

Voice

of
the Federal Reserve Bank of Dallas

El Paso · Houston · San Antonio

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Dear Reader:

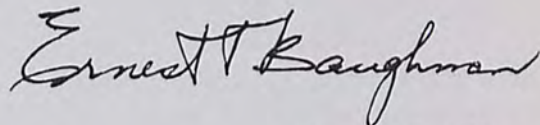
"Voice" is the successor to the monthly business review that has been issued under various titles by the Federal Reserve Bank of Dallas since 1916. The main purpose of the change in title is to highlight the broader Bank-wide scope of the new publication.

In addition to reports of research being done at the Federal Reserve Bank, "Voice" will include brief articles on current developments in agriculture, banking, and business in the Southwest.

Also, recent regulatory and operational changes will be reported in "laymen's" language. While this should be of assistance to banks utilizing Federal Reserve services, the new publication is not intended, and should not be used, to supplant the technical regulations and operating circulars.

And we will be commenting from time to time on current economic problems and issues. Our comments will be designed to provide background, perspective, and objective economic analysis, not to promote any particular point of view.

Finally, announcements and analyses of operational developments of interest to member bankers will also be included in this monthly publication.

A handwritten signature in cursive script that reads "Ernest T. Baughman". The signature is written in dark ink and is positioned above the printed name and title.

Ernest T. Baughman
President

Policies for Better Business in the U.S.

Excerpts from an address by

**Ernest T. Baughman, President
Federal Reserve Bank of Dallas**

to the

**Rotary Club of Fort Worth and Annual Meeting
of Tarrant County Better Business Bureau
Fort Worth, Texas**

October 28, 1977

My remarks today are directed primarily to the nature and the requirements of the free enterprise environment and what I perceive to be possibly its greatest challenge yet.

I am quite aware that man has been "blessed" with predictors of gloom and doom almost from the beginning—those who have "foreseen" the end of private enterprise and the end of personal freedom. Yet, we humans exist in greater numbers and enjoy greater means for creature comfort than ever before. And within this turbulent sea of humanity that covers the earth, there continue to be islands supporting large measures of personal freedom and security. The doomsayers have been discredited, it would appear.

Nevertheless, there is a chorus of dissatisfaction, if not discontent, even upon this most-favored island of private enterprise and personal freedom. And this, notwithstanding the fact that in the past 20 years, this country has increased total production of goods and services 89 percent; has more than doubled its production of manufactured products; has increased real personal income after taxes by 100 percent—57 percent on a per capita basis, after allowing for an increase of 28 percent in population; has increased agricultural production by one-third while reducing the number employed in agriculture by nearly one-half; has witnessed a rise in the annual number of new business incorporations from 140,000 to 326,000; has generated the savings and made the investments needed to add 24 million jobs; and has recorded a fourfold increase in annual gross private savings (from \$68 billion to \$276 billion).

This performance appears quite satisfactory; it seems not to provide grist for complaint. Yet, complaint there has been and, at times, even evidence of social unrest. For no matter how much progress is made, everyone wants more income, better jobs, and lower prices. And people have more cause for complaint at some times than at others. I think this is probably one of those times. Most people feel that after three years of recovery, we should have an unemployment rate lower than 7 percent and a rate of inflation lower than the 6-percent average that has prevailed for nearly three years.

Turning to the current economic situation, we see a mixed picture. If we were to measure economic performance in absolutes, we would draw low grades. Sizable amounts of unused or underused resources are present, and prices have been rising rapidly. However, these indicators of economic performance have been improving. Resource utilization rates are up substantially from two years ago, and the pace of inflation is down substantially. Unemployment has declined from 8.5 percent of the labor force in 1975 to about 7 percent in recent months. Capacity utilization in manufacturing has risen from 74 percent in 1975 to around 83 percent. Inflation averaged 9.3 percent in 1975 (10 percent in 1974) and probably will average 5.5 percent in 1977. So, we have been moving in the right direction and at a fairly respectable pace.

What can be done to help bring this economy closer to full employment and stable prices?

We have two major economic policy tools—fiscal policy and monetary policy. The first consists, of course, of the taxing and spending policies of the Federal Government. Most analysts agree that large, persistent deficits in the national treasury tilt an economy toward inflation and restrict the flow of savings to private investment. There is a role for fiscal policy, properly managed, to help keep an economy on a stable course. But this role is not that of large and continuous deficits.

Only once since 1960 has the Federal budget shown a surplus. The cumulative deficit over the last 17 years is \$296 billion. Including the off-budget agencies, it is over \$330 billion. We have shown a marked unwillingness to tax ourselves apace with our willingness to commit to enlarged Federal spending. Also, we have shown a strong proclivity to enact programs that commit to larger expenditures in future years. If fiscal stimulus were to work the way it was believed to work in "preinflation" years, our labor force and our industrial facilities should be fully employed. More and more, however, the linkage between persistent deficit financing and inflation has moved into clearer perspective, and more and more the economic decisions of businessmen and households are being conditioned by the prospects of continued deficits and continued inflation; and this further intensifies the inflation problem.

Monetary policy is concerned with the supply of money and credit—that they be available in amounts consistent with the full utilization of resources at stable prices or in amounts that will tend

to move the economy toward those goals. In retrospect, monetary policy, as with fiscal policy, appears clearly to have been overly supportive of increased spending at various times as it has been used to promote full utilization of resources. In a noninflationary environment, it is a powerful tool of economic policy. In an inflationary environment, it loses much of its "punch," as does fiscal policy.

In the recent past the basic objective of monetary policy has been to help provide an environment conducive to substantial expansion in economic activity while gradually wringing inflation out of the economy. To this end, the Federal Reserve System has followed a policy of providing credit conditions and growth in money substantially in excess of those that would be consistent with full utilization of resources at stable prices but somewhat less than those consistent with full utilization with accelerating inflation. During the three years 1974, 1975, and 1976, the currency in circulation and private demand deposits in commercial banks increased 5.1, 5.4, and 5.6 percent, respectively. A broader measure of money, including in addition to currency in circulation and private demand deposits the time deposits of commercial banks, showed increases of 7.7, 8.3, and 10.9 percent, respectively. If the deposits of the so-called thrift institutions are included also, the increases were 7.1, 11.1, and 12.6 percent, respectively. Total bank credit—total loans and investments of all commercial banks—increased 9.2, 4.4, and 8.6 percent, respectively, in these years.

Speaking very generally, these monetary and credit growth rates are much higher than normally would be consistent with noninflationary growth of the economy, and they are about half the rates that a number of critics have urged upon the Federal Reserve System. The results thus far, in terms of recovery and diminishing pace of inflation, have exceeded even the most optimistic expectations of supporters and critics alike. Much progress has been made in moving the economy toward full employment and price stability since the bottom the recession 2½ years ago. But the course is difficult and there still is a long way to go. Furthermore, the course becomes more difficult as the goals are approached more closely.

Why are not the prospects more favorable? There are many reasons, many of them well known. But there is one that, if well known, is not given the attention it deserves, and it is this matter I wish

to emphasize in the remainder of my remarks today.

In economists' terminology, I refer to *structural* elements of the economy that are incompatible with the achievement on a sustained basis of full employment and stable prices in a competitive, free enterprise environment. These structural elements have been built into the economy through the years as the Congress and private-interest groups have attempted to achieve certain goals or solve "seen" problems, all too often by laying restrictions upon competition. An important by-product of these policies and actions is a higher price-oriented, lower production-oriented, more unused-resources-oriented, less flexible economy—an economy that has reduced capacity to respond to and digest changes imposed on it from outside (such as the OPEC petroleum price increase) or that emerge from within (such as changes in Government policy or in business inventory or investment policy). The observed results include upward drifts of prices and idle resources while the economy adjusts slowly to imbalances instead of rapidly. And as the economy adjusts slowly, the demand for more Government action intensifies and the proclivity for Government to respond rises.

If there were a sound basis for believing that a more closely regulated, more closely directed economy would perform better than a relatively free economy directed largely by the forces of competition, there would be no call for concern. But I know of no such evidence. I am persuaded, therefore, that it is of utmost importance for us to recognize that many of the anticompetitive rigidities we have built into the economy should be re-examined and reevaluated and, where found to be significantly in restraint of competition and price flexibility, should be wiped from the statute books and cleared from the regulatory forest.

This is not necessarily a call for less Government participation in or concern with economic affairs, although that almost certainly would be the outcome. It is a call for the forthright recognition that individuals and firms in competition with each other in that very impersonal and elusive environment we call the "marketplace" will do a better job of marshaling the available resources to enlarge the economic pie than any alternative form of economic organization. The acceptance of and adherence to this principle would not preclude governmental actions to influence the

allocation of the products of economic endeavor, within some significant range, largely transferring income by utilizing the power to tax and spend. And where regulation was found to be necessary, it would be shaped so as to minimize interference with competition and the free movement of prices.

A few examples may serve to clarify the concept. What economic sense is there in substantially raising the legal minimum wage when the existing level prices out of the market large numbers of the young, inexperienced, and unskilled? The insulation of the employed against the competition from the unemployed that is provided in this type of law causes the labor market to work imperfectly and contributes significantly to the upward wage-price tilt, the idle resources tilt, and the slow adjustment characteristic of the economy. The minimum wage laws may have a small effect on total wages paid, but they probably have a significant effect on the distribution of wages among members of the labor force. Income distribution can be handled more effectively and more equitably by means other than the promotion of monopolistic pricing in the labor market.

The regulation of petroleum and natural gas prices provides another example. The situation calls for restriction of consumption, the direction of supplies to the highest-order uses, and stimulation of production. These things Government is badly equipped to do, except in a framework where legislation and regulation are designed to promote, not restrain, competition and price flexibility.

Further examples stand forth in bold relief in the important agricultural and transportation industries. And they are not lacking in the financial sector. The list is long.

The task of reorienting public policies so as to minimize the restraint of competition and to promote price flexibility would be a demanding one. But, nevertheless, it is a task we should undertake. Absent a forthright goal to reinvigorate competition, we probably will be unable to achieve full employment and price stability except possibly intermittently for brief periods. And we probably will continue to attempt to achieve those goals through an expanding regulation of economic activities and increased direct participation of Government.

I believe that full employment and price stability are achievable and that there is available to us a path that, if pursued, holds strong promise

of success. Monetary and fiscal policies, used with discretion and judgment, can make a strong contribution, but they can only help to create an environment conducive to full employment and price stability. The market processes must perform effectively if the goals are to be achieved. We

should address ourselves to those structural elements that restrain competition and price flexibility and, hence, impede the effective performance of markets. A successful attack upon structural rigidities would do much to reestablish the punch of monetary and fiscal policies.

Interest Authorized on U.S. Treasury Demand Deposits at Commercial Banks

Legislation authorizing the U.S. Treasury to collect interest on its tax and loan accounts at commercial banks was signed by the President October 28, 1977, and is tentatively scheduled to be implemented on April 1, 1978. The legislation also authorizes savings and loan associations, credit unions, and mutual savings banks to hold Treasury tax and loan accounts, under certain circumstances.

For many years, the Treasury's demand deposits at commercial banks have been available for the banks to use interest-free, and the use of these funds has been considered compensation for the services the banks provide to the Treasury. This practice has been criticized, however, and under the new legislation the Treasury will collect interest on funds remaining with banks more than one day and will directly compensate banks for services rendered.

Two options are available to banks that wish to serve as Treasury depositories. Banks choosing the Note Option will credit deposits from the Treasury to its tax and loan account at the time of receipt. The next day, funds equal to the amount of the previous day's Treasury deposits will be transferred to an interest-bearing note account. The note will be callable on demand without prior

notice. In effect, the Treasury will be lending call money to the bank.

Under the Remittance Option, banks will not purchase funds from the Treasury but only act as a channel in the tax collection system. Banks receiving deposits from the Treasury will credit the funds to its tax and loan account. At the end of each business day, an advice of credit in the amount of the previous day's Treasury deposits is to be sent to a Federal Reserve Bank, where, upon receipt of the advice of credit, the funds will be withdrawn immediately from the commercial bank's reserve account. The advice of credit must arrive at the Reserve Bank before the Treasury-established cutoff hour of noon in order to avoid penalty.

The interest rate to be used for both the Note Option interest and the Remittance Option penalty will be the repurchase agreement rate on U.S. Government securities. This rate will be published monthly in the *Federal Reserve Bulletin* and the *Treasury Bulletin*. Historically, this rate has been lower than the Federal funds rate.

The repurchase agreement rate was chosen because it most closely approximates the rate that the Treasury could earn if it maintained cash

balances at the Federal Reserve Bank or invested in its own securities.

The Treasury will pay banks and other depositories 50 cents for each Federal tax deposit card processed. In addition, the Treasury will pay 70 cents for each savings bond sold over the counter and 30 cents for each savings bond redeemed. The fee for issuing bonds through payroll deduction plans will be 30 cents for noncomputerized payroll issues by financial institutions, 10 cents for computerized payroll issues by financial institutions, and 10 cents for all issues by nonfinancial institutions. Also, 5 cents will be paid for reissues to distribute trustee bonds to participants in thrift, sav-

ings, vacation, and similar plans.

Previously authorized Treasury depositories wishing to maintain their status should file with a Federal Reserve Bank an "Election of Option" form. Other eligible institutions wishing to be authorized as depositories should file an application and supporting documents with the Federal Reserve Bank.

The Federal Reserve Bank of Dallas will begin holding seminars with commercial bankers throughout the District in February 1978 to explain the new Treasury Tax and Loan Investment Program. For further information, contact J. A. Clymer, (214) 651-6340.

Questions on NOW Accounts?

In response to requests from banking groups, Federal Reserve staff members have developed a 25-minute slide presentation on negotiable order of withdrawal accounts and are available to present it at banker meetings. The presentation provides historical data on the experience of banks offering NOW accounts in six New England states. Also included is an analysis of the problems encountered and the measures taken by the New England banks to resolve them. If interested, contact the Bank and Public Information Department, (214) 651-6370.

New nonmember bank

American State Bank, Broken Bow, Oklahoma, a newly organized insured nonmember bank located in the territory served by the Head Office of the Federal Reserve Bank of Dallas, opened for business December 15, 1977.

Farm Exports Conditioned by World Supplies and U.S. Government Policy

By Carl G. Anderson, Jr.

Exports are a substantial part of the market for U.S. agricultural products, and changes in exports have an important effect on U.S. farm income. In 1976, for example, the products from almost 30 percent of all harvested acreage were exported, and these sales overseas provided about 25 percent of farmers' cash receipts. Furthermore, the export sector of the market for U.S. agriculture has been increasing over the years as production has grown faster than domestic consumption.

Despite import restrictions imposed by many countries, foreign markets still offer the greatest expansion opportunity for U.S. agriculture. Industrialized nations will continue to provide the major foreign markets for U.S. agricultural exports, but a fast-growing potential for expanding exports lies with the less developed countries. The demand for food in these less developed countries has been rising faster than their domestic production, and they have become increasingly dependent on foreign supplies.

The volume of farm exports will be influenced strongly by government policies, both in the United States and in other countries. Recent declines in U.S. farm prices have generated strong demands for Government supplement of dwindling farm income. The outcome has been a new Government farm program that, instead of focusing on maintaining or increasing production as the previous market-oriented policy did, has raised price-support levels and is moving to curtail output by requiring some cropland acreage to be set aside from production for the first time since 1973.

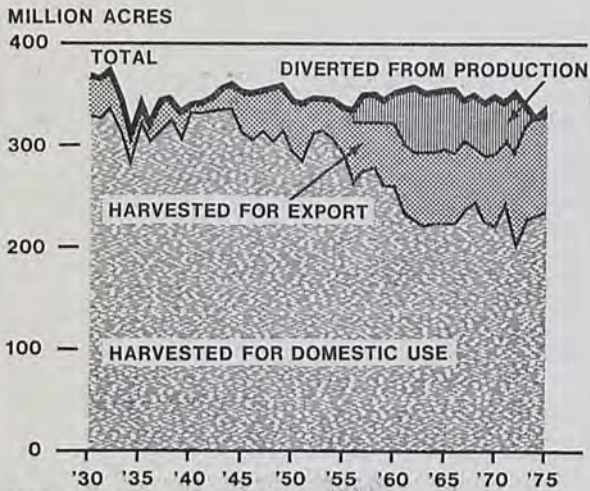
When price supports have exceeded market levels in the past, Government-owned stocks have been accumulated, farm exports have been curtailed, and foreign agricultural production has been stimulated, while U.S. farmers have intensified efforts to boost acre yields. A similar pattern of developments can reasonably be expected again unless production is constrained by unusually adverse weather, pests, or disease in important agricultural areas in the world. Unused or inefficiently used agricultural resources in the United States, at a time when this country's foreign trade is in deep deficit, would further complicate the farm policy picture. In 1976, net agricultural exports were \$12.1 billion, a magnitude greater than half of the total U.S. nonagricultural trade deficit of \$21.3 billion.

Despite import restrictions imposed by many countries, foreign markets still offer the greatest expansion opportunity for U.S. agriculture.

The 1977 farm program blends old and new

The 1977 farm program features a system of commodity loans and target prices that provides price and income protection to farmers. It also provides for acreage set-asides to curtail total harvested

A growing share of U.S. cropland acreage devoted to exports



SOURCE: U.S. Department of Agriculture.

acreage and, thereby, the accumulation of price-depressing stocks. Major objectives of the program are higher prices, greater price stability, higher farm incomes, and a relatively large inventory of grains that can be released into markets in the event production is severely curtailed by adverse circumstances at some future time.

Government loans and target prices impact on the markets in different ways. When loan levels exceed market prices, the carryover stocks tend to move largely into the Government's hands. The nonrecourse loan program of the Commodity Credit Corporation (CCC) enables farmers, for a specified period, to obtain cash shortly after harvest and to hold their crops for later sale. However, when loans are above market prices, farmers may, and typically do, forfeit the crops in full satisfaction of the loans. In these circumstances, the Government accumulates inventories of farm commodities. As inventories grow, the resulting inventory management problems call forth measures to restrict production.

The target price program that was introduced in the 1973 farm act impacts on markets much less than programs that undertake to establish specific "floor" prices. This program provides Government

payments to farmers to the extent that market prices are below the authorized target prices. It avoids the accumulation of large stocks in Government hands and provides a means for American farmers to keep their products competitively priced in world markets, while extending income protection to U.S. farmers. The impact on the U.S. Treasury is probably greater than that of the commodity loan policy, and the effect on consumer prices probably less.

The 1977 program includes both the more market-oriented target price policy, which was an important feature of the 1973 act, and the commodity loan policy that dominated farm legislation for 40 years before the act. Reflecting the effects of inflation on farm production costs and the decline of commodity prices from exceptionally high levels in 1973-74, both loan levels and target prices have been raised considerably above those experienced in prior years.

There is danger that the program's commodity loan aspects may overshadow its target price features. The 1977 loan of \$2.25 per bushel for wheat, for example, led growers to place 803 million bushels—about a year's domestic consumption—under CCC loans as of September 30, 1977. This has caused the Secretary of Agriculture to require a 20-percent set-aside of wheat acreage as a condition to qualify for price protection for the 1977-78 crop. Similarly, the 1977 loan for corn, at \$2.00 per bushel, may lead to a large accumulation of stocks under the loan program that will be difficult to move onto the market unless the flow of new supplies is curtailed by production controls.

A stated objective of the 1977 program is to place primary reliance on market-oriented target prices for the support of farm income rather than on nonrecourse loans. Presumably, loans are to be used primarily to assure the desired carryover stocks and to enable farmers to borrow on commodity inventories without risk of price declines. While loans are at least 65 cents a bushel below target prices for wheat, the difference is only 10 cents a bushel for corn. Hence, corn farmers may be strongly inclined to use the loan program.

The 1977 farm program abandons the historic acreage bases that tended to cause producers to plant specified acreages of various crops regardless of supply-demand levels and market prices for alternative crops. This feature should facilitate more flexible and efficient use of cropland than the rigid acreage allotments of predecessor programs. The

act authorizes the Secretary of Agriculture to reduce loan rate levels for certain crops when the commodity loan program is restricting exports. However, the adjustment is limited to a maximum of 10 percent per year and a lower limit of \$2.00 per bushel for wheat and \$1.75 per bushel for corn. Thus, the Secretary may be precluded from lowering loans sufficiently to promote foreign sales.

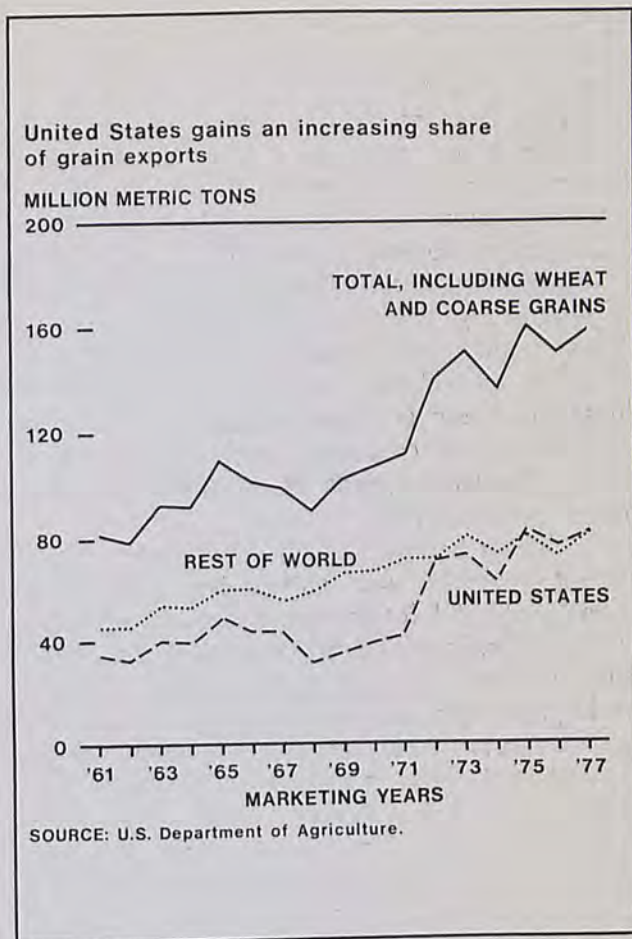
By contrast, loans can be lowered automatically for cotton. The nonrecourse loan level must be set at 85 percent of the average spot market price in the preceding four marketing years or at 90 percent of the average price in Northern Europe (adjusted for transportation costs) for the first two weeks of October each year, whichever is lower. And when supplies are short enough to raise the spot price by 30 percent or more above the average market price during the previous 36 months, the quota on cotton imports into the United States can be temporarily raised.

It is clear that the current farm program will increase net farm income over what it otherwise would have been in the short run, albeit at substantial expense to the U.S. Treasury. But longer-term effects are far from clear. The outcome will depend heavily on the vagaries of weather and on trade policies at home and abroad. One thing seems certain. If American farm products are priced out of the world's markets, farmers in other agricultural countries, both exporting and importing, will benefit at the expense of the United States.

Trade policies also a threat to exports

International trade in agricultural products is heavily laced with restrictions. Countries generally desire to expand exports so that farm resources can be employed efficiently, but they also choose to protect their agriculture in varying degrees from foreign competition. In part, this reflects the great variety of agricultural commodities produced in most countries and the divergent interests of their farmers. In their efforts to protect domestic producers from changes in world prices, many of the world's important trading nations use tariffs, quantitative import restrictions, variable levies, and marketing agreements.

One of the most striking developments affecting international trade in farm products has been the formulation of a Common Agricultural Policy by a number of European countries. In 1962, agreement



among six countries—Belgium, Luxembourg, the Netherlands, France, West Germany, and Italy—created a uniform agricultural trade policy that allowed free movement of farm products among the member countries and presented a common restriction on imports from outside the area. The United Kingdom, Denmark, and Ireland joined the original six countries in 1973. Negotiations are underway for Greece to become a member, and Spain and Portugal have recently applied for membership.

The policy has primarily had the effect of encouraging production of farm commodities by the member countries and discouraging exporters' attempts to market products in these countries. Since formation of the Common Agricultural Policy, U.S. commercial farm sales to the member countries have grown at a significantly slower rate than sales to other countries. Though U.S. commercial agricultural exports to the six member countries in 1972 were over 100 percent larger than their average

value in 1959-61, exports to other countries increased much more—by about 175 percent. And since 1973, when the group was enlarged to nine countries, farm exports to these countries have continued to increase more slowly than exports to the rest of the world. In addition, the U.S. share of farm exports to the European Common Market countries has declined somewhat.

Not all farm commodities are equally restricted from entering the Common Market countries. Grains, poultry, lard, rice, and dairy products are subject to variable levies, while commodities that do not compete strongly with those within the Common Market countries—such as cotton, vegetables, oilseeds and products, and tobacco—are not subject to such levies.

The levies imposed by the European Common Market countries can automatically offset the normal potential for increased exports of lower-priced agricultural products to the area. These levies are designed to offset the difference between world prices of commodities and the desired price in the Common Market. For example, in early September the asking price for U.S. No. 2 Hard Winter wheat was \$3.08 per bushel at Rotterdam, \$1.02 less than a year earlier. But over that span of time, the Common Market import levy had risen \$1.67 to a total of \$3.49 per bushel, more than offsetting the decline in the price of foreign supplies.

American export opportunities growing

Despite such obstacles to international trade, total U.S. farm exports are projected to rise up to an average of 3 percent a year over the next decade. Not only has world trade in farm products risen in recent years, but so also has the share of the United States—from 11 percent in 1955 to 17 percent in 1975.

The pattern of world grain trade has changed considerably over time. By the late 1930's, much of the world except for Western Europe was self-sufficient in grain production, with most major regions exporting some grain to Western European markets. Since then, Asia, Africa, Eastern Europe, and the Soviet Union have become importers of grain, while North America and Australia have become the major exporters.

The percentage of harvested acreage used for producing farm exports is a common measure of the importance of exports to agriculture. In 1910 the foreign market accounted for about 12 percent

of the cropland harvested in the United States. By the end of World War II, the export share had risen to 15 percent. Then, with fewer harvested acres and sharply increased exports, the proportion of cropland used to produce farm exports averaged about 20 percent during the 1960's. The proportion jumped to 31 percent in 1972 and, since then, has held near 30 percent.

Without the recent expansion in farm exports, U.S. farm production would have been below recent levels and, presumably, farm income would have been much lower. For example, annual wheat and coarse grain production is expected to be about 23 million metric tons higher in 1977 than in 1971; yet, domestic consumption is estimated to be down about 13 million tons. However, exports of these types of grain increased around 39 million tons in the same period.

In recent years, purchases by developed countries outside the Communist bloc have accounted for nearly three-fifths of all U.S. agricultural exports, while those by less developed countries have accounted for about three-tenths. The share of exports to Russia and other Communist countries has been around a tenth. Purchases of exports by long-standing U.S. customers—such as Western Europe, Asia, Canada, and Latin America—have held fairly steady. But purchases by the Soviet Union, Eastern Europe, and the People's Republic of China have been more sporadic. To help smooth these exports, the United States signed a five-year agreement with the Soviet Union in 1975 committing the Soviets to buying between 6 and 8 million metric tons of wheat and feed grains each year. With the abundant U.S. grain supply and a shortfall in the Soviet harvest, the upper limit has been raised to 15 million tons for the 1977-78 marketing year.

Countries where meat production and consumption are growing—such as Western Europe, Japan, and Russia—are leading markets for U.S. feed grains, soybeans, and protein meal for livestock feed. While wheat, cotton, and tobacco have long been important export commodities, feed grains, soybeans, and oilseeds now rank higher. Feed grains exported in 1976 totaled nearly \$6.0 billion, up from about \$3.5 billion as late as 1973.

It is clear that industrialized nations will continue to provide major markets for U.S. exports of agricultural commodities. However, the biggest potential for future expansion may lie with the

less developed countries. Food demand in the less developed countries is expected to increase at a yearly rate of 3.5 percent until the mideighties, while food production in these countries is expected to rise only 2.6 percent a year. By contrast, food demand in the developed countries (including the United States) is expected to increase 1.6 percent a year and production 2.8 percent.

Farm exports may increase even faster beyond the 1980's. The share of the world's population in low-income countries is expected to rise from 71.5 percent in 1975 to 78.3 percent in the year 2000. And because the income elasticity of demand for food is still relatively high in the low-income countries, rising incomes will increase total demand faster than domestic production grows, resulting in an increase in the demand for food imports.

These trends would be a continuation of those evident over the last decade or so. From 1963 through 1975, the developed countries increased the volume of their agricultural imports by 34 percent, and developing countries by 71 percent.

Foreign food aid exports expand markets

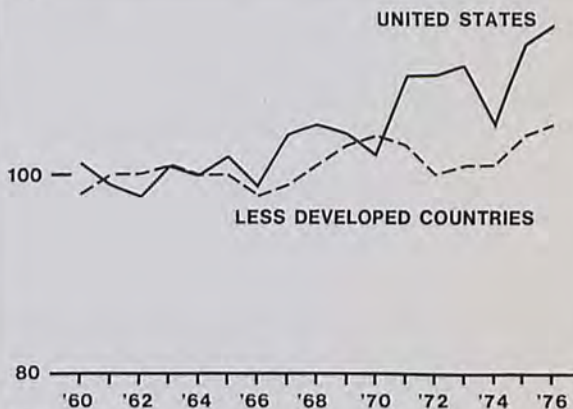
After World War II, U.S. Government farm programs supported commodity prices above levels in the world market. This restricted commercial farm exports and promoted the accumulation of large inventories in Government hands. The Agricultural Trade Development and Assistance Act of 1954 (PL-480) was passed to provide an outlet for U.S. farm production exceeding normal commercial market demands and to assist friendly countries around the world that needed food and development assistance.

PL-480 authorizes the Government to make soft-currency sales or gifts of surplus agricultural commodities to less developed countries. The leading item shipped under the Government-financed program has been wheat and wheat flour. Feed grains, rice, vegetable oils, dairy products, tobacco, and cotton are other important commodities. In recent years the major recipients of Government shipments have been Egypt, Israel, Bangladesh, Pakistan, and India.

Shipments under PL-480 reached a maximum of 32 percent of the dollar volume of all U.S. agricultural exports in fiscal 1957 and declined to a low of 4 percent in 1974. With the disappearance of surplus grain stocks and a steep rise in grain prices

Opportunities for exporting to less developed countries being created by relative increase in U.S. agricultural production per capita

1961-65=100
120



SOURCE: U.S. Department of Agriculture.

Food demand in the less developed countries is expected to increase at a yearly rate of 3.5 percent until the mideighties, while food production in these countries is expected to rise only 2.6 percent a year.

in late 1972, shipments under the PL-480 program fell sharply, averaging about 6 percent of the value of farm exports in 1972-76.

The extent to which foreign food aid can successfully serve as an overflow market hinges on the amount of Government money the American public is willing to spend and the political acceptance of recipient countries and other exporting countries. Foreign food aid has allowed surplus production to be exported, but the bill for U.S. tax-

payers has been significant. Agricultural exports shipped under specified Government programs from mid-1954 through 1976 totaled \$28.7 billion. Currently, if Government program exports were increased to levels similar to the average share of annual shipments during the 1960's, the value of commodities moved under these noncommercial programs would be around \$5.0 billion annually—compared with the \$1.4 billion of commodities actually exported under Government programs in 1976.

However, an increase in foreign food aid would not necessarily generate additional foreign exchange earnings, as would increases in commercial agricultural exports. So even though greater aid would boost total agricultural exports, it might not help to improve the country's overall balance-of-payments position. And to the extent that foreign food aid displaces commercial exports instead of simply supplementing them, the cost to the country would include a loss of foreign exchange earnings as well as the direct cost to the taxpayer.

Seasonal Borrowing from the Fed

Since 1973 the Federal Reserve banks have provided "streamlined" procedures at the discount window for member banks that have sizable seasonal swings in loans, deposits, or both. Letters will soon be sent to member banks that appear to qualify for the seasonal loan program in 1978. The letters will note the amount and duration of eligibility for the seasonal borrowing program, based on an analysis of data available at the Reserve Bank for each member bank. Those preliminary estimates are tentative and are subject to revision on the basis of any additional information supplied by member banks desiring to use the program. Member banks that expect to need seasonal accommodations in 1978 should make arrangements with the loan officer at their Federal Reserve Bank or Branch.

Treasury Checks to Be "Truncated"

A new program for the processing of Treasury checks has been pilot-tested at the Federal Reserve Bank of Dallas since June 1976 and is scheduled to be put into effect nationwide by June 1, 1978.

The program marks one further step to contain the rising tide of paper. In this instance, Treasury checks are "truncated" in that they will no longer be returned to the Treasury. Instead, check information that is recorded on magnetic tape and microfilm at the Reserve banks is sent to the Treasury for processing, storage, and retrieval as needed. Truncation will accelerate the clearing of Treasury checks, speed up adjustments for lost items, and save the Treasury money.

Long turnaround time has been a serious problem with Treasury checks. Most Treasury checks arrive at Reserve banks in the first few days of the month—about 60 percent within a three-day period. With some 700 million Treasury checks processed nationwide every year and with commercial bank checks given priority, many of the Treasury checks are delayed in processing and shipment to the Treasury.

In the meantime, inquiries about lost checks are received by the Treasury, and there is considerable delay before the Treasury can respond to these inquiries. The average response time is six to eight weeks. Since approximately 50 percent of the Treasury checks are social security payments, recipients have been seriously inconvenienced while waiting for action. Consequently, the Congress has stepped in and required the Treasury to issue duplicate checks in response to all requests, then check the validity later.

This duplication process is very expensive for the Treasury because about 90 percent of all inquiries result in unnecessary double payments. These cost the Treasury over \$1 million per month. The cost of redeeming the duplicate payments averages approximately equal to the value of the payments.

Besides the expense of duplicate payments and the inconvenience inherent in the long turnaround time, there are other problems with the current Treasury check program. After the checks are processed at the Federal Reserve Bank and sent to the Treasury, they are reprocessed there. Also, checks have to be stored by the Treasury for almost seven years before they can be destroyed. The Treasury now has almost 6 billion paid Treasury checks in storage.

The Treasury check truncation program is designed to alleviate these problems. In June 1976 the Federal Reserve Bank of Dallas began a "live" test of the truncation equipment and procedures, using the new system for a portion of its Treasury checks. In April 1977 the Federal Reserve Bank of Richmond also began testing the program, utilizing different equipment.

By January 15, 1978, all Treasury checks coming to the Federal Reserve Bank of Dallas will be truncated. By June 1, 1978, all Treasury checks will be truncated at all the Federal Reserve banks.

The major advantages of the truncation program will be a reduction in Treasury expense, accelerated processing, and shorter turnaround time for Treasury checks. Many Treasury checks are now delayed as long as a month in processing, but under the truncation program, 39 percent of the checks will be processed in the first 24 hours after delivery to a Federal Reserve Bank, 19 percent in the next 24 hours, and 17 percent in the next 24 hours.

The program will have little direct effect on commercial banks; it impacts primarily on the Treasury and the Federal Reserve banks. But one significant advantage to commercial banks will be the much faster response on adjustments.

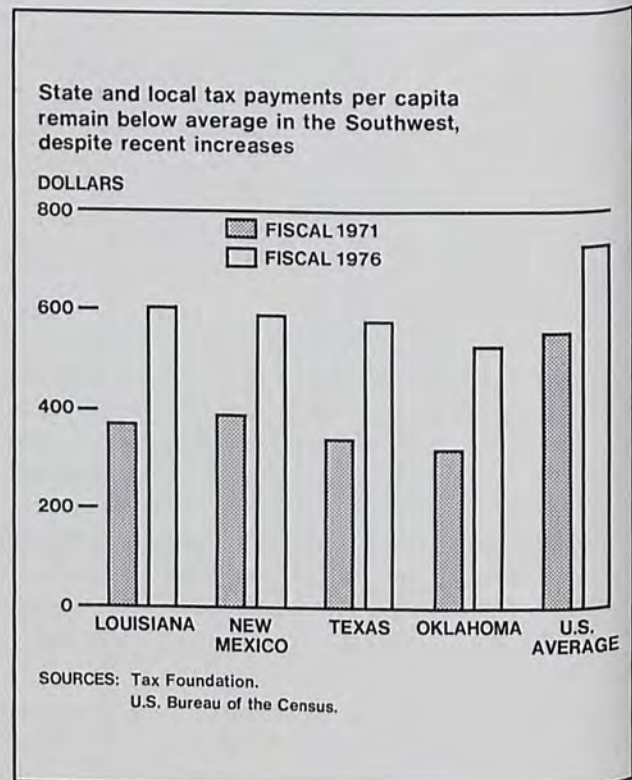
Longer term, however, the program could have important implications for commercial banks. Truncation of commercial bank checks may be in our future, as electronics continues to nibble away at erupting mountains of paper.

State and Local Tax Collections Rise Sharply in Eleventh District

Total tax collections by state and local governments in the states of the Eleventh District—Louisiana, New Mexico, Oklahoma, and Texas—rose about 74 percent from fiscal 1971 through fiscal 1976. (Fiscal years end on June 30 for all states except Texas, where the fiscal year ends on August 31.) The increase for the four states was somewhat higher than the national average of 66 percent for all state and local governments. Despite the faster rise in total tax collections in the District states, however, per capita state and local tax payments in each of the four states remained well below the national average.

State sales tax revenues received by the four southwestern state governments increased at a compounded annual rate of about 11 percent between 1971 and 1976, as higher levels of personal income and consumption boosted retail sales sharply. Each of the four southwestern states collects both general and selective sales taxes. General sales taxes are collected in 45 of the 50 states, at rates ranging from 2 percent to 5 percent. All states levy selective sales taxes on such items as motor fuel, motor vehicles, tobacco products, and alcoholic beverages.

The second biggest source of state tax revenues in the four states was severance taxes. These revenues—which include taxes on production of natural gas, oil, and motor fuel—accounted for 21 percent of total state tax collections in the southwestern states in fiscal 1976. Revenues from this source have been sharply higher because of the



rapid rise in oil and natural gas prices since the Arab oil embargo in late 1973. The District states collect four-fifths of all severance taxes paid in the nation, so revenues from this source are negligible for most other states.

For most states, income taxes are the second largest source of state tax revenues. Income taxes accounted for almost a third of the tax collections of state governments in the nation as a whole. For the four southwestern states, however, taxes on income accounted for only 7 percent of total tax collections in fiscal 1976. Income taxes represented a proportionately smaller share of total tax revenues in Louisiana, New Mexico, and Oklahoma than in the nation. But a major reason income taxes represented a sharply lower share of total tax collections in the four-state area was that Texas is one of the six states in the nation that do not have state income taxes.

For local governments, property taxes are the primary source of tax revenues in both the nation and the four southwestern states, accounting for 82 percent and 86 percent, respectively, in fiscal 1976. Some local governments also levy sales taxes in their jurisdictions, and such taxes provided the second largest source of income to local governments.

On a per capita basis, state and local tax collections between 1971 and 1976 increased more rapidly in three of the District states than in the nation as a whole. Per capita taxes rose 69 percent in Texas, 64 percent in Oklahoma, and 61 percent in Louisiana—compared with an increase of 59 percent for the nation. New Mexico lagged with a 53-percent increase.

Despite the more rapid increases in per capita state and local taxes in three of the southwestern states, the per capita tax payments in the District states were considerably lower than the U.S. average of \$731. Per capita state and local taxes in Louisiana totaled \$610 in fiscal 1976 and were only 83 percent of the U.S. average. That state ranked 30th among the 50 states and the District of Columbia in per capita tax collections. Per capita taxes in

New Mexico were slightly lower at \$598, and that state ranked 32nd. Texas ranked 39th with \$581, while Oklahoma was 45th with \$530.

The sharp rise in state and local taxes has been in response to higher demands for governmental services and their increasing costs. The sharpest relative increase in expenditures in the four southwestern states between fiscal 1971 and 1975 occurred in health and hospital expenses. These costs almost doubled at the state level and advanced 75 percent at the local level.

The largest governmental expense in the four states, however, was expenditures for education. In 1975, education accounted for about 47 percent of total government budgets in the Southwest—or sharply more than the 38-percent share nationwide. Education expenditures increased about 51 percent—or at a compounded annual rate of about 11 percent—both in the District states and in the nation between 1971 and 1975.

The next largest expenditure categories of state and local governments in the four states were highways and public welfare. Compared with health and hospital costs and education costs, these two categories grew slowly between 1971 and 1975. Highway expenditures rose at a compounded annual rate of slightly over 8 percent, while public welfare costs rose at an annual rate of 5 percent. For the nation, highway expenditures by state and local governments rose at an annual rate of 6 percent, while public welfare costs rose at an annual rate of more than 10 percent.

State and local tax collections in the four-state area are likely to continue to increase more rapidly than those in the nation. The generally stronger economy in the region than in the nation as a whole has continued to attract a migration of people and industries to the Southwest. That should help to provide the impetus to keep the regional economy growing at a healthy pace. At the same time, the need for governmental services will grow, and the increase in state and local expenditures should be met easily by the expanded tax base.

Mary G. Grandstaff

A Bank Management Tool: Income, Expenses, and Profits Analyzed

Functional cost analysis is a cost accounting service available to Federal Reserve member banks. It will be offered again in 1978, for the 13th consecutive year.

The FCA program makes available to banks a comparative analysis of profitability and cost-effectiveness of 12 major bank activities, including demand deposits, instalment loans, and time deposits. Participating banks submit detailed data on their own activities, and the Federal Reserve banks develop detailed comparisons with similar banks.

Each participating bank receives its individual report containing detailed cost figures and comparisons for each bank function. In addition to

interbank comparisons using averages for banks similar in size and type of activity, the individual report shows changes for the bank from the preceding year.

The FCA program also produces a national average booklet, a district average booklet, and a booklet on the characteristics of high-earning banks—all of which are available to participating member banks.

There will be some changes in the FCA program this year to make it easier for participating banks to provide the necessary data. Also, some sections of the reports will be expanded to provide additional information.

FCA analysts are available on request to help interpret results to a participating bank's officers and/or directors and to assist in developing the individual bank data input.

Official announcement of the 1978 program and invitations to participate will be sent to member banks in January. Banks interested in participating should contact the Bank and Public Information Department, (214) 651-6370.

Supervision of Bank Holding Companies

Inspections of bank holding companies will be increased in 1978. The expanded program requires that the Federal Reserve banks make annual inspections of most large bank holding companies and use a standardized "Report of Bank Holding Company Inspection" so that inspections will be uniform in all Reserve districts.

All bank holding companies with consolidated assets over \$300 million will be reviewed annually unless inspection is waived because a company has an exceptionally low debt-to-equity ratio and has subsidiaries that extend relatively little credit. Inspections of bank holding companies with under \$300 million in consolidated assets will continue to be made no less than once in three years.

The standardized report will be used also for bank holding companies with assets of less than \$300 million that control nonbank subsidiaries that extend credit.