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# Interrelationship of *Monetary and Fiscal Policies*

**I**N RECENT DECADES, attitudes toward Government finance have undergone a gradual but striking change. As the growing importance of Government budgets in the national economy has created a heightened public awareness of their significance, concurrent advances in economic analysis have demonstrated that budget policy can make a positive contribution to the over-all performance of the economy. Whereas at one time the financial operations of Government were judged in terms of what were held to be inflexible laws, present thought is more nearly characterized by its consideration of the appropriateness of budget policy in terms of prevailing national economic objectives.

Perhaps the outstanding example of this change in attitudes has been the rather general agreement that budgetary policy should be designed to contribute to the over-all stability of the economy, rather than to maintain an annual balance. Thus the stimulus to economic activity provided by the reduction of tax liabilities during the economic decline of 1957-58 was widely held to be felicitous under the circumstances, and fiscal policies during the decline were made with a recognition that attempts to increase tax revenues might tend to reinforce recessionary developments. Similarly, the increase of tax liabilities that has accompanied economic recovery is generally regarded as appropriate to a period when total demands for goods and services are rising in relation to productive capacity. The conscious approbation of year-

to-year instability in the net financial position of the Treasury is striking evidence of the widespread recognition that budget policy has a vital bearing on the performance of the economy.

## **The Basic Budget Position**

However, the cyclical behavior of the budget is only one aspect of budgetary policy, and the abandonment of the principle of annual balance in favor of a flexible budget designed to modify economic fluctuations leaves open the question of what might be referred to as the underlying or long-run budgetary position of the Federal Government. The Federal budget might tend toward more or less continual deficit or surplus over the course of an entire business cycle, or it might tend toward balance, with the surpluses accumulated in years of prosperity tending to match the deficits resulting from recession. Compensatory fluctuations in the Treasury's budget position can take place under any of the three alternative underlying budgetary trends.

It might seem at first glance that the long-run budgetary position of the Federal Government should be permitted to evolve out of short-run considerations of economic stabilization. For example, it has been argued that, given prevailing economic and financial conditions, the Federal deficit or surplus each year should be of a magnitude which provides for high levels of employment and production without inflation. But this argument

overlooks the fact that there are alternative economic policies, particularly monetary policies, that are presently employed as tools of economic stabilization, and that different mixtures of monetary and fiscal policies may each be consistent with economic stability. While there are various alternatives that may lead to economic stabilization, the choice of a particular blend of monetary and fiscal policies is significant with respect to the achievement of other social objectives, since monetary and fiscal policies tend to produce differing effects on the distribution of the economy's productive resources among their various possible uses.

This article deals with the effects on resource allocation that may stem from alternative mixtures of monetary and fiscal policies. Following the general discussion of these effects, a brief review of past trends in the Federal budget is followed by some consideration of possible trends in the Federal budgetary position during the years ahead.

#### **Goals of Fiscal and Monetary Policies**

The underlying trend of the Federal budget plays an important role in determining the strength of private demands for goods and services through its influence on the finances of the businesses, households, and other spending units that comprise the private sector of the economy. Aside from Federal fiscal influence, the other major area of control over private demands is monetary and credit policy. Primarily through its control over the lending power of the banking system, monetary and credit policy affects the cost and availability of borrowed funds for use in financing private spending. A paramount objective of credit and fiscal policies taken together is to regulate the strength of private demands for goods and services so as to achieve the full utilization of the productive capacity of the economy without generating excessive demands that would create

inflationary pressures. Stated more specifically, the goal of credit and fiscal policies combined is to foster a "target" level of demand for goods and services that is appropriate to the realization of the national economic goals of full employment and stable prices.

Although the ultimate level of private demand is affected both by fiscal and by monetary and credit policies, a given target level of spending can be achieved with a wide variety of combinations of the two types of influence. The possible influences of the budget on private spending range, by continuous gradations, from the very expansive effects of a large deficit to the very restrictive effects of a large surplus. Regardless of the phase of the business cycle, the more permissive is fiscal policy with respect to private spending, the more restrictive must be monetary and credit policy if a given target level of private demands is not to be exceeded. Conversely, the more restrictive is fiscal policy, the more permissive may be monetary and credit policies.

#### **The Government Budget and Private Incomes**

The significance of the state of the budget lies mainly in its effects on the level of disposable income available for private spending. When the budget is balanced, the fiscal actions of the Treasury leave private disposable incomes unaffected in the aggregate. Federal outlays, which are sources of private income, are precisely matched by Federal revenues, which reduce the disposable incomes of those who pay them. Thus a balanced budget subjects the aggregate disposable income of the private sector of the economy to two opposing influences of equal strength. This accounting truism has led economists to the preliminary working proposition that a balanced budget has no impact on private demands for goods and services. The conclusion is correct only under strictly

limited conditions not likely to be realized in practice, mainly because almost any combination of spending and taxes has important effects on the distribution of private wealth and income that will invariably influence both the amount and the kinds of private demands for goods and services. For example, corporation income taxes bear more heavily on incomes otherwise destined for investment spending than do personal income taxes, and the relative importance of the two taxes has an important influence on the composition of private demands as between investment goods and consumer goods and services.

However, even though such considerations weigh heavily against the probability that a balanced budget is actually neutral with respect to private demands for new output, an unbalanced budget can exert a profound influence of a different nature because it directly affects the level of disposable income in the private sector. If the budget shows a deficit, disposable private incomes are raised as the Government outlays add more to them than is being taken out by current taxation. This increased income is available for disposition in the form of both larger consumption outlays and greater private savings which are potential sources of demand for investment goods. Conversely, a budgetary surplus lowers private disposable incomes as the Government takes more funds from the private sector than it provides through its current outlays. This influence operates to reduce private consumption spending and the amount of private savings being made available for investment.

In the light of the influence of the budget on the ability of the private sector to finance consumption and investment out of current income, it is clear that the credit conditions appropriate to the achievement of a given target level of private spending are not independent of the state of the budget. The

higher the level of private disposable income (that is, the smaller the budget surplus or the greater the deficit), the greater must be the restriction on the ability of the private sector to finance demands through borrowing if the target level of spending is not to be exceeded.

#### Offsets to Unbalanced Budgets

To a certain extent, the Treasury debt operations that normally accompany an unbalanced budget provide a credit market offset to the effects of the imbalance on private disposable incomes. A deficit is usually accompanied by a roughly equal amount of Government borrowing which involves an absorption of funds from the money and capital markets that might otherwise be used to finance private spending. The superimposition of Government demands for borrowed funds on private demands creates upward pressures on interest rates which discourage private borrowing, and fosters more restrictive bank lending policies. In effect, then, the deficit leads to a channeling of funds away from private borrowers to finance the gap between Government receipts and expenditures.

However, the upward pressure on interest rates may attract new supplies of loan funds into the credit markets as it becomes profitable for individuals and businesses to cut down working cash balances to take advantage of the higher level of interest rates. To the extent that this happens, the Government demand for borrowed funds tends to create its own supply without reducing the amount of funds available to private borrowers. Additional restraint in the credit markets may be required to compensate fully for the stimulus to private spending arising out of the deficit. Thus, in the achievement of a given target level of demand for goods and services, a deficit implies a greater stringency in the credit markets than would be appropriate if the budget were balanced.

Conversely, when a Treasury surplus is devoted to the retirement of outstanding Government debt, the holders of the repaid Government obligations are in a position to buy private securities or invest the money directly, thus augmenting the sources of private demands for new output. The reduction of private disposable incomes that goes with a surplus is thus at least partly offset by an expansion in the availability of credit funds. Interest rates tend to be lower, and bank credit accommodation easier, than they would be if the budget were balanced. However, the augmentation of the supply of loan funds that accompanies the surplus may work, through its downward pressure on interest rates, to discourage the economizing of working cash balances because it lowers the cost of holding cash in terms of forgone interest income. To the extent that the debt retirement merely leads to an increase in private cash balances, it must be reinforced by a further easing of credit if the desired level of spending is to be achieved.

#### **Cyclical Developments Obscure Fiscal Influence**

The foregoing line of reasoning as to the influence of the state of the Federal budget on credit conditions might lead to the supposition that Treasury deficits are typically accompanied by tight money, while Treasury surpluses normally produce conditions of credit ease. More often than not, the pattern has been just the opposite because other financial developments have tended to obscure the influence of Federal debt operations on credit conditions. Wartime experiences aside, Treasury deficits are generally expected to occur during periods of recession and recovery when tax revenues are low. These are precisely the times when private demands for borrowed funds are weak.

Conversely, Treasury surpluses are usually expected during periods of general economic

prosperity when tax yields are high; during these periods, private demands for loan funds are very active and tend to overpower the influence of debt retirement on the supply of loanable funds.

It is nonetheless true that the state of the Federal budget has an important bearing on the credit conditions existing at any time because the influence of the budget on the private sector's ability to finance demands out of disposable income operates at all points in the economic cycle. At any given point smaller deficits or larger surpluses would make appropriate easier credit conditions; looked at the other way, larger deficits and smaller surpluses make necessary greater credit restrictions throughout the course of the business cycle if a given target level of spending is to be achieved.

Thus, the more or less continual use of debt rather than taxes to finance Government spending implies the development of substantially greater restraints on private credit financing than would be necessary if the budget were basically in balance. On the other hand, an underlying surplus in the Federal budget makes possible an augmentation of the supply of funds available for private borrowing while still holding spending down to the appropriate target level.

#### **The Underlying Trend of the Budget and the Composition of Private Demands**

The significance of the choice of a particular blend of budget and credit policies to achieve a given target level of private demands derives importantly from its influence on the character of private demands. Although compensations in monetary and credit conditions can allow for a wide range of alternative budgetary policies while preserving the target level of demand for goods and services, the particular mixture of fiscal and monetary influences that is used has an important influence in shaping the *kinds* of demands

that make up the total. Since the greater part of private disposable income is used to finance household expenditures on current consumption, while the greater part of private borrowing is used to finance spending on producer and consumer durable goods, a fiscal policy that is permissive with respect to private spending is generally looked upon as exerting upward pressures on consumer demand in particular, while restrictive credit policies are thought to hold down the demand for durable goods that add to the wealth and productive capacity of the economy. To the degree that this is true, the choice of a particular blend of fiscal and monetary policies influences the allocation of the economy's productive resources between producing for current consumption and producing durables that add to wealth and future capacity.

An awareness of this aspect of the implications of Federal budgetary policy is highly useful in making intelligent policy decisions. Those who favor the promotion of economic growth at the expense of current standards of consumption are prone to argue that the monetary and credit restrictions necessitated by an underlying budgetary deficit are in general prejudicial to capital formation. It is widely recognized, however, that the present state of empirical knowledge can offer only limited information concerning the precise effects of fiscal and credit policies. While it is true that credit is extended primarily for the purchase of producer and consumer durable goods, and that credit restrictions tend to hold down these outlays, just which kinds of spending on durables are most sensitive to credit restrictions is problematical.

On the consumer side, the rate of spending for residential housing appears to be much more sensitive to interest rate changes than does the demand for the shorter-lived consumer durable goods, such as automobiles, furniture, and home appliances, that are often financed by consumer instalment loans. In

part this is because the ceiling rates of interest on Government-insured mortgages discourage investment in them as the general level of interest rates rises, although the practice of discounting these mortgages has, to some extent, made it possible for lenders to realize more than the legal maximum rate. In addition, since the interest component of the total payments on long-term mortgages bulks much larger than does the interest component of payments for shorter-term consumer instalment loans, the demand for mortgage funds is apt to be the more sensitive to interest rate changes.

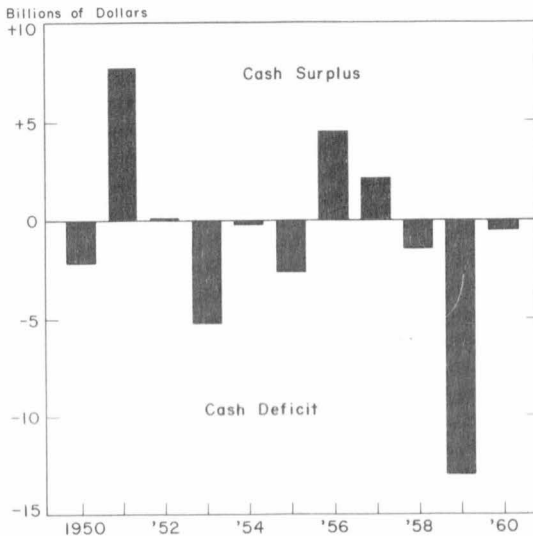
The same kind of logic is used to argue that long-term capital investment is generally more susceptible to influence through changing interest rates than is shorter-term business spending on such items as inventories and short-lived machinery. There is some empirical evidence that may be used to buttress the logic of this point, but the analyst must be wary of trying to push too far his reasoning as to the effects of credit conditions on particular kinds of business investment. Many who favor Government policies designed to promote long-term capital investment therefore argue for the use of other devices, such as tax incentives for capital outlays, or reduced corporation income taxes to increase the amount of corporate earnings retained for investment.

#### Recent Experience and Possible Future Trends

In spite of these qualifications, it is important to recognize the role of the underlying state of the budget in determining the financial atmosphere surrounding investment decisions; appraisals of the adequacy of the over-all level of Federal taxation in relation to expenditures cannot be divorced from a consideration of these effects. The balance of this article deals with the fiscal experiences of the recent past and the possible course of



### Federal Cash Surplus or Deficit Fiscal 1950 - 1960



SOURCE: *The Budget of the U. S. Government: 1961.*

developments in the near future, without attempting to judge their appropriateness. The purpose is to clarify the facts upon which a judgment as to the appropriateness of present levels of taxation might be made in the light of their importance in determining the availability of loan funds for private borrowers.

The fiscal experience of the Federal Government over the past decade is summarized in the chart, which shows the cash receipts and expenditures of the Treasury for each of the fiscal years 1950-59, along with the latest official projections for fiscal 1960. These cash budget figures, which involve the consolidation of Federal transactions with the public, including trust fund operations, give a more accurate indication of the financial impact of the Federal Government on the rest of the economy than does the administrative (or President's) budget, which carries certain items on an accrual basis and excludes trust fund transactions. Until very recently, the administrative budget has tended to show

larger deficits and smaller surpluses than have the cash budgets for the same years. The absolute levels of spending and receipts carried in the administrative budget are lower than those shown by the cash budget, primarily because the former excludes the trust funds.

The fluctuations between surplus and deficit shown in the chart have tended to conform, in general, with the variations in business conditions for the economy as a whole. For the entire decade from fiscal 1950 through fiscal 1959, Federal deficits exceeded surpluses by \$11 billion. By and large, the underlying state of the budget appears to have been one of near balance over most of the period.

However, some observers have felt that recent developments point to a basic budgetary deficit. The \$13.1 billion cash deficit of fiscal 1959, the highest in peace-time history, occurred in the face of cash receipts that were down less than \$300 million from the previous year, and only about \$500 million below the record high of 1957. The \$14.8 billion increase in Federal payments over the 1957 level was composed partly of recession-induced "automatic" increases, such as Social Security payments for unemployment compensation. Added to this were unusually large payments for agricultural price supports necessitated by the large crops of 1958. But in addition, more or less permanent increases, both in defense and nondefense outlays, were pushing up the total. Furthermore, Treasury payments have failed to recede in fiscal 1960—*Midyear Budget Review* estimates project a level of payments slightly over \$95 billion for the current fiscal year. Current revenue estimates, made in the light of the impact of the steel strike on tax receipts, point to a slight deficit in the cash budget. Fiscal 1961 holds out promise of a surplus, provided the economy remains prosperous. The President's Budget Message



forecasts a sizable cash surplus which traces partly to new revenue proposals.

The uncertainty concerning future trends in expenditures, which depend on such unpredictable elements as national defense needs and the climate of public opinion concerning the proper scope of Federal nondefense spending, makes it impossible to assess precisely the long-run adequacy of present Federal revenue laws, even if the proper underlying budgetary trend is agreed upon. Nevertheless, it is interesting to consider the projections of Federal Government expenditures and receipts through fiscal 1968 prepared by Professor Otto Eckstein of Harvard University for the Committee for Economic Development.

Without attempting to forecast short-run economic fluctuations or changes in the price level, and assuming that the international situation does not change appreciably, Eckstein submits four different projections of Federal Government cash outlays: very high, high, medium, and low—the medium projection being the one he considers most probable. The level of Federal cash receipts is projected on the assumption that there will be no change in the present tax laws, and the growth in tax revenues therefore depends largely on the rate of increase in the gross national product, which Eckstein assumes will average 3 per cent a year in real terms. On the basis of his medium projection of Government expenditures, Eckstein foresees a Federal cash surplus of about \$6 billion by 1964, presuming that there is no recession at that time. Such a surplus would seem to be ade-

quate to make up for the deficits that would arise if recessions continue to be as mild as those experienced in the 1950's.

Eckstein's projections for fiscal 1968 show an increase in the cash surplus (again assuming no recession) to about \$11 billion under the medium range of projections of Federal expenditures, which would seem to provide for an underlying surplus if the extent of cyclical swings remains as limited as it has been in the recent past.

Such projections are, of course, only informed guesses, and the swing back toward an underlying balance or a slight surplus is not the only possibility to be considered. On the basis of his very high expenditure projection, Eckstein foresees a cash deficit of \$6 billion to \$7 billion by fiscal 1968 provided there is no recession at that time and that there are no changes in the tax laws. Conversely, the low expenditure projection, which assumes a strong economy-minded attitude throughout the period, would lead to a surplus of about \$21 billion in 1968.

As the future unfolds, decisions concerning the fiscal adequacy of Federal revenues will be importantly involved in establishing the availability of private credit and hence the division of economic resources between producing for current consumption and producing consumer and producer durables. Only in the case of Eckstein's low expenditure projection does it appear that the present revenue laws would provide a substantial underlying surplus. Such a surplus would imply a marked alteration in the influence of fiscal policy on financial conditions.

# BUTTER—

## *The "Balance Wheel" of an Industry*

**B**UTTER PLAYS AN important role in balancing supplies and stabilizing prices in the dairy industry. While other dairy products help fulfill this role, butter is most important because of its larger market and its combination of characteristics—responsiveness of consumption to price changes, storability, and lack of bulk.

### **Seasonality Creates the Need for a Stabilizer**

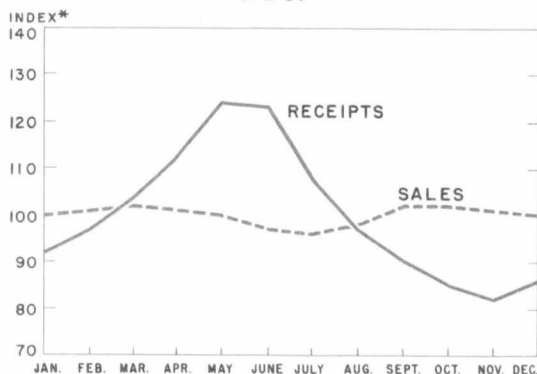
Seasonal imbalances between production and consumption of milk cause markets to be unstable. Milk in fluid form is highly perishable and bulky. It can be stored for only a short time and at a high cost. Excess supplies of fluid milk (grade A) have a strong price-depressing effect because fluid consumption is relatively unresponsive to price changes. Consequently, fluid milk plants find it profitable to divert supplies in excess of what can be sold at prevailing prices into manufactured products, such as butter and cheese. The output of an individual plant may have a significant influence on prices in a local fluid milk market, but have no discernible influence on prices in large national markets for butter or cheese. Large seasonal excesses of milk can be processed into butter and other manufactured products with small effects on their prices because of their storability and nationwide markets.

The diversion of excess fluid milk into manufactured products not only stabilizes selling prices of fluid milk products, but it helps reduce price fluctuations to producers. If

some method of diversion were not possible, fluid milk markets probably would be demoralized. Prices would drop so low during flush production seasons that many producers would be forced out of business. This would result in shortages during slack production periods. Consumers would suffer an uncertain supply of milk and pay widely fluctuating prices. Average prices to consumers probably would be higher, while profits to producers and distributors would be lower.

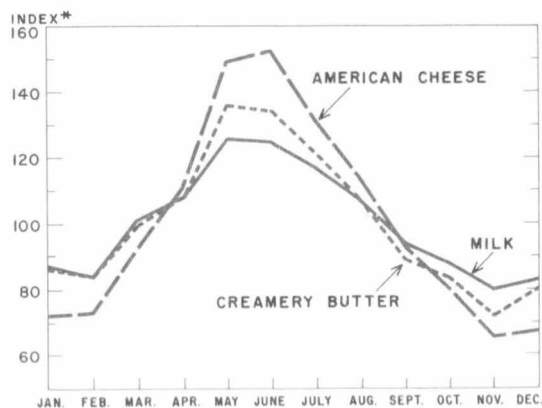
The basic instability in fluid milk markets is illustrated by statistics from 22 markets operating under Federal milk marketing orders. Average physical receipts varied seasonally for this group from 82 to 124 per cent of a 12-month moving average for the period

**Seasonal Variation in Average Physical Receipts and Sales of Fluid Milk**  
22 Selected Markets Under Federal Milk Marketing Orders  
1947-51



\*Index numbers of physical volume are average ratios to 12-month moving averages, adjusted to total 1200.  
SOURCE: U. S. Department of Agriculture.

### Seasonal Variations in Production of All Milk, Creamery Butter, and American Cheese United States, 1947-55



\*Index numbers of physical volume are average ratios to 12-month moving averages, adjusted to total 1200.  
SOURCE: U. S. Department of Agriculture.

1947-51. Average physical sales, in comparison, varied only from 96 to 102 per cent, and the variations were contraseasonal relative to receipts. The seasonal variation in total milk production is similar to that in the 22 markets. The amplitude of seasonal fluctuations in milk sold for manufacturing uses tends to be greater than for milk sold for fluid use. New technology and management methods have reduced seasonal variations in recent years and this has been most effective in fluid milk sheds where seasonal pricing plans have been used. Despite these changes, milk production has by no means approached an even flow.

The production of butter and cheese varies more than milk production from season to season. This is because excess fluid milk is used for manufacturing butter and cheese during flush seasons. Consumption of butter and cheese varies much less than production and, apparently, contraseasonally to production. This results in large variations in cold storage stocks. Butter stocks varied from a February average of 170 million pounds to a July average of 295 million pounds for the period 1953-57. Cheese stocks averaged 402

million pounds in February and 544 million pounds in August for the same period.

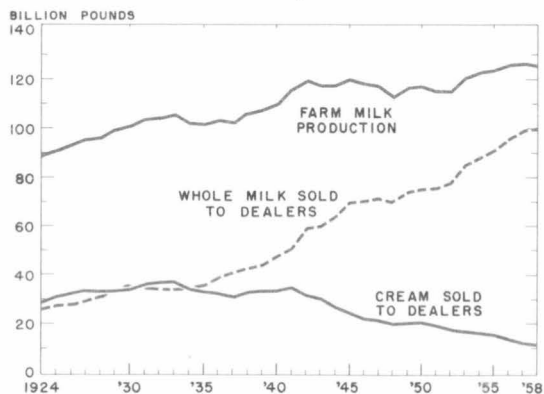
### Trends in Production and Utilization

Butter's stabilizing role has changed over the years and its importance has grown despite declines in butter production and consumption. The changing role has resulted from the concurrent changes in farm milk production, sales of whole milk, use of milk on farms, consumption patterns, and use of whole milk for butter production.

Farm milk production increased from 89 billion pounds in 1924 to nearly 126 billion in 1957, and has declined slightly during the past 2 years. Whole milk sold to dealers quadrupled from 1924 to 1958, while cream sold to dealers declined by two thirds. Milk used on farms and milk and cream retailed by farmers declined considerably during this period.

Butter production declined precipitously during World War II, but has leveled off since, although there have been considerable annual fluctuations. The use of milk in fluid milk and cream and in manufactured products, other than butter, increased rapidly during the early 1940's, and has increased steadily, but

### Farm Milk Production and Sales to Dealers, Whole Milk or Equivalent (Fat Basis) United States, 1924-58



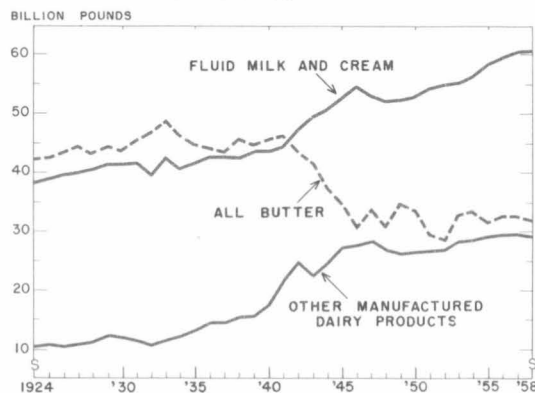
SOURCE: U. S. Department of Agriculture.

more slowly, for the past decade. The proportion of milk utilized in butter production has declined over the past two decades. Despite these changes, more milk has been used for butter production than for all other manufactured products combined for every year through 1958. About one fourth of the butterfat in milk and cream sold by farmers was used for producing butter in 1958.

Butter was made almost exclusively from farm-separated cream prior to 1934. Farm-churned butter exceeded creamery-churned butter until about 1900, and it exceeded creamery butter made from whole milk (factory-separated) through 1948. Use of farm-separated cream for butter production declined rapidly during the early 1940's, and has declined continuously since 1950. Butter manufactured from factory-separated cream purchased as whole milk has increased some 800 per cent since 1946. This resulted from two different trends — farmers shifting from the sale of cream to that of manufacturing milk and the use of more excess grade A milk for producing butter.

Per capita consumption of butter declined slowly from 1934 to 1943, then dropped precipitously. There was another period of

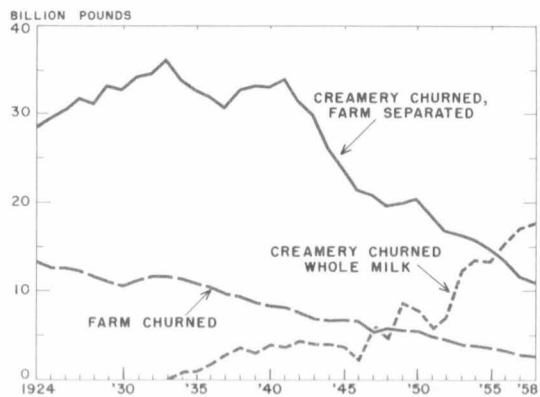
**Utilization of Milk in Fluid and Manufactured Products, Whole Milk Equivalent (Fat Basis)**  
United States, 1924-58



SOURCE: U. S. Department of Agriculture.

**Use of Milk in Butter, Whole Milk Equivalent (Fat Basis)**

United States, 1924-58



SOURCE: U. S. Department of Agriculture.

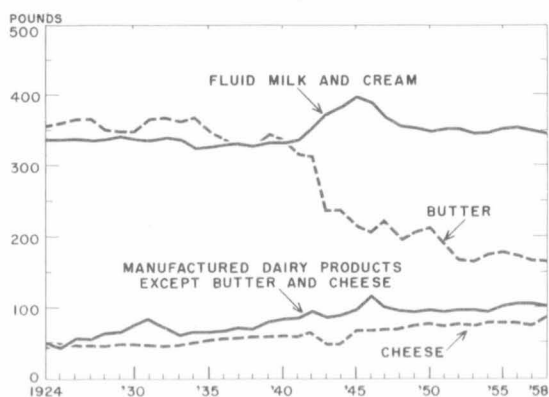
gradual decline from 1944 to 1953, followed by a fairly stable period since. In terms of whole milk equivalent (fat basis), per capita consumption of butter exceeded or equaled fluid milk and cream consumption up to 1941. Per capita consumption of milk fat in fluid milk and cream has averaged about twice as much as in butter for the past 8 years. Cheese consumption has increased fairly steadily since 1924. The ratio of cheese to butter consumption increased from 1-7 in 1924 to 1-2 in 1958 on a whole-milk-equivalent basis. Per capita consumption of manufactured dairy products, other than butter and cheese, has more than doubled from 1924 to 1958. Much of this increase was in ice cream consumption.

The pattern of nonfat milk solids consumption has changed even more than has milk fat consumption. Whole milk sales to dealers have increased as farm milk use and cream sales have declined. Nonfat dry milk, cultured buttermilk, skim milk used in chocolate drinks, and frozen milk desserts have accounted for most of the increased consumption of nonfat solids.

These trends suggest that butter is declining both as a user of milk and as a consumer product. However, recent experience sug-

### Per Capita Consumption of Various Dairy Products, Whole Milk Equivalent (Fat Basis)

United States, 1924-58



SOURCE: U. S. Department of Agriculture.

gests that butter production may have reached a stable level which will be maintained indefinitely. On the other hand, the downward trend may have been slowed but not stopped. Use of fat-type table spreads declined during World War II as a matter of Government policy. Following the war, margarine of improved quality was produced in large quantities and sold at comparatively low prices. When price controls were lifted, butter prices increased and margarine prices remained low. Federal and most state taxes and restrictions on the sale of yellow margarine were lifted in the early 1950's. The shifts from butter to margarine during this period can be attributed largely to these special causes. There has been very little change in the per capita consumption of either butter or margarine since 1952.

#### Effect of Government Programs On the Role of Butter

Two Government programs — dairy price supports and Federal milk marketing orders — have increased the importance of butter's stabilizing role. Prices of manufacturing milk and cream are supported by Government purchases of butter, cheese, and nonfat dry

milk. Market prices have differed little from support prices for several years until quite recently. This has resulted in fairly stable price levels for manufacturing milk and cream. Also, it has supported fluid milk prices to a large extent because they are related to manufactured product prices through Federal milk marketing orders and a degree of interproduct competition.

The Federal milk market order program included some 78 markets in mid-1959. About 40 per cent of the whole milk sold by farmers is sold under the terms of these orders and about 10 billion of the 36 billion pounds marketed under Federal milk orders in 1958 were diverted to manufactured products. Federal orders provide for the setting of minimum prices to producers according to pricing formulas based on manufactured product prices or various economic variables. Some 67 of the orders use a manufacturing milk formula for determining minimum prices, and the price of butter is involved to some extent in most of these formulas. A typical order sets the minimum prices of excess class milk (milk in excess of fluid use) according to some measure of its value for manufacturing purposes and provides a higher differential price for milk used in fluid form. Various adjustors are used to keep class prices in line with each other, prices in other markets, and various other economic factors. Thus, to some extent, much of the milk sold under Federal milk marketing orders is related to butter prices.

Producers' milk prices are regulated by some 15 states. The U. S. Department of Agriculture estimates that 16-17 billion pounds of milk were affected directly by state regulation in 1958. This is in addition to the amount regulated by the Federal Government. Thus, from 55 to 60 per cent of the whole milk sold by farmers is subject to price regulation by various government agencies. State regulation follows no set pattern, but most of the prices are set in relation to prices in

Federal order markets and/or prices of manufacturing milk. Prices in many markets not subject to Federal or state regulation are influenced by them through intermarket competition. The relationships among various market areas are not close enough to constitute an integrated national market for milk, but they do seem to be sufficiently strong to permit the conclusion that the price of butter is an important factor in the pricing of milk in general.

### **The Importance of Butter's Economic Role**

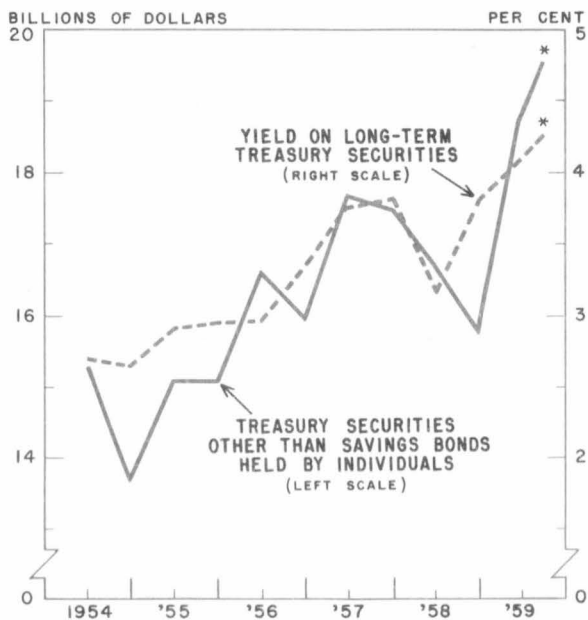
Butter's role as a milk price regulator is not unique. Cheese and evaporated milk also serve this role but to a lesser extent. If the ability of butter to fulfill its role should decline, it is doubtful that cheese and evaporated milk could assume this function satisfactorily because of their limited consumption. However, other products may be developed which can assume this role as well or better. The improvement of techniques to produce sterile milk concentrate and dry whole milk are particularly significant. While butter and cheese production is a one-way

process, the newer products can be reconverted to fluid form. Evaporated milk also can be reconstituted, but the new products have the advantage of tasting more like fresh milk when reconstituted. Sterile milk concentrate seems to be the more promising of the two. It is quite possible that, in the future, fluid milk plants will use part of their seasonal excesses to make sterile milk concentrate which they will reconstitute for distribution when milk supplies are short.

Several conclusions may be drawn about the economic role of butter: (1) It has declined in importance as a "primary" farm product in that sales of farm-churned butter and farm-separated cream have declined sharply. (2) The importance of butter as a consumer product decreased sharply during the 1940's but has stabilized since. (3) The importance of butter in stabilizing milk prices has been enhanced by Government programs. (4) Butter probably will continue to play an important, stabilizing role for a long time in the future unless new products are developed which can perform the function more effectively.

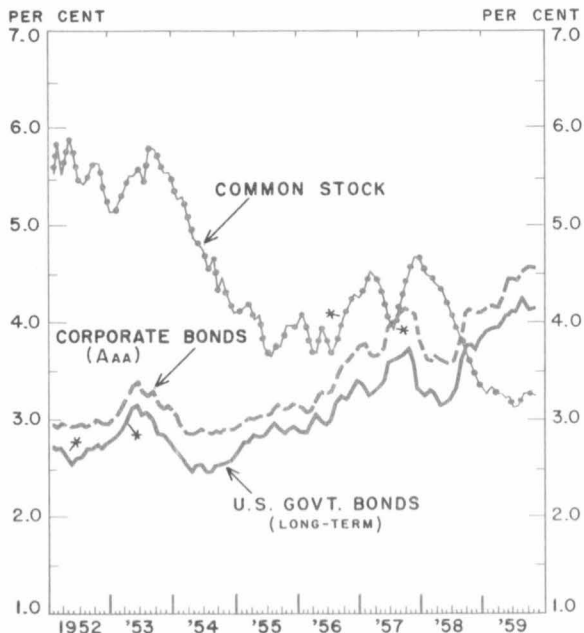


## Marketable Treasury Securities Held by Individuals And Yield On Long-Term Treasury Securities



\*September data. All other data June 30 and December 31.

## Comparative Market Yields January 1952-November 1959



\*Change of issues included.

## BANKING IN THE TENTH DISTRICT

District and States	Loans				Deposits			
	Reserve City Member Banks		Country Member Banks		Reserve City Member Banks		Country Member Banks	
	Nov. 1959	Dec. 1958	Nov. 1959	Dec. 1958	Nov. 1959	Dec. 1958	Nov. 1959	Dec. 1958
December 1959 Percentage Change From								
Tenth F. R. Dist.	+2	+9	†	+9	+4	-6	+2	†
Colorado	+2	+14	+1	+13	+1	-1	†	+1
Kansas	+8	+8	+1	+3	+2	-6	+4	†
Missouri*	+3	+15	†	+15	+8	-2	+3	†
Nebraska	-4	+4	†	+9	-1	-11	+1	-3
New Mexico*	**	**	+2	+4	**	**	+4	-1
Oklahoma*	+1	+3	-3	+11	+7	-11	+1	+2
Wyoming	**	**	+2	+11	**	**	+1	-1

\*Tenth District portion only.  
†Less than 0.5 per cent.

\*\*No reserve cities in this state.

## PRICE INDEXES, UNITED STATES

Index	Dec. 1959	Nov. 1959	Dec. 1958
Consumer Price Index (1947-49=100)	125.5	125.6	123.7
Wholesale Price Index (1947-49=100)	118.9	118.9	119.2
Prices Rec'd by Farmers (1910-14=100)	228	230	244
Prices Paid by Farmers (1910-14=100)	297	297	295

## TENTH DISTRICT BUSINESS INDICATORS

District and Principal Metropolitan Areas	Value of Check Payments		Value of Department Store Sales	
	Percentage change—1959 from 1958			
	Dec.	Year	Dec.	Year
Tenth F. R. Dist.	+5	+9	+2	+6
Denver	+12	+12	+4	+8
Wichita	-6	+2	-4	0
Kansas City	0	+9	+4	+8
Omaha	+1	+9	+5	+7
Oklahoma City	+12	+11	+2	+6
Tulsa	+3	+5	+4	+6



