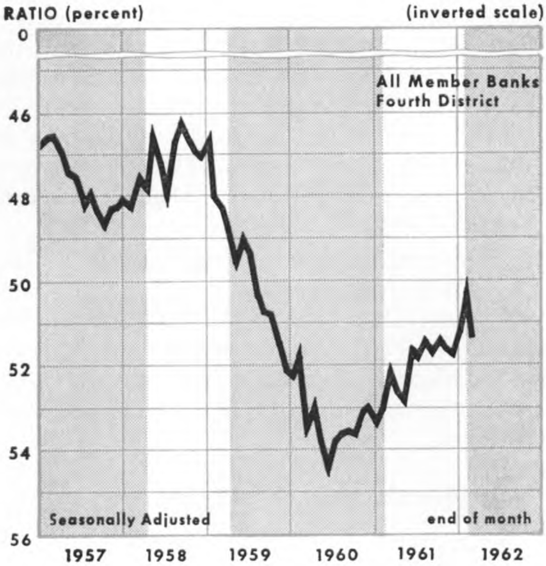
Moreover, real estate loans and consumer loans at weekly reporting member banks this time failed to equal the advances posted during the prior recovery period. Real estate loans scored a 4-percent gain in the recent period, as compared with a 6-percent advance in the 1958-59 recovery year. Consumer loans advanced roughly 3 percent, as compared with a 9-percent increase in the prior period.

One result of the slack loan demand during the recent period was a decrease in the ratio of loans to deposits of District banks. (See the following chart.) The loan-to-deposit ratio, which is a traditional measure of bank liquidity of District member banks, was 51.3 percent at the end of February, having declined nearly 1 percentage point in the recovery year. Quite the opposite development occurred during the previous recovery year, when the aggregate loan-to-deposit ratio at District member banks rose from 46.5 percent to 49.5 percent in response to a sharp upturn in loan demand. It is apparent from the respective ratios, however, that District member banks showed a lower loan-to-deposit ratio at both the beginning and the close of the 1958-59 recovery year than during the initial 12 months of the current expansion period.

Changes in Investment Policy. Although the loan-to-deposit ratio is a widely-accepted indicator of bank liquidity, it is only one of several liquidity measures. An equally important gauge is the maturity pattern of bank investment portfolios.

Substantial holdings of readily-marketable, short-term securities may provide bank management with the liquidity to meet an up-

The loan-to-deposit ratio of District member banks declined from 52.2 percent to 51.3 percent during the first twelve months of this recovery; in the comparable period of the previous recovery, the ratio rose from 46.5 percent to 49.5 percent. (See white areas.)



surge in loan demand or deposit withdrawals while, at the same time, preventing sizable capital losses on the sale of securities. Thus, the proportion of security holdings devoted to short-term obligations also constitutes an important measure of commercial bank liquidity.

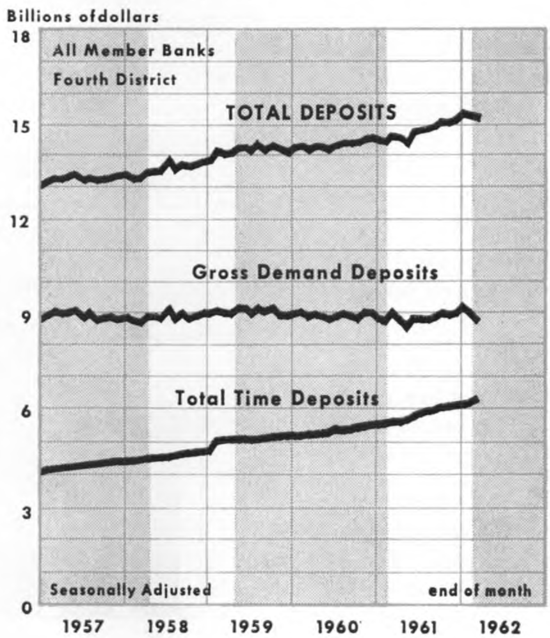
A review of the composition of the investment portfolios of weekly reporting member banks in the District indicates that there were significant changes in the holdings of Treasury obligations during the recent recovery year. In that 12-month period marketable Treasury securities held by reporting member banks advanced $300 million, which contrasted sharply with the $151-million decline in Treasury obligations experienced during the prior recovery year.

In addition to the increased holdings of Governments, there also occurred a shift in the maturity pattern of such issues, as member banks attempted to acquire additional liquidity to meet any near-term improvement in loan demand. As a result, reporting banks' holdings of short-term governments advanced $526 million, while those bearing a maturity in excess of one year declined by $226 million.

Such a development is in marked contrast to previous recovery periods, when commercial banks sold large quantities of Treasury obligations in an attempt to accommodate rising loan demand. In addition, in the early stages of past recovery periods many commercial banks acquired substantial amounts of long-term governments in an attempt to improve the average yield on investment portfolios.

The trend toward increased liquidity in investment portfolios during the recent recovery year was further supported by the availability of short-term Treasury securities issued for new cash borrowing as well as for refunding purposes. In addition, the "aging" of existing securities aided in expanding the

A net reduction in gross demand deposits at District member banks during the initial twelve months of the current recovery was more than offset by a record increase in total time deposits.



quantity of short-term liquid assets held by member banks.[2]

The emphasis on investment liquidity notwithstanding, District member banks have been increasingly attracted to "other securities", which are predominately state and local, tax-exempt issues. During the recent recovery year, the amount of other securities held by member banks increased 18 percent, as compared with a 7 percent expansion in the prior recovery year.

The recent acceleration in purchases of other securities reflects in large part the influence of increased time deposits and an accompanying rise in interest expense, as well as the sluggish demand for longer-term, higher-yielding bank loans, e.g., mortgage and consumer instalment loans.

Deposit Expansion

Reflecting the availability of additional reserves and the marked increase in bank credit during the recent period, total deposit liabilities at District member banks advanced $520 million, or 3.6 percent.

Demand deposits, seasonally adjusted, moved up $114 million during the initial 10 months of the recovery year. However, in the final two months of the period (January and February) member banks experienced a $300-million takedown in demand deposits.

The net reduction in demand deposits of $186 million was more than offset, however, by a record $710-million, or 12.4-percent, increase in total time deposits. Furthermore, about one-third of the accretion in time deposits occurred in the final two months of the recent recovery period following increases in interest rates at many District member banks.

The relatively sharp expansion in time deposits during January and February may also provide a partial explanation of the takedown in demand deposits, in that some idle balances may have been shifted from demand to time deposits in response to higher rates of interest.

Income and Expense Patterns

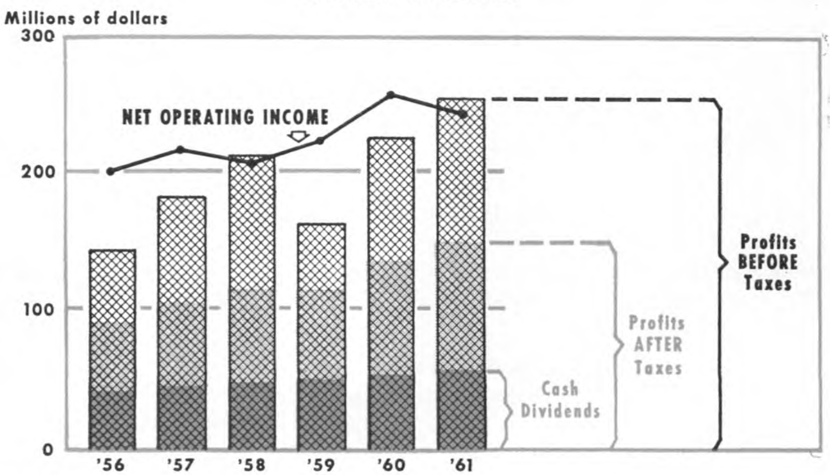
The course of economic activity also influenced income and expense experience at District member banks during calendar year 1961.[3]

(2) The "aging of existing securities" refers to the process whereby a security originally classified as long-term or intermediate-term is reclassified as a short-term security after having arrived within one year of the actual maturity date.

(3) Information on Fourth District member bank income and expenses is available only on a year-end basis; year-to-year comparisons are limited therefore to calendar years.

COMPOSITION OF INCOME BEFORE TAXES
All Member Banks (Fourth District)

In both 1958 and 1961, nonoperating income exceeded nonoperating expense, so that net nonoperating earnings provided a substantial increase in profits before taxes of District member banks.



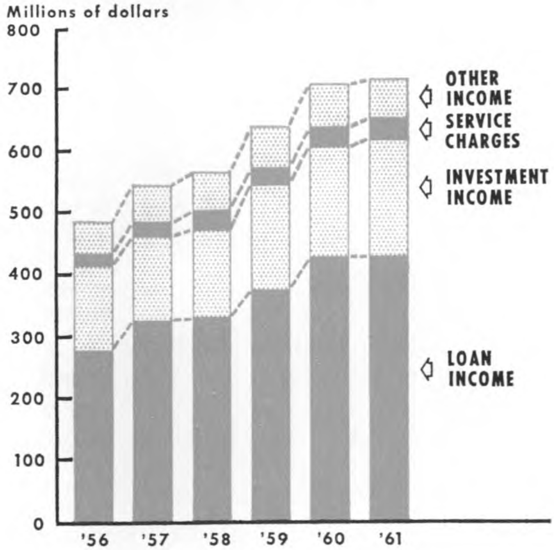
Gross operating income of member banks registered the smallest annual increase since 1949. On the other hand, *total operating expense* continued to move up moderately, resulting in a 5-percent decline in *net operating income.* This drop in net operating earnings was more than offset, however, by an increase in *nonoperating income,* which was derived primarily from capital gains on the sale of Treasury securities by member banks during 1961. (See the chart on page 10.)

Following the payment of Federal as well as state and local income taxes, the aggregate *net income* of District member banks registered a 10.4-percent advance, as compared with an 8.3-percent improvement in 1958. Approximately 38 percent of the 1961 net income was distributed among the stockholders in the form of cash dividends, while the remainder was placed in member bank surplus and undivided profit accounts.

Composition of Operating Income. Considering the $715-million increase in earning assets at District member banks during 1961, the modest advance in gross operating income would appear to be paradoxical at first glance. However, a close inspection of bank credit activity reveals two factors which may serve to explain the behavior of operating income. First, due to the lack of vigorous loan demand, nearly 70 percent of the addition to earning assets occurred in security holdings. Because the average yield on investment portfolios during 1961 was roughly one-half as large as that received on loan portfolios, the expansion in the investment portion of the earning-asset mix contributed to a decline in operating income.

A second factor was that the average yield on loans and investments at District member banks either moved up fractionally or, in some instances, declined during 1961. The average rate of return on bank loans rose from 5.99 to 6.01 percent and the yield on other securities edged from 3.06 to 3.07 percent.[4] Furthermore, the average rate of return on Treasury securities held by District member banks declined from 3.14 to 3.07 percent, as many member banks shifted out of longer-term Treasury securities into shorter-term, lower-yielding issues.

COMPOSITION OF OPERATING INCOME
All Member Banks
(Fourth District)



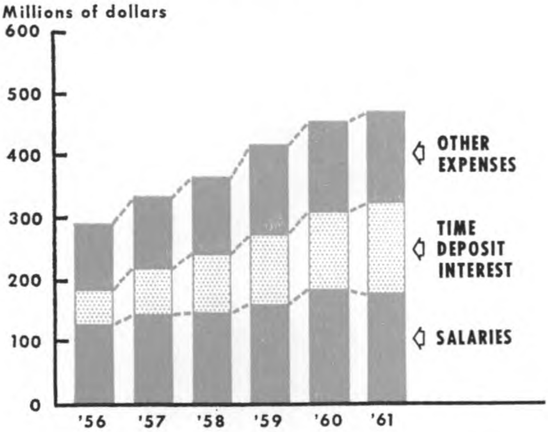
The effect of increased holdings of lower-yielding Treasury securities is also visible in the composition of gross operating income. Despite the fact that the share of total earning assets represented by security holdings advanced during 1961, the proportion of total operating income accounted for by investment portfolios dropped from 29.1 to 28.6 percent. Conversely, earnings generated via bank loan portfolios moved up from 61.9 to 63.2 percent of total operating income.

Moderate Rise in Operating Expense. Total operating expense at District member banks moved up approximately 4 percent in 1961, as compared with a 9.5-percent advance in 1958. (See the accompanying chart.) Nevertheless, operating expenses in 1961 absorbed 73.2 percent of gross operating income, whereas in 1958 less than 71 percent of the

(4) It should be borne in mind that other securities are comprised predominantly of state and local obligations which are exempt from Federal income tax, and therefore return an "after-tax" yield to commercial banks of roughly twice the quoted yield.

COMPOSITION OF OPERATING EXPENSES

All Member Banks (Fourth District)



operating earnings of member banks was used to cover the costs of operation.

Within the major categories of operating expense, an 11-percent increase in interest expense on time deposits accounted for the largest proportion of additional operating costs during 1961. Moreover, as a result of the rise in the volume of time deposits and increases in the average rate paid, interest expense rose from 19.6 percent of total operating expense in 1956 to 32.1 percent in 1961.

Although salaries and wages continued to constitute the largest single category of member bank operating expense, for the first time on a year-to-year basis in the entire postwar period, the total salary expense at District member banks declined in 1961. The recent stability of total salary expense is also evidenced in the fact that as a proportion of total operating costs salary expenditures declined from 44.3 percent in 1956 to 35.7 percent in 1961.

For the most part, the remaining categories of member bank operating expense were relatively stable in 1961.

Contribution of Nonoperating Earnings. As in each of the two preceding years in which a recovery period was initiated (1954 and 1958), income derived from nonoperating sources of District member banks exceeded nonoperating expense, thereby providing an addition to net profits before tax.

Similar to the 1954 and 1958 experience, member banks in 1961 sold a substantial share of their intermediate- and long-term Treasury obligations as the market prices of these securities rose on balance during the year. As a result, District member banks registered a $55-million capital gain on security transactions.

Following the deduction of nonoperating expense, the net nonoperating income of all District member banks was approximately $9 million.

Return on Investment. The net income pattern at District member banks during 1961 was similar to that experienced during 1958. Net profits were 7.5 percent of capital accounts and .72 percent of total assets in 1961, as compared with 7.4 percent and .66 percent, respectively, during 1958. The cash dividend payments of District member banks during the past year were equal to 3 percent of total capital accounts, the largest proportion reported in the entire postwar period.