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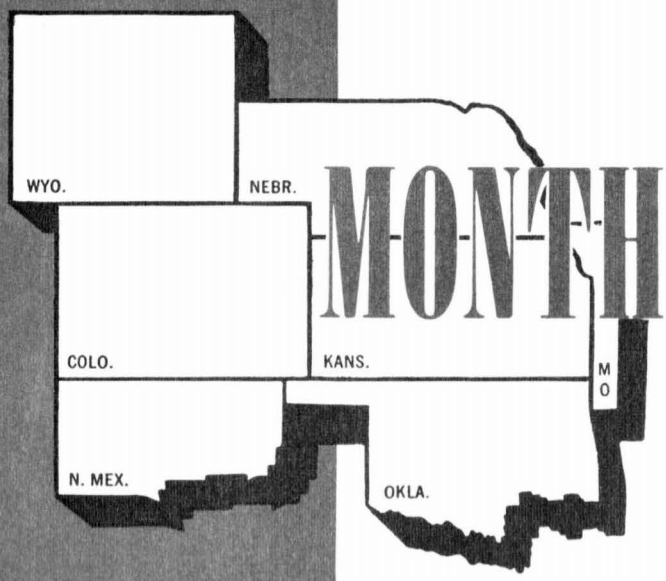

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ECONOMIC ADVANCE AND UNEMPLOYMENT

By Sheldon W. Stahl

TWENTY YEARS ago, the Congress of the United States passed the Employment Act of 1946. The action was taken in response to concern over the existence of a serious unemployment potential, following the release of millions of personnel from the Armed Forces and the termination of war production—with the attendant discharge of workers—at the close of World War II. The Act established a Council of Economic Advisers to the President and created the Joint Economic Committee of the Congress to maintain a continuing watch on the national economic scene. Most important, however, the legislation committed the Federal Government to pursue such economic policies as might be conducive ". . . to promote maximum employment, production, and purchasing power."

In the 2 decades since the Employment Act was passed, the record of the United States in promoting maximum employment has been mixed. The U. S. economy has experienced four recessions during the postwar period and, although these fluctuations in business activity all may be described as relatively moderate, the rate of unemployment in each successive recovery peak was higher than in the one that preceded it. From 1947 through 1965, the unemployment rate varied considerably, ranging from below 3 per cent to nearly 7 per cent. Unemployment averaged approximately 5 per cent for the entire period, while for the 6 years from 1958 through 1963 it did not fall below 5.5 per cent and averaged 6 per cent. Thus, it should be recognized that, while the unemployment rate fell below 4 per cent early this year, this more favorable turn in the unemployment picture is of relatively recent origin. Even at that, one should recognize that the aggregate unemployment rate provides but one dimension of the magnitude of the problem, since the aggregate rate encompasses many diverse rates.

Unemployment represents the most overt waste of resources. Productive manpower which goes unutilized represents lost output for society which cannot be recouped. Estimates made by the President's Council of Economic Advisers in the 1965 *Economic Report of the President* point out that had the unemployment rate in 1964 been 4 per cent, rather than the 5.2 per cent rate which prevailed that year, the gross national product (GNP) would have been about $27 billion larger. Although less easily measured, the social costs involved in overly high rates of unemployment undoubtedly are significant as well. This article will explore the relationship

between economic growth and the problem of unemployment, and their implications for public policy.

THE ECONOMIC GROWTH FACTOR

Because employment opportunities are a function of the state of the economy, it readily can be seen that one of the prime requisites for high levels of manpower utilization is a correspondingly high level of aggregate economic activity. This point may be driven home forcefully by noting—as was done in the 1966 *Manpower Report of the President*—that, given the expected increase in the civilian labor force of about 1.6 million people for the current year, the economy would have to provide approximately 4,500 new jobs each day—31,000 new jobs each week—or 134,000 new jobs each month. It should be emphasized, however, that even if the economy succeeds in supplying this number of jobs, the rate of unemployment need not change. Only if more than this number of jobs were made available during the year, or if the growth in the labor force were less than projected, would the level of unemployment fall. As a matter of economic judgment, however, reducing unemployment by making available the maximum number of productive jobs may be preferred to the specious improvement in unemployment levels which may come from a diminished growth in the labor force.

It has been indicated that there is a direct relationship between the level of aggregate economic activity and the level of employment or unemployment. It also should be pointed out that changes in employment levels are responsive to at least two other basic variables—productivity and hours of work (or workweek). Thus, to the extent that real gains in GNP are traceable to rising productivity, employment growth will be smaller than if real GNP had increased without any accompanying productivity gain. For example, if the relative increase in real GNP should fall below the rate of gain in productivity for any given year, then employment may show no advance or may register an actual decline. Conversely, should real GNP increase faster than productivity, employment will rise. The reader should be cautioned, however, lest he reach the erroneous conclusion that employment growth would be continually maximized if productivity gains were held to a minimum. Increased productivity allows both labor and capital to share in the fruits of economic advance in the form of higher wages and greater profits. At the same time, it is the key vehicle in preserving relative price stability. As the upswing progresses, if productivity gains diminish, unit labor costs will be affected adversely and upward pressure will be exerted on costs and prices generally. As these pressures mount, the threat of inflation and declining profit margins could endanger the longevity of the economic advance itself and, thereby, any prospective growth in employment which would stem from real GNP gains. Hence, the role of continued productivity gains in sustaining economic growth must be given considerable weight in any appraisal of the laborsaving impact which these gains might have on employment levels.

In discussing the impact of productivity on employment growth, it should be understood that the preceding examples implicitly assume no change in the actual number of hours worked. Clearly, this impact could be offset, to some extent, by a decrease in the number of hours worked by each employee. Hours of work actually have exhibited a secular, or long-run, downtrend between 1947 and 1965, indicating that labor has chosen to take part of its productivity gains in the form of reduced hours.

In addition to the long-run behavior of productivity and length of workweek, it is important to spell out the cyclical, or shorter-run, behavior of these variables, since their impact on employment growth over the business

cycle is notably different than over the longer period. For example, in the case of hours of work, the observable postwar secular trend operated to enhance employment growth. The cyclical behavior of this variable, however, has a distinctly negative impact on the growth of employment in the rising phase of the business cycle. As the economy moves upward from a cyclical trough, the length of the workweek typically rises from its reduced level at the trough of the cycle to progressively higher levels. Thus, as aggregate demand gains strength and the demand for labor increases, the lengthening of the workweek partly undercuts the employment growth which would be associated with a given advance in real GNP.

Productivity, on the other hand, exhibits a cyclical behavior which, up to a point, is favorable to employment growth as the upswing lengthens. Gains in physical output typically are large in the early phases of the upswing, because of considerable unutilized plant capacity as well as a large pool of experienced, unemployed workers. Given these circumstances, productivity gains are correspondingly high. However, as the level of economic activity continues to move higher, output gains become more difficult to realize in the face of rising rates of capacity utilization and shrinking numbers of unemployed laborers with requisite skills. These factors contribute to a tapering off in the rate of productivity gains, and, consequently, the farther along in the upswing, the less would be the laborsaving impact of productivity gains on employment growth. Once again the reader is cautioned to refer to the earlier caveat regarding the impact of productivity on employment growth.

Table 1 shows annual changes in real GNP, employment, and related data for the period 1947-65. The purpose of the preceding paragraphs was to point out that, although the GNP-employment relationship may be direct, it is far from simple. Any conclusions which may be drawn from an examination of the table, therefore, must be subject to qualification. Nonetheless, certain valid points can be made regarding the economy's growth and employment-unemployment record.

Table 1
ANNUAL CHANGES IN REAL GROSS NATIONAL PRODUCT, EMPLOYMENT, AND RELATED DATA, 1947-65

	Per Cent Change			Absolute Change (Millions)		
Year	Real Gross National Product	Total Employment	Total Private Output Per Manhour*	Total Employment	Civilian Labor Force	Unemployment
1947-48	4.5	2.3	3.4	1.3	1.3	**
1948-49	0.1	−1.2	2.4	−0.7	0.7	1.4
1949-50	9.6	2.3	9.2	1.3	1.0	−0.3
1950-51	7.9	1.7	4.6	1.0	−0.2	−1.3
1951-52	3.1	0.4	2.9	0.3	0.1	−0.2
1952-53	4.5	1.5	4.6	0.9	0.8	−0.1
1953-54	−1.4	−1.7	2.7	−1.1	0.7	1.7
1954-55	7.6	3.4	4.3	2.1	1.4	−0.7
1955-56	1.8	2.8	−0.1	1.8	1.7	−0.1
1956-57	1.4	0.5	2.7	0.3	0.4	0.1
1957-58	−1.1	−1.6	2.3	−1.0	0.7	1.7
1958-59	6.4	2.5	4.0	1.6	0.7	−0.9
1959-60	2.5	1.7	1.2	1.1	1.2	0.1
1960-61	1.9	0.2	2.7	0.1	1.0	0.9
1961-62	6.6	1.6	5.2	1.1	0.3	−0.8
1962-63	4.0†	1.4	3.1	1.0	1.1	0.2
1963-64	5.3†	2.2	3.2	1.5	1.3	−0.3
1964-65	5.9†	2.6	2.4	1.8	1.4	−0.4
Average, 1947-65	3.9	1.2	3.4	0.8	0.9	0.1

*Labor force basis.
**Less than 100,000.
†Revised as of July 1966.

SOURCE: **Manpower Report of the President and A Report on Manpower Requirements, Resources, Utilization, and Training,** U. S. Department of Labor (Washington: U. S. Government Printing Office, March 1966), Table 10, and **Economic Report of the President** (Washington: U. S. Government Printing Office, January 1966), Table C-31.

It already has been established that productivity has been rising at an average rate of about 3 per cent a year during the postwar period—although the rates of change may vary widely from year to year. The downtrend in hours of work—though not significant in its impact in any single year—over the same period has been roughly .5 per cent a year, thus partly offsetting the laborsaving effect of productivity gains. This suggests that, as a general rule—assuming a 3 per cent annual average productivity gain—for employment growth to occur, the average annual increase in real GNP would have to exceed 2.5 per cent. As Table 1 shows, for the period 1947-65 the average annual increase in real GNP has

been 3.9 per cent, while employment has advanced at an average annual rate of 1.2 per cent.

A closer examination of Table 1 lends support to the general rule just stated. For example, in three recessionary periods—1948-49, 1953-54, and 1957-58—real GNP showed either no change or a decline. In each of these cases, total employment declined. In the brief 1960-61 recession, real GNP rose by less than 2 per cent. Productivity gains in that period, however, were below 3 per cent; consequently, total employment showed a small increase.

In connection with the important role which productivity changes can play in employment growth for any given year, an examination of the years 1955-57 proves instructive. In 1954-55, real GNP rose by 7.6 per cent while total employment advanced by 3.4 per cent, or, by some 2 million jobs. In 1955-56 with a rise in real GNP of only 1.8 per cent, the percentage increase in total employment was four fifths as large as the year before. In terms of actual numbers, 1955-56 showed an increase in jobs about 85 per cent as great as 1954-55. The key difference between these 2 years, in which markedly different real GNP gains were associated with only narrow differences in employment growth, was the productivity factor. In 1954-55, output per manhour rose by more than 4 per cent, but in 1955-56 it actually registered a small decline. When, in 1956-57, productivity again turned upward at a rate of nearly 3 per cent, a real GNP gain not very different from a year earlier produced an employment gain only one sixth as large as in the preceding year. Further examination of Table 1 strongly suggests that, where widely differing employment changes may be associated with specified real GNP gains, the key factor making for that difference is productivity.

Given the postwar trends in productivity and hours of work, a real GNP growth rate of about 2.5 per cent would, on the average, suffice to maintain total employment constant. For employment growth to occur, real GNP would have to rise in excess of 2.5 per cent per year. However, in order to keep unemployment from rising, or, still more important, to lower unemployment, an annual growth rate in real GNP considerably higher than 2.5 per cent would be required. Growth in real GNP must not only be able to offset the rise in productivity, but, additionally, it must be able to absorb the continuing flow of entrants into the labor force. Clearly, any step-up in the rate of labor force growth over the postwar average correspondingly would raise the minimum rate of real GNP growth needed to reduce unemployment.

As shown in Table 1, the record of the U. S. economy in lowering unemployment has been less successful than its achievements in expanding total employment. During the postwar period, unemployment has fallen in only 10 out of 18 years. Although there have been two occasions during those 10 years of falling unemployment when the rate of growth in real GNP was less than 4.5 per cent—1951-52 and 1955-56—it is interesting to note that 1951-52 was marked by a very slight rise in the labor force, while in 1955-56, the very large increase in the civilian labor force was offset largely by an actual decline in productivity. Thus, in each of these cases, growth in real GNP did not have to contend with either of the elements which operate against lowering unemployment levels. In the remaining years when unemployment levels were reduced, real GNP growth ranged from 4.5 per cent per year to a high of 9.6 per cent. From the limited evidence in Table 1, 4.5 per cent appears to represent the minimum real GNP growth rate needed to lower unemployment levels, based on productivity and labor force trends which have prevailed during the postwar period. Should the trend rate of increase in productivity rise above 3 per cent, or should labor force growth accelerate, a still

higher rate of growth in real GNP would be needed to lower the level of unemployment. Data on projected labor force growth for the remainder of this decade from the U. S. Department of Labor, Bureau of Labor Statistics, indicate that such an acceleration is to be expected. The following paragraphs will take a closer look at projections of manpower demand and supply and their implications for unemployment in the period ahead.

LOOKING AHEAD

The Bureau of Labor Statistics estimates that the civilian labor force will grow by an estimated 7.7 million persons between 1965 and 1970, or at an average annual increase in excess of 1.5 million. The significance of this anticipated rate of increase may be grasped by noting, in Table 1, that for the entire postwar period the annual increase in the civilian labor force averaged less than 1 million persons. During the first half of the 1960's, the average absolute change approximated 1 million annually. There was one occasion—1955-56—when the labor force growth was in excess of the 1965-70 projected rate, and several other occasions—including 1947-48, 1954-55, 1963-64, and 1964-65—when the labor force grew at rates close to those anticipated for the next 5 years. However, the data clearly show that at no time during the postwar years has there been an extended period of high labor force growth such as that being contemplated for the latter half of this decade. The labor force-employment experiences of 1955 and 1956 were viewed in detail earlier in this analysis. Some comment on 1964 and 1965 also may be instructive. In the past 2 years, labor force increases have approached those levels projected for 1965-70. Real GNP gains in 1964 and 1965 averaged well above the postwar record, while productivity gains averaged somewhat below the postwar trend rate. As a consequence, employment in 1964 and 1965 advanced by a total of 3.3 million—or at an average annual rate twice as high as for the entire postwar period. Unemployment in those same 2 years fell by 700,000, in contrast with an annual average increase of 100,000 for the 1947-65 period.

Table 2

PER CENT DISTRIBUTION OF THE TOTAL LABOR FORCE, BY SEX AND AGE, 1965-75

Sex and Age	1965	1970	1975
Both Sexes			
14 years and over	100.0	100.0	100.0
14 to 24 years	21.5	23.6	24.1
25 to 44 years	41.1	38.9	39.9
45 years and over	37.4	37.5	36.0
45 to 64 years	33.4	33.8	32.5
65 years and over	4.0	3.7	3.5
Male			
14 years and over	66.0	64.9	64.4
14 to 24 years	13.4	14.7	14.9
25 to 44 years	28.3	26.7	27.4
45 years and over	24.3	23.5	22.1
45 to 64 years	21.6	21.1	19.9
65 years and over	2.7	2.5	2.2
Female			
14 years and over	34.0	35.1	35.6
14 to 24 years	8.1	8.9	9.2
25 to 44 years	12.8	12.2	12.5
45 years and over	13.1	14.0	13.9
45 to 64 years	11.9	12.7	12.7
65 years and over	1.2	1.3	1.3

SOURCE: **Manpower Report of the President and A Report on Manpower Requirements, Resources, Utilization, and Training,** U. S. Department of Labor (Washington: U. S. Government Printing Office, March 1966), Table E-4.

To provide for an increase of 7.7 million persons in the civilian labor force during the remainder of this decade, the economy must generate an average of more than 1.5 million new jobs each year simply to keep pace with the flow of new entrants. It should be pointed out that such a performance by the economy would not offset the impact of productivity gains during the period, nor would it lower unemployment levels. Along with the expected sharp rise in the rate of growth in the labor force, the economy will have to contend with the additional factor of the changing composition of the labor force—in particular, the increasing proportion of younger workers.

Table 2 shows the per cent distribution of the total labor force by sex and age for the years 1965, 1970, and 1975. Although the data in the table include members of the Armed Forces, the Bureau of Labor Statistics' esti-

mate of a 7.7 million increase in the civilian labor force for 1965-70 is only slightly different from the estimated change in the total labor force for the same period, thereby implying essentially no change in the level of the Armed Forces. Thus, data in Table 2 would tend, almost wholly, to reflect the behavior of the civilian labor force. Assuming that no drastic change will occur in the level of the Armed Forces between 1970 and 1975, the data in Table 2 for that period as well may be interpreted as reflecting civilian labor force behavior.

An examination of the data shows that only the 14- to 24-year-old age group—for both sexes—is expected to increase its percentage distribution of the labor force between 1965 and 1975. The rising proportion of females 45 years and over during that same period is offset by a decline in the male component of that age group. Thus, younger workers will form an increasingly important part of the manpower pool in the next decade. It may be helpful to draw on the unemployment experience of this group in the recent past to form some conclusions regarding the future implications of these expected changes in labor force composition. In 1957, when the aggregate unemployment rate—4.3 per cent—was about the same as the prevailing rate in 1965—4.6 per cent—the unemployment rate for white teenagers was 9.9 per cent as compared to an unemployment rate of 18 per cent for nonwhite teenagers. In 1965, the unemployment rates for these same two groups were 12.2 per cent and 25.3 per cent, respectively. Thus, after almost 5 years of economic expansion, both groups of teenagers were characterized by a worsening of their unemployment positions, with nonwhites maintaining double the white unemployment rate in both periods. In the case of workers in the 20- to 24-year-old age group, the respective unemployment rates for white males for 1957 and 1965 were 7.1 per cent and 5.9 per cent; for nonwhite males, 12.7 per cent and 9.3 per cent. White females in this age group had an unemployment rate of 5.1 per cent in 1957 and 6.3 per cent in 1965; while nonwhite females had a 12.2 per cent unemployment rate in 1957 and 13.7 per cent in 1965. Although the relative position of both white and nonwhite males, 20 to 24 years old, improved between 1957 and 1965, their unemployment rates—as in the case of teenagers—were still above the over-all unemployment rate in both years. This indicates that younger workers—including the teenage group—continue to be at a disadvantage in sharing the employment benefits of a growing economy.

There are a number of reasons to explain the plight of younger workers. First, a sizable proportion of youths will, during any given period, either be new entrants to the labor force or in the job-changing category. Both these groups are marked by a high degree of short-term—transitional—unemployment. Their familiarity with the mechanics of the job market is limited, and their lack of experience or seniority makes them highly susceptible to layoffs. Among youths with less than a high school education, unemployment is even more of a problem—with unemployment rates about double those of high school graduates. Generally, most teenage and older youths will find employment in those occupations where skill requirements are low, and, consequently, where both earnings and job security are correspondingly low. These basic factors underlying the high unemployment rates for younger workers have been compounded as a consequence of two observable trends. First, the unemployment problem of youths has been intensified by demographic factors—such as the post-World War II "baby boom"—which have added substantially to the younger component of the labor force, and promise to continue to do so in the future—a point emphasized early in the analysis. Second, the rate of growth of unskilled jobs has been

Table 3

ACTUAL AND PROJECTED EMPLOYMENT, BY MAJOR OCCUPATION GROUPS, 1960-75

Major Occupation Groups	Actual				Projected*				Change 1960-65		Change 1965-75	
	1960		1965		1970		1975					
	Number (millions)	Per Cent Distribution	Number (millions)	Per Cent Distribution	Number (millions)	Per Cent Distribution	Number (millions)	Per Cent Distribution	Number (millions)	Per Cent	Number (millions)	Per Cent
TOTAL EMPLOYMENT	66.7	100.0	72.2	100.0	81.2	100.0	88.7	100.0	5.5	8.2	16.5	22.9
White-collar workers												
Professional, technical, and kindred workers	7.5	11.2	8.9	12.3	11.1	13.7	13.2	14.9	1.4	18.8	4.3	48.6
Managers, officials, and proprietors, except farm	7.1	10.6	7.3	10.2	8.4	10.3	9.2	10.4	0.3	3.9	1.9	25.3
Clerical and kindred workers	9.8	14.7	11.2	15.5	13.2	16.3	14.6	16.5	1.4	14.1	3.4	30.8
Sales workers	4.4	6.6	4.7	6.5	5.3	6.5	5.8	6.5	0.3	7.1	1.1	23.0
Blue-collar workers												
Craftsmen, foremen, and kindred workers	8.6	12.8	9.2	12.8	10.4	12.8	11.4	12.8	0.7	7.7	2.2	23.6
Operatives and kindred workers	12.0	18.0	13.4	18.6	14.2	17.5	14.8	16.7	1.4	11.7	1.4	10.5
Laborers, except farm and mine	3.7	5.5	3.9	5.3	3.7	4.6	3.7	4.2	0.2	5.2	−0.2	−4.0
Service workers (including private household)	8.3	12.5	9.3	12.9	11.0	13.5	12.5	14.1	1.0	11.9	3.2	33.8
Farmworkers												
Farmers and farm managers, laborers, and foremen	5.4	8.1	4.3	5.9	3.9	4.8	3.5	3.9	−1.1	−20.9	−0.8	−17.9

*Based on an assumption of 3 per cent unemployment.

SOURCE: **Manpower Report of the President and A Report on Manpower Requirements, Resources, Utilization, and Training,** U. S. Department of Labor (Washington: U. S. Government Printing Office, March 1966), Table E-6.

lagging behind the growth of higher skilled occupations—jobs which typically are not available to the relatively unskilled younger entrant to the labor force.

One of the more impressive aspects of the current economic expansion has been the turnaround in blue-collar employment growth from the 1957-60 experience when such employment declined by more than half a million. In particular, the increase in unskilled blue-collar workers in 1964 and 1965—300,000 in total—following a period of more than 10 years of no growth, was especially welcome at a time when sharply rising numbers of untrained teenagers were entering the labor market. However, in spite of the improved position of semiskilled and unskilled blue-collar workers during this expansion, these two groups still accounted for nearly one third of all unemployment in 1965. In addition, their unemployment rates remained well above the rates for either skilled blue-collar workers or white-collar workers, and also well above the over-all unemployment rate.

Table 3 provides estimates of projected employment by major occupation groups through 1975. The outlook for growth in the semiskilled blue-collar category in the next decade points toward a slowing down in employment growth from the 1960-65 rate. For the unskilled—nonfarm laborers—group, a decline by 4 per cent in the next decade is expected, in contrast with an increase of 5 per cent recorded between 1960 and 1965. Skilled blue-collar employment, on the other hand, is expected to grow at a rate three times faster than in the past 5 years. Among white-collar workers, the outlook calls for stepped-up employment growth over 1960-65 rates in the next decade. The expected growth in service-worker employment is equally bright. The outlook for farmworkers is for a continuation of declining employment levels.

The projections of either reduced or negative employment growth among the semiskilled and unskilled categories of blue-collar workers, shown in Table 3, take on added sig-

nificance in the context of an expected step-up in the rate of labor force growth in the next decade. Since the younger entrants into the labor force typically find access to the job market at the lower end of the skill spectrum, the projected shrinkage in these employment opportunities coming in the face of accelerated increases in the 14- to 24-year-old component of the labor force further compounds the problem of younger workers.

SOME FINAL THOUGHTS

The subject of unemployment encompasses a wide sweep and, in the course of this analysis, of necessity, much has been left unsaid. Emphasis has been placed on the plight of the younger worker group, because the problems of this largely unskilled group pose a most difficult dilemma for public policy planners. Considerable attention has been directed toward the relationship of economic growth to the problem of aggregate unemployment. It was shown that, in a dynamic economy, one has to run very fast to keep from falling behind, and faster still to move ahead. That lesson is applicable to the problem of unemployment for particular groups as well. An indispensable prerequisite to an improved unemployment picture for certain disadvantaged groups is a rapidly growing economy. The dramatic improvement in unskilled employment in 1965 attests to this. While high rates of growth in national output are indeed a necessary condition for reducing unemployment, the structure of the U. S. unemployment problem also indicates that rapid economic growth alone is not sufficient. More finely honed weapons will have to be forged and brought to bear on particular circumstances. In an economy operating at relatively high rates of resource utilization—measured in the aggregate—the cost of additional economic growth comes quite high. The dilemma facing public policy makers is to weigh that cost against the economic and social costs of unemployment in all its dimensions.

District Banking, 1961-65

By Frederick M. Struble

As the current economic expansion moves well into its sixth year with no signs of termination, a review of major developments at member banks in the Tenth Federal Reserve District over the first 5 years of this period seems appropriate. This article provides this review and attempts to place these recent developments in perspective by answering the questions: How has the recent experience of District member banks differed from their experience in the 1950's? In what ways has it been similar?

DEPOSIT DEVELOPMENTS

At the end of 1965, total deposits of member banks in the Tenth Federal Reserve District stood at $11.4 billion, approximately $2.8 billion above their level at the end of December 1960, a date which roughly corresponds to the beginning of the current business expansion. This increase of nearly 32 per cent was truly remarkable, surpassing the deposit growth recorded in the entire 9 years preceding this period.

This expansion appears even more remarkable when it is compared with the growth in deposits that took place in preceding periods of expansion. As shown by Table 1, banks did not usually experience large deposit gains during the periods of economic expansion in the 1950's. To the contrary, a sharp slowdown in deposit growth usually occurred. Deposits increased only 1 per cent over the 35-month expansion period ending July 1957 and only 2.8 per cent in the following 25-month expansion period ending May 1960. Moreover, it is apparent that the recent developments in both demand and time and savings accounts differ markedly from those in earlier periods. To be sure, the recent growth in time and savings deposits contrasts more dramatically with developments in earlier expansion periods, but the behavior of demand deposits also is markedly different, as demand deposits in-

Table 1

DEPOSIT GROWTH AT MEMBER BANKS IN THE TENTH FEDERAL RESERVE DISTRICT IN SELECTED PERIODS

Data For Period	No. of Months	Demand Deposits		Time Deposits		Total Deposits	
		In Millions of Dollars	Per Cent	In Millions of Dollars	Per Cent	In Millions of Dollars	Per Cent
Aug. 1954-July 1957	35	−126	−2.0	+199	+18.9	+73	+1.0
Apr. 1958-May 1960	25	−20	−0.3	+232	+16.3	+212	+2.8
Dec. 1960-Dec. 1965	60	+540	+7.9	+2,217	+122.4	+2,757	+31.9

creased moderately contrasting with declines in earlier periods.

The periods compared in this table are not strictly comparable. The current period under consideration—with a length of 60 months—was roughly twice as long as the two earlier periods. Moreover, the data for the earlier periods encompass developments over the full expansion phase from trough to peak, while the recent data reflect developments only from the trough to some date well short of the peak. Nonetheless, it is obvious that, even if full allowance is made for these discrepancies, the recent developments represent a marked departure from past experience.

Growth in total deposits at all member banks in the Nation over the first 5 years of the current expansion was even greater than at District member banks—total deposits expanded 42.7 per cent in the Nation compared with a gain of 31.9 per cent in the District. And, as was true for District member banks, this recent growth at all member banks in the Nation contrasts sharply with their experience in preceding expansion periods. This similarity provides a very important clue for explaining the recent deposit behavior at District member banks. With the advent of our modern communications system, our regional banking community has been well integrated into the national financial system, so that to a major extent developments at District member banks reflect the effects of forces dominating conditions at all banks in the country. One must look to these factors which affected deposit developments throughout the Nation over the period under consideration to find the explanation for the recent record deposit growth in the District.

A major factor encouraging the recent deposit growth at commercial banks was the sharp advance in income and savings that took place over the 5-year period, for this advance generated a substantial increase in demand for various types of financial assets. However, although this development created a climate conducive to deposit growth, it quite obviously was not the only factor responsible for the recent growth. Preceding periods of economic expansion also generated sharp increases in savings which led to increased demand for various types of financial assets; yet this did not lead to unusual deposit growth. In these earlier periods, a slowdown in growth of the reserve base available to the banking system and a sharp increase in interest rates on other financial assets—an increase relative to the rates that banks were able to offer on their deposits—acted as constraints on the ability of commercial banks to capture a share of the rising savings volume. In the current expansion period these constraints were relaxed. Changes in Regulation Q over this period—changes which increased the maximum interest rates banks were permitted to pay on time and savings deposits—enabled banks to compete effectively for a share of the rising savings that were channeled into various forms of financial assets. In addition, the Federal Reserve System followed a relatively easy monetary policy during the early years of this period and, even when monetary policy was tightened, this did not—as in earlier expansion periods—result in a marked slowdown in the availability of bank reserves.

The effects of these factors on the growth in deposits at District member banks can be detected in Table 2. The influence of a relatively easy monetary policy and relatively low interest rates on competing forms of financial assets in 1961 is in evidence, as demand deposits increased 7.3 per cent and time deposits rose 18.6 per cent. Over 90 per cent of the total 5-year growth in demand deposits was recorded in this 1 year. In addition, the expansion in time deposits was greater than in every other year of the period except 1962.

The effects of the first of four changes in maximum rates payable on time and savings deposits made effective on January 1, 1962,

Table 2

DEPOSIT GROWTH AT TENTH DISTRICT MEMBER BANKS
1961-65

	1961		1962		1963		1964		1965		Entire Period	
	In Millions of Dollars	Per Cent	In Millions of Dollars	Per Cent	In Millions of Dollars	Per Cent	In Millions of Dollars	Per Cent	In Millions of Dollars	Per Cent	In Millions of Dollars	Per Cent
Demand Deposits	+496	+7.3	−205	−2.8	+148	+2.1	+75	+1.0	+26	+0.4	+540	+7.9
Time Deposits	+337	+18.6	+527	+24.5	+447	+16.7	+449	+14.4	+457	+12.8	+2,217	+122.4
Total Deposits	+833	+9.6	+322	+3.4	+595	+6.1	+524	+5.0	+483	+4.4	+2,757	+31.9

also are clearly indicated, as growth in time deposits over that year was 24.5 per cent. This advance in time deposits was partly at the expense of demand deposits held at District banks, as the drop in demand deposits in 1962 would seem to suggest. A much more important source of funds for the growth in time deposits, however, would appear to have come from funds which otherwise would have been placed in other types of financial assets.

The competitive position of banks was reinforced by further upward movements in maximum permissible rates on July 17, 1963, November 24, 1964, and December 6, 1965. These additional increases permitted banks to offset the effects of rising interest rates on competing financial assets as the period progressed, increases induced by a continued strong credit demand and a slowly tightening monetary policy. Over the final 3 years of the period, time deposits continued to expand at historically high rates, although there was a noticeable decline in annual rates of expansion over this period. Growth in demand deposits was generally weak over this period.

The behavior of demand and time deposits over this recent period augmented a trend in the composition of deposit accounts that may be traced to the early 1950's. Since that time, there has been a generally steady upward movement in the proportion of time and savings deposits in total deposits at District banks. This ratio moved slightly above 35 per cent at the end of 1965, up from 22.9 per cent at the end of 1960 and 10.5 per cent at the beginning of the 1950's.

ASSET DEVELOPMENTS

The funds obtained from the record expansion in deposits over the 5 years ending last December enabled District member banks to make substantial additions to their holdings of earning assets, as total loans increased 63.3 per cent and total investments 16.4 per cent. The advances in these accounts fell somewhat short of those recorded at all member banks in the Nation, where total loans increased 69.5 per cent and total investments expanded 23.7 per cent. In the process of expansion, the structure of their asset portfolios was altered considerably. In many respects, these alterations closely coincided with the types of restructuring that occurred throughout the 1950's, particularly during the periods of economic expansion in that decade.

As indicated in Table 3, the composition of asset growth at District member banks varied considerably over the period. In 1961, total investments increased as rapidly as total loans, as almost 60 per cent of the expansion in total investments over the entire period occurred in this 1 year. In the following years, however, a continued strong demand for loans, together with a smaller expansion in total deposits, held down the growth in total investments. In fact, in 2 of the final 4 years of this period, moderate reductions were made in investment holdings, although for the 4 years as a whole a net advance was recorded.

In contrast to the slowdown in investment growth, the growth in loans remained strong throughout the period with the largest an-

Table 3

ASSET GROWTH AT TENTH DISTRICT MEMBER BANKS 1961-65

	1961		1962		1963		1964		1965		1961-65	
	Thousands of Dollars	Per Cent	Thousands of Dollars	Per Cent	Thousands of Dollars	Per Cent	Thousands of Dollars	Per Cent	Thousands of Dollars	Per Cent	Thousands of Dollars	Per Cent
Loans and Investments	746,876	10.4	541,286	6.8	497,260	5.9	660,370	7.4	645,440	6.7	3,091,232	43.0
Total Loans	423,326	10.4	434,936	9.7	501,263	10.2	549,586	10.1	673,710	11.3	2,582,821	63.3
Total Investments	323,550	10.4	106,350	3.1	−4,003	−0.1	110,784	3.1	−28,270	−0.8	508,411	16.4
U. S. Treasury Securities	238,791	10.0	−24,375	−0.9	−113,258	−4.4	−15,866	−0.6	−205,696	−8.3	−120,404	−5.0
Other Investments	84,759	11.8	130,725	16.3	109,255	11.7	126,650	12.1	177,426	15.2	628,815	87.4

nual advance actually occurring in 1965. Substantial gains were recorded in all major loan categories over the 5-year period. The largest absolute gain was recorded in business loans as these accounts increased $758 million, or by 55 per cent. Absolute growth in other major categories was not as great but the percentage increases in these categories exceeded the growth in business loans. The advance in these loan categories in both absolute and percentage terms were: real-estate loans, up $543 million or by 87 per cent; nonguaranteed loans to farmers, up $414 million or by 65 per cent; and consumer loans, up $679 million or by 79 per cent.

The structure of investment accounts was altered considerably over this period. Holdings of U. S. Treasury securities, after increasing rather sharply in 1961, declined in each of the following 4 years. In contrast, "other investments"—mainly state and local bonds and federal agency issues—increased consistently and substantially throughout the period. The net result of these developments was a 5 per cent decline in holdings of U. S. Treasury issues and an 87 per cent increase in holdings of other securities. This reduced the proportion of U. S. Treasury securities in total investment holdings to roughly 63 per cent, down from about 77 per cent at the start of the period.

Table 4

ASSET RATIOS AT DISTRICT MEMBER BANKS ON SELECTED DATES

	Dec. 1950	Dec. 1955	Dec. 1960	Dec. 1965
Loan/Total Asset	27.3	31.5	39.0	47.4
Cash/Total Asset	27.0	25.1	20.8	17.5
U. S. Treasury/Total Investment	82.9	79.0	76.9	62.7

CHANGES IN DISTRICT BANK LIQUIDITY

The percentage increase in total loans at District member banks was almost twice as large as the gain in total assets. Consequently, the ratio of loans to total assets increased further over the period. In addition, changes in two other measures also give some indication of a decline in liquidity at District member banks. As previously discussed, the proportion of U. S. Treasury securities in total investment holdings of District member banks declined over the period. Since U. S. Treasury securities are generally more marketable than other types of investments, the decline in this ratio would appear to imply a reduction in the liquidity of member bank asset portfolios. The proportion of cash assets in total asset holdings also declined over the period, dropping from 20.8 per cent to 17.5 per cent. While it is widely recognized that each of these ratios are but crude measures of bank liquidity, taken together the changes in these indexes would appear to point rather clearly to a substantial reduction in the liquidity position of member banks over the recent period.

This development is not unique to the period under discussion, as the measures of these ratios in Table 4 clearly indicate. To the contrary, the liquidity of District member

banks has declined almost steadily since the early 1950's with only minor interruptions in this trend occurring during periods of recession.

Several reasons can be given for this almost steady decline in liquidity positions. One of these is that the stark comparison of the current position with that prevailing in the early 1950's gives a somewhat distorted picture. Quite clearly, District member banks were then in what might be called an excess liquidity position. For example, the loan to total asset ratio was not much higher than it was at the end of World War II when it was at a historically low level. Moreover, experience of the past 20 years has led to a considerable reassessment of the need for liquidity by banks. Preferences for a given condition of liquidity in asset portfolios depend, to a great extent, upon an assessment of how likely it is that substantial declines in deposits will occur. And postwar experience would seem to indicate to banks that this contingency is much less likely today than it was believed to be 20 years ago, for total deposits of all member banks in the District, as well as in the Nation, have increased almost steadily since the end of the War.

A further factor that quite possibly helps to explain past declines in liquidity positions is the previously mentioned trend toward a greater proportion of time and savings deposits in total deposits. Historically, the volatility of these deposits, particularly the savings deposits, is much lower than that of demand deposits, and it seems likely that this has led District member banks to reappraise their need for maintaining a highly liquid asset portfolio.

Each of these considerations provides a fairly acceptable explanation for the demonstrated willingness of District member banks to reduce their liquidity positions in the past. It is a matter of judgment, of course, whether they also lead to the conclusion that a further reduction in liquidity will be permitted in the future. The fact that changes in these liquidity measures over the current expansion period occurred at least as rapidly as in the 1950's suggests, however, that District member banks will permit some further decline in their liquidity positions. Supporting this conclusion is the added fact that the liquidity of District member banks, at least as indicated by a comparison of the loan-asset ratios, remains higher than that for all member banks in the Nation.

These comments apply only to the decisions of member banks in the aggregate. It is quite possible, of course, that preferences will differ markedly among individual banks. However, it is difficult to find any particular group of banks in the District in which the logic of these statements would not seem to apply. For example, one type of grouping—by size—initially might indicate marked differences in preferences among groups of banks. In this regard, however, Table 5, which compares developments in loan-asset ratios at six groups of banks classified according to size, is worth examining. Two characteristics of the data in this table are most striking. The first is the rather marked similarity in the levels of these

Table 5

LOAN-ASSET RATIOS AT DISTRICT MEMBER BANKS GROUPED ACCORDING TO DEPOSIT SIZE ON SELECTED DATES

	Under $1 Million in Deposits	$1-2 Million in Deposits	$2-5 Million in Deposits	$5-10 Million in Deposits	$10-50 Million in Deposits	$50 Million and Over in Deposits
1950	30.5	29.9	25.9	24.8	24.3	27.5
1955	35.0	33.6	30.4	29.5	30.2	34.0
1960	39.6	40.2	38.6	37.1	39.1	44.3
1965	49.3	46.8	47.5	47.1	46.8	51.0

NOTE: These ratios were computed by averaging arithmetically the ratios of individual banks in each size group.

ratios at the different groups of banks at the end of 1965. While differences do exist, they are not wide and there does not appear to be any consistent relationship between size and the level of this ratio. For example, the ratio for the smallest group of banks is higher than for any other group except the very largest.

The second interesting characteristic is the general similarity in the manner in which these ratios have changed over time. Again, to be sure, there are some differences in the changes in these ratios over the full 16 years among the different size groups of banks. But, in general, the correlation among the changes is obviously quite high.

SUMMARY AND CONCLUSIONS

Periods of rapid economic expansion customarily have generated strong demands for credit at member banks in the Tenth Federal Reserve District and the current expansion period has been no exception. The manner in which the current expansion has been financed to date differs markedly, however. In contrast to past experience, District member banks were able to increase their deposit accounts sufficiently from 1961 to 1965 to finance not only a substantial growth in total loans but also a moderate increase in their investment holdings. Growth in total assets lagged substantially behind the gain in total loans over the period, however, and as in past periods of expansion, the ratio of loans to total assets increased further. In addition, the ratio of cash assets to total assets was reduced and the proportion of U. S. Treasury securities in investment portfolios declined. Thus, District member banks began the sixth year of the current expansion with greatly expanded asset and deposit accounts but substantially reduced liquidity positions.

Over the first 6 months of this year total deposits increased only .8 per cent compared with gains of 2.2 per cent and 2.4 per cent during the same periods in 1965 and 1964. It seems a safe assumption that growth in deposits throughout the remainder of this year, at least, will fall short of that recorded in earlier years of this expansion. The effects of the tight monetary conditions currently prevailing would seem to point in this direction. Moreover, with interest rates on competing financial assets already at historically high levels, the competitive opportunities that banks derived from the increases in maximum rates allowed under Regulation Q in recent years would appear to have diminished. Finally, the recent Regulation Q changes—changes restricting the rate of interest banks can pay on multiple maturity time deposits to 5 per cent for certificates with first maturity over 90 days, and 4 per cent on those with first maturity of less than 90 days—and the increase in reserves required to be held against time deposits may place a further dampening influence on deposit growth at District member banks.

While it is possible to point to these factors which suggest a slowdown in deposit growth in coming months, there are few signs that a comparable reduction in loan demand will occur. Although the growth in total loans during the first half of this year fell below that recorded in 1965 and 1964, the advance was sizeable. This expansion took place against a background of reduced liquidity positions at District member banks, which suggests that the banks found it necessary to meet a large part of this demand despite the further effects this would have on their liquidity positions.

Taken together, these projections of deposit growth and loan demand indicate that the coming months will be a particularly challenging period for member banks in the Tenth Federal Reserve District.