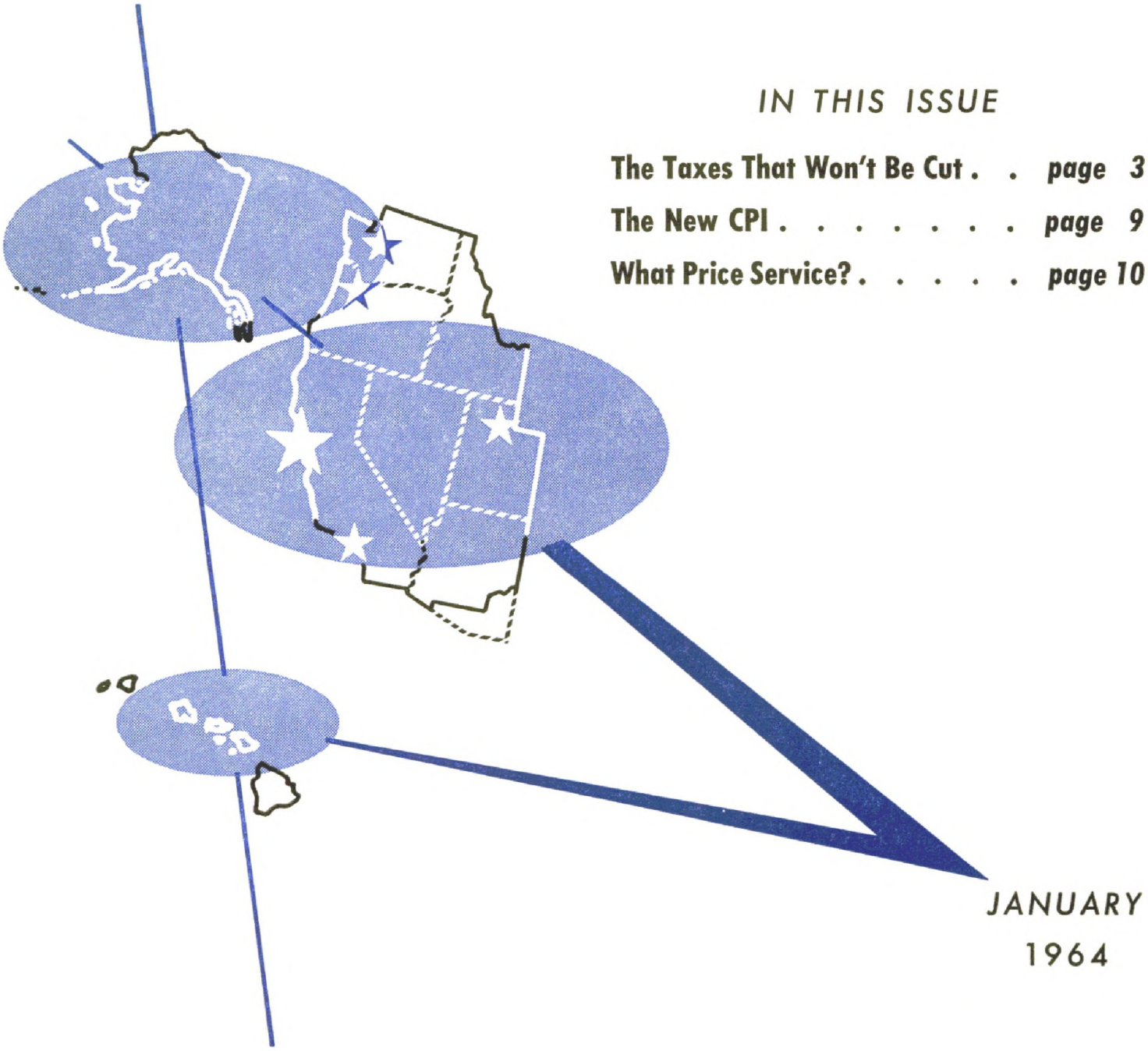
FEDERAL RESERVE BANK OF SAN FRANCISCO

MONTHLY REVIEW



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The Taxes That Won't Be Cut

THE taxpayer's joyous expectation of an $11 billion reduction in Federal taxes perhaps should be tempered by the realization that state and local taxes, in 1964 and in the years to come, will almost certainly continue their inexorable upward surge. The nation's demand for more schools, more highways, and more health and welfare services — all of which are predominantly financed through state and local governments—has more than doubled the state and local tax bill just within the past decade, and no relaxation in that demand is in sight.

The Johnson Administration has given explicit recognition to the state and local financial problem, by presenting the proposed tax cut as a device for releasing resources which can be utilized for meeting community needs as well as for meeting the individual needs of consumers and businessmen. But what are the dimensions of these community needs? How much must the state and local governments collect in increased taxes to satisfy those requirements, and how will their increasing tax bite interact with the Federal government's decreasing take?

Released resources

The funds scheduled to be released by the Federal tax cut, according to the House bill passed last year, would include almost $9 billion in individual tax reductions and more than $2 billion in corporate tax reductions. The $11 billion total tax cut would be the net result of some major cutbacks in the tax laws, partially offset by other changes which would increase the payments of some taxpayers.

The bulk of the tax saving would result from a change in the rate scale applied to individual incomes; the range would be pared from 20-91 percent to 14-70 percent. In addition, several provisions would reduce further the tax burden on low-income groups. The most important of these provisions, scheduled

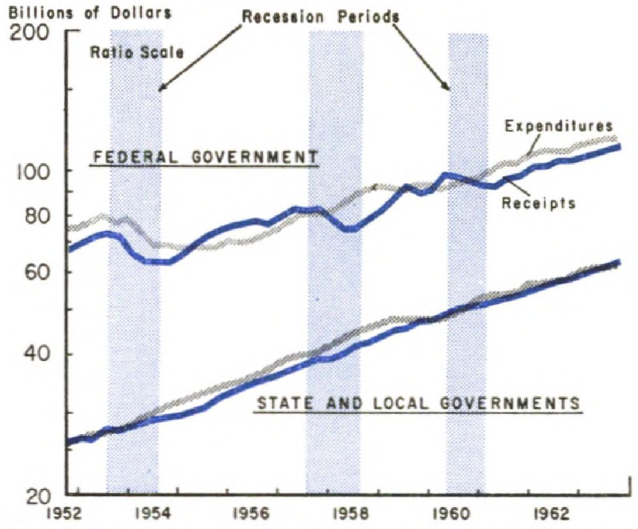
to reduce tax payments by about $320 million, would impose a minimum standard deduction of $300 for single persons and $400 for married couples filing joint returns; at present, the standard deduction is $1,000 or 10 percent of taxable income, whichever is the smaller of the two.

For corporations, the normal tax rate would be reduced but the surtax rate applied to taxable income over $25,000 would be increased; the net result would be a lowering of the combined rate from 52 to 50 percent in 1964 and to 48 percent in later years. (Again, the figures are from the 1963 House bill.) On the other hand, the Act also contains provisions for accelerating corporate tax payments. The present law permits corporations to pay half of their tax liability over $100,000 during the year it is incurred, and the other half during the first two quarters of the following year. The planned acceleration would shift the timetable for tax payments made by large (but not small) corporations, so that by 1970 all taxes on income over $100,000 would be paid in the current year.

The rising spiral

How would the resultant $11-billion reduction affect total collections from state-local taxes as well as Federal income taxes? In the first place, it may be assumed that the growing needs of state and local governments will cause their tax burden to increase, quite apart from any change in the Federal tax burden. In the second place, only $7 billion of the $11 billion Federal tax cut will take effect in 1964, even if the new law is retroactive to January 1. But specifically, the total take from Federal, state, and local governments was about $5-6 billion higher in 1963 than in the preceding year; in 1964, the total take probably would be increased almost as much as if there were no tax cut but would be reduced by $1-2 billion if a tax cut were made retroactive to January 1. The latter eventuality could develop partly because of rising incomes, which would permit a growing tax base to offset part of the reduction in Federal rates, but also because of the steady rise expected in state-local tax revenues.

Rapid growth of expenditures strains state-local tax resources

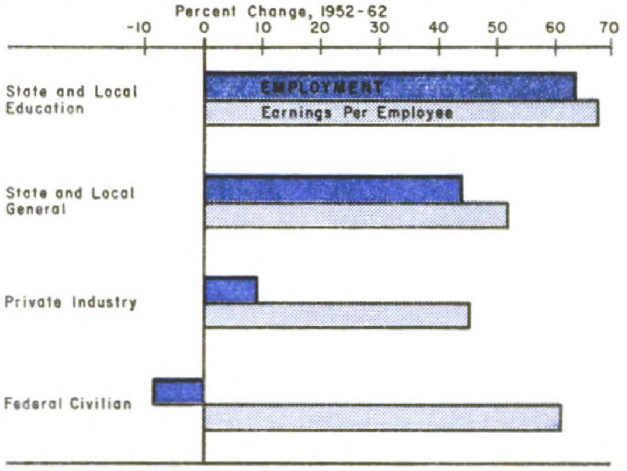


Source: U. S. Department of Commerce (national income basis).

In recent years, state-local revenues have been rising by $4-5 billion annually; the total in 1962 was $59 billion (including $8 billion in Federal grants-in-aid), and it reached about $64 billion in 1963. Yet even at this level, revenues have been hard put to match the ever-growing volume of expenditures. The 50 states and the multitude of local government units now spend about $63 billion annually, which works out to more than $300 a year for every resident of the United States. The most striking phenomenon about state and local expenditures, however, is their continued uptrend; these expenditures have expanded more rapidly than gross national product ever since the turn of the century, and their growth in relation to GNP has speeded up during the last decade.

Rapid increases in both employment and employee earnings have contributed to this much greater increase in state and local expenditures. In the last decade, the education sector recorded gains of over 50 percent in

Wages rise everywhere . . . job gains centered in state-local sector



Source: U. S. Department of Commerce.

both employment and average earnings, and the general administration sector did almost as well. Private industry and the Federal civilian sector also experienced substantial wage increases during this period, but their increases in total payrolls were smaller because of much smaller gains in employment.

The mushrooming of state-local expenditures can be explained partly by the rapid rise in the postwar demand for government services—a rise stimulated by substantial population growth, a shift in the population mix (with increased concentration in the youngest and oldest age brackets), and a heavy migration of people to urban and suburban areas (which provide an increasingly extensive, as well as expensive, range of services). But a major part of the spending increase has been due to a substantial increase in prices, which is related to the fact that this sector's disbursements are dominated by such increasingly expensive cost items as employee payrolls and construction.

From cradle to grave

The most noteworthy element in this upsurge of state and local spending has been the increasing demand for public education —now a $20 billion annual item. The nation's population has increased 20 percent in the last decade, and the school-age population has increased even faster. State and local governments, which provide more than 95 percent of the funds for education, have thus felt the constant pressure of this growth. They have also felt the pressure of demands for increased spending per pupil, created by the nation's increasing emphasis on higher teacher salaries and improved curricula and equipment. As one consequence of this dual drive for greater quantity and improved quality of education, state and local governments have doubled their school-construction bill (to $3 billion a year) just within the past decade.

Another major expense has been transportation facilities—a $10 billion item. During the past decade this item has more than doubled, because of the construction and improvement of highways, waterways, and air transport facilities. But the trend of these expenditures recently has tended to level off, and thus it may not represent so intense a worry to budget makers as some of the other expenditure items.

Other major spending categories—public assistance and relief, and public health and sanitation—have increased substantially during the past decade to around $12 billion.

These expenditures have not risen quite so rapidly as total expenditures, but their costs tend to increase with population growth and urbanization, so state and local governments seem destined to require ever-growing sums for such purposes.

California and the West provide the outstanding examples of expanding community needs and rising spending. To finance its rapidly growing activities, California increased its state-local tax take from $2 billion to more than $5 billion just within the the past decade, and thereby increased its share of the national total from 10.5 to 12.5 percent. Other District states as a group have grown less rapidly, but have continued to account for roughly 5 percent of total state-local tax revenues.

Where the money comes from

The pressure of expanding activities, rising prices, and higher salary scales has helped to create the widely-discussed fiscal "crisis" of state and local governments. To meet this situation these governments have called increasingly upon the resources of the capital market as well as upon the resources of the Federal government and their own taxpayers. Increased borrowing throughout the postwar period has pushed total state-local debt to about $85 billion, or to more than one-fourth of the level of the Federal debt. But while Federal government debt per capita has declined during the postwar period, state-local debt per capita has more than tripled, from $113 in 1946 to $436 in 1962.

The state-local fiscal "crisis" has also developed from the pressure to find adequate tax resources to meet the ever-rising trend of expenditures. The problem is related to the capacity of the state-local tax structure to siphon off its share of the increases in incomes and consumer expenditures that develop from the growth of the national economy. This tax structure, despite its many criticized features, however, has been successful in increasing total collections in the 1952-62 period from about $20 billion to about $43 billion, divided equally between the states and the myriad local government units.

States still rely mainly on sales taxes for their current revenue. To supplement this source, however, many states by now have turned increasingly to income taxes. Corporate tax payments to state governments have doubled since the early postwar period, and the increase in individual income tax payments has been even more striking; in fact, individuals have so far outdistanced corporations as a tax source that the latter, which used to pay more into state coffers than individuals, now contribute less than half as much. Even so, individual income taxes still provide only about one-eighth of state tax revenues, as opposed to the three-fifths share contributed by sales taxes.

At the local level, the principal tax remains the property tax. Today, as for years past, taxes on property account for nearly 90 percent of all the revenues collected by local governments; another 7 percent comes from sales and gross receipts taxes, and the remainder from income and miscellaneous taxes.

In general, then, the tax structure of state and local governments has not changed markedly over the past decade, despite increasing reliance on income and other taxes which cause revenues to grow as the economy grows. The states now obtain about 20 percent of their revenue from income taxes but still rely on sales taxes as the foundation of their tax systems; local governments obtain less than 2 percent of their revenue from income taxes and still depend overwhelmingly on property taxes.

Will the multiplier multiply?

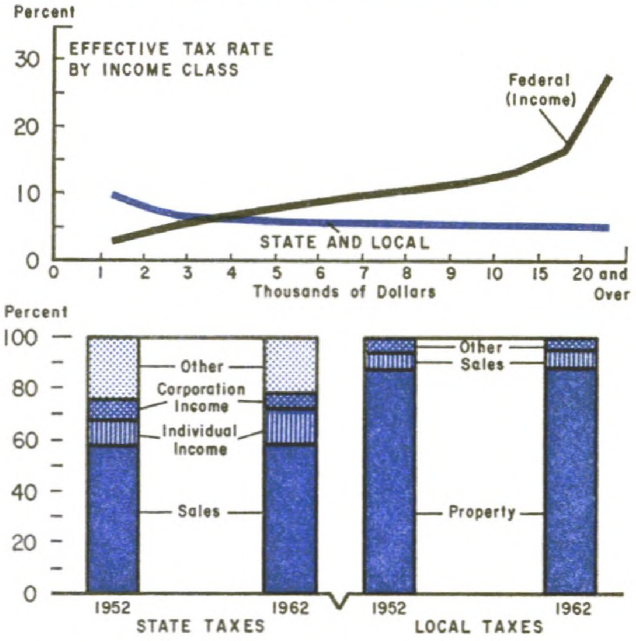
The proposed Federal tax cut is expected to ease this state-local tax problem, by stimulating business and consumer spending so that the present state-local tax structure yields

more than it did in past years. According to the official Administration argument, the tax cut should stimulate extra spending by consumers and business investors, and it should thus help to close the $30 billion gap between actual and "potential" GNP. This conclusion is based on the pragmatic assumption that a "multiplier" of roughly 2 can be applied to the initial spending increase, since the higher incomes generated by that initial increase will generate still further increases in incomes and spending in an endless (albeit diminishing) chain.

The strength of these secondary bursts of spending may depend, however, on which consumers and businessmen get more to spend. This presents, in other words, a question of tax incidence. People who pay less taxes, of course, will have more money left to use for other purposes, but the extent to which the reduced tax dollar is reflected in higher consumption spending or saving depends on the size of the reduction in each individual's tax burden. Since the percentage of income consumed typically declines as individuals move up the income scale, a reduction in taxes paid by people in the lower-income brackets should raise consumption more than an equal reduction of taxes contributed by people in the higher-income brackets.

The proposed cut in Federal tax is designed to achieve precisely that effect; for example, the average reduction in tax liability would be 38 percent for taxpayers in the $0-$3,000 bracket, 20 percent for those in the $5-10,000 bracket, and 15 percent for those in the $20-50,000 bracket. But will the spending urge created in these families through the courtesy of the noncollecting Federal tax collector be reduced by the dunning of the state-local tax collector? The answer may depend upon the extent of regressiveness in the state-local tax structure, that is, the extent to which lower income groups pay more tax in relation to income than do higher income groups. The answer may also depend upon the difference in impact between the type of tax that is scheduled to be reduced—the Federal income tax—and the type of tax that almost certainly will not be cut—the regressive group of state-local taxes.

Tax structure at state-local level depends on property, sales taxes



Source: Internal Revenue Service; Bureau of the Census.

Facts versus theories

The facts are rather clear about the continued regressiveness of the state-local tax structure, despite the slightly increased importance of (progressive) state and local income taxes. Most studies show that property and sales taxes have created a regressive state-local tax structure, as opposed to the progressive Federal structure created by the income tax. According to one basic study, in 1954 the tax-payment-to-income ratio, on the state-local level, ranged from 11 percent for the $0-2,000 bracket to 8 percent for the $10,000-and-over bracket, while on the Federal level the corresponding tax-to-income ratios were 16 and 33 percent respectively.[1]

[1] Richard A. Musgrave, "Incidence of the Tax Structure and Its Effects on Consumption," Papers Submitted by Panelists—*Federal Tax Policy for Economic Growth and Stability* (Washington: Government Printing Office, 1956).

An examination of a limited group of tax returns for 1960 reveals essentially the same regressive pattern as in earlier years, which is not surprising in view of the relatively stable nature of the state-local tax structure. This examination, limited to returns of individuals who listed their state-local tax payments as deductions on their Federal tax returns, shows a moderate regression in the state-local structure but, of course, a definite progression in the Federal income structure.

This 1960 analysis shows that the state-local tax burden was 9.9 percent for those in the $1,000-1,500 adjusted-gross-income bracket, 6.7 percent for those in the $2,500-3,000 bracket, and 5.7 percent for those with incomes of $5,000 or more. For those same categories, the Federal tax progression ranged from 2.5 to 5.2 to 14.6 percent. As a result of these contrasting patterns of incidence, taxpayers with incomes below $2,000 paid more taxes to state and local governments than they paid in Federal income tax.

So much for the difference in incidence between the two types of tax structure. But the more important question remains—will this difference reduce the stimulus to consumer and other spending expected as a result of the $11 billion Federal tax cut? The answer may well be — theoretically, yes; practically, no. Theoretically, the state-local tax structure may limit the ultimate expansion initiated by the Federal tax cut; practically, the increase in state-local tax revenues resulting from their regressive structure should be only a small offset to the expansive force created by the Federal tax cut.

The amount of goods and services that will be purchased by the average taxpayer (especially the lower-income taxpayer) may very well be restrained by the regressive state-local tax structure—but only on certain conditions. One qualification is fairly obvious: the individual burden may actually be lessened if the burgeoning demands of state and local governments are met through an enlarged tax base (such as could be created by a strong economic expansion) rather than through increased tax rates. The beneficent effects of an expansionary tax reduction at the Federal level thus could swamp the restraining effects of a regressive state-local tax structure.

State and local governments, of course, will continue to exert an expansionary influence of their own through a large and rising level of spending for community needs. On the restrictive side, meanwhile, these governments seem far more likely to restrict consumer and business spending through their rising tax take than through their regressive tax structure. (As was suggested earlier, the total effect this year of an expansionary tax base, a reduced Federal take, and a larger state-local bite may be only a modest, rather than a substantial, decline in total revenues.) All these considerations thus add weight to the official argument that economic expansion dictates a reduction in taxes at least at one major level of government in 1964.

The New CPI

The "new" consumer price index now being unveiled by the Bureau of Labor Statistics will be based on prices in an up-to-date sample of cities, retail stores, and service establishments. The list of consumer goods and services for which prices are obtained will be modernized, and the index will be calculated with expenditure weights which reflect spending patterns for urban wage-earner and clerical consumers in 1960-61.

Throughout the first half of this year, BLS will publish both "old" and "new" series, both based on the period 1957-59=100. The "old" series will not be continued beyond the middle of 1964; instead, the updated index will be considered as a continuation of that previously published series.

To make the index more representative of the total urban wage and clerical-worker population, BLS has extended its sample coverage to include single persons. A national index covering only wage-earner and clerical-worker families of two or more persons will also be published, as in the past, for the convenience of those who prefer to adhere to the more limited index.

To make the index more representative of changing consumer spending habits, the Bureau has based its index weights on current expenditure surveys, rather than on the 1950-51 surveys from which the "old" index weights were derived. The updated index also will introduce some changes in the list of published group and subgroup indexes. Henceforth, the five major groupings will be: food, housing (including shelter, fuel and utilities, and household furnishings and operation), apparel, transportation, and health and recreation.

To make the index more representative of the nation's changing pattern of population, BLS has developed a national index by combining city indexes with weights based on the 1960 Census of Population. Thus, price trends in rapidly-growing Los Angeles, for example, will influence movements in the national index more than heretofore. The revised city sample contains 50 metropolitan areas and cities selected to represent all urban places in the country (including Alaska and Hawaii).

Individual city indexes will be published, for families and single consumers combined, for 14 large metropolitan areas which were included in the "old" index. The list includes three District areas—Los Angeles, San Francisco, and Seattle. In addition, individual indexes on the updated basis will be available this year for three new areas (including Honolulu), and will be available in 1966 for six other areas (including San Diego). However, several other areas (including Portland) will be dropped from the index this year.

It should be emphasized that city indexes indicate only the difference in the rate of price movement in various cities; they cannot be used to compare price levels in one city with those in another, as a true cost-of-living index would. Nonetheless, rough intercity comparisons can be made on the basis of BLS consumer expenditure data. For example, recent estimates derived on this basis by the National Industrial Conference Board show that consumers generally encounter higher living costs in the major Western cities than they do elsewhere.

According to these estimates, living costs last spring for the average Los Angeles family were 2.5 percent higher than in Washington, D. C., while costs were 4.4 percent higher in Seattle and 8.3 percent higher in San Francisco. Average living costs were also above the Washington level in New York and Chicago, but were below that norm in most of the larger Midwestern and Southern cities.

What Price Service?

STATISTICIANS and labor contract negotiators, as well as ordinary consumers, will follow with great interest the revised index of consumer prices that is scheduled to make its introduction next month. They will be primarily interested in whether the new index—based on an up-to-date consumer expenditure pattern that recognizes the increasing importance of service items as compared with food and other commodity items—will behave any differently than the index which it replaces. If the consumer price index rises more rapidly than heretofore, it may well become a front-page story again (after several years of relegation to the back pages), and this will be true even if a more rapid rise results only from the statistical procedure of assigning more weight to the (service) components which have increased most rapidly in price and in consumer preference during the postwar period. This possible development — even though its net effect may be somewhat small —suggests the need for a new look at the diverse behavior of the major CPI components.

Up, down, sideways

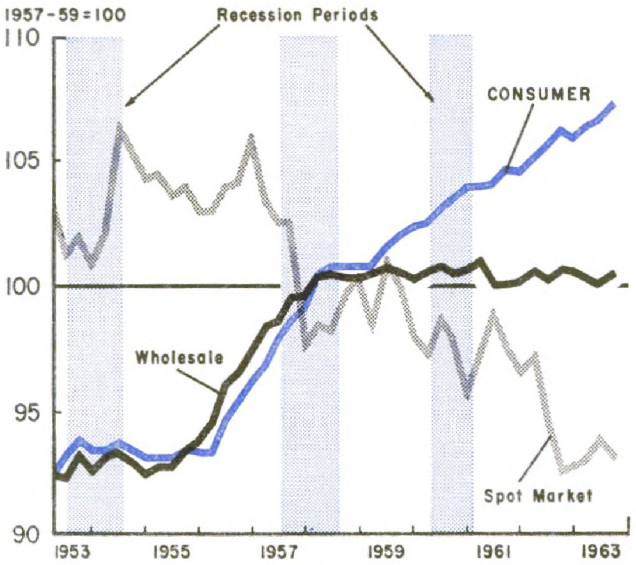
It should be noted at the outset that the various national price indexes—such as the consumer, wholesale, and spot market indexes—each measures price changes at different levels of business activity; thus, they need not follow the same path—and frequently (as today) move in different directions. In recent years, the absence of a strong upward trend has been a prominent characteristic of two of the most widely-known price indexes: the spot market index and the wholesale price index. The spot index—which is designed to measure price movements in 22 primary industrial commodities that are usually among the first to reflect changes in economic conditions—has failed in the last decade to regain the peak it attained during the period of Korean hostilities and is currently about 2 percent below its level at the February 1961 cyclical trough.

The wholesale price index, which measures prices at a later stage of the productive process, scarcely has budged in the last five years; its most recent reading (November) was 100.7 percent of the 1957-59 average. High levels of agricultural and manufacturing productivity, unused industrial capacity, and the competitive pressures of new products and foreign imports have consistently held the index below its level at the beginning of the business expansion in February 1961. (In the comparable expansion of the two preceding business cycles, the wholesale index moved upward by almost 6 percent and by 1 percent, respectively.)

The behavior of the consumer price index stands in marked contrast to the long-term decline or stability of the other two indexes. This index, which measures average price changes in the "market basket" of goods and services purchased by city wage earners and clerical workers, rose almost 6 percent between mid-1958 and mid-1963, for an average annual increase of about 1.2 percent. The annual increase in the prior five-year period —which was concentrated in the years 1957-58—averaged 1.6 percent. The continuing increase supports the contention that inflation is still "creeping," but the deceleration in the rate of increase also shows that the process is slowing down. Nonetheless, in either case the CPI has exhibited a stronger upsurge than the other two yardsticks.

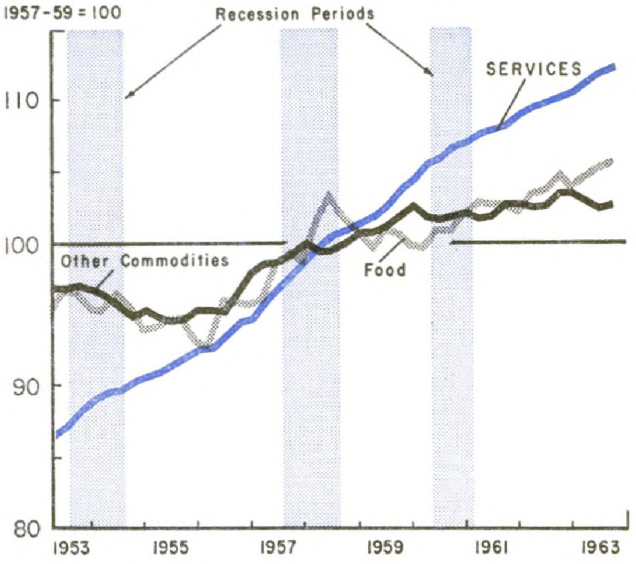
Much of the difference in the behavior of the various indexes can be explained by the fact that the indexes measure prices at different stages of the productive and distributive process. But more important has been the influence on the consumer price index of the dramatic upward trend in service prices,

Consumer price rise contrasts with movement of other indexes



Source: Bureau of Labor Statistics.

Expensive services dominate gain in consumer price index



Source: Bureau of Labor Statistics.

which are not included in the other two indexes. Throughout the last decade, service prices have risen annually, without interruption, at almost triple the rate of commodity prices. In the last half of the decade alone, service prices recorded an increase of 11 percent, while commodity prices rose by only 3 percent. Despite the perennial outcry of housewives, the cost of the major nondurable product—food—has risen only slightly in the last five years. In fact, the major increase in this category has occurred because of the soaring costs of restaurant meals, an expenditure which contains a large service element despite its classification as a nondurable commodity. In the last five years, meanwhile, prices of durable goods—automobiles, appliances, and other household furnishings—have exhibited remarkable stability, recording only a ½ percent increase despite substantial improvements in quality.

The culprit: services

In glaring contrast to this stability in commodity prices is the record of service prices in the last five years. Rents and medical-care services showed 7 and 21 percent gains, respectively; transportation services shot up by 11 percent, while prices of gas, electricity, and other household maintenance expenses showed a similar increase. The increase in service prices has slowed considerably since 1960, however. Between 1953 and 1960, the annual increase in service prices averaged 2.7 percent, but in each of the last three years, the annual increase has been 2 percent or less. Does this deceleration indicate that inflation in service prices is slowing to a "creep"? The answer can only lie in further analysis of the underlying characteristics of the market for individual services.

To some extent, the more rapid gain in service prices has gone along with a shift in the pattern of consumer expenditures. Over the postwar period, total outlays for services (in current dollars) have risen steadily; in fact, the continued growth in services during each of the postwar recessions offset part of the weakness in purchases of goods, particularly durable items. As a result, the share of services in the consumer budget has risen, in constant dollar terms, by several percentage points during the last decade. The record has been even more spectacular in current dollar terms; on that basis, the service share rose

from 35 to 41 percent between 1953 and 1961, and has since stabilized near that 41-percent level.

The three-year plateau in the service share of consumer spending may be partly responsible for the recent deceleration in the advance of service prices. This development suggests that market pressures during the present decade may generate a much less dramatic upsurge in this sector than during the 1950's. The strength of individual market pressures can only be evaluated, however, in terms of the complex diversity of the service component of the consumer price index.

Services, unlike commodities, are intangible consumer items that are produced and consumed simultaneously. Based on this distinction, the category of services in the consumer price index is broader than might be expected. In addition to medical care and transportation services, which are easily distinguished as service items, the total includes categories for rent, household-operation services (such as gas and electricity), and "other services." Rent is included as a service item because rented housing provides the "service" of the rented dwelling unit. "Other services" include such intangible items as homeowner costs (mortgage interest, insurance, taxes, and repairs), personal care, and recreation.

Soft-hearted landlords?

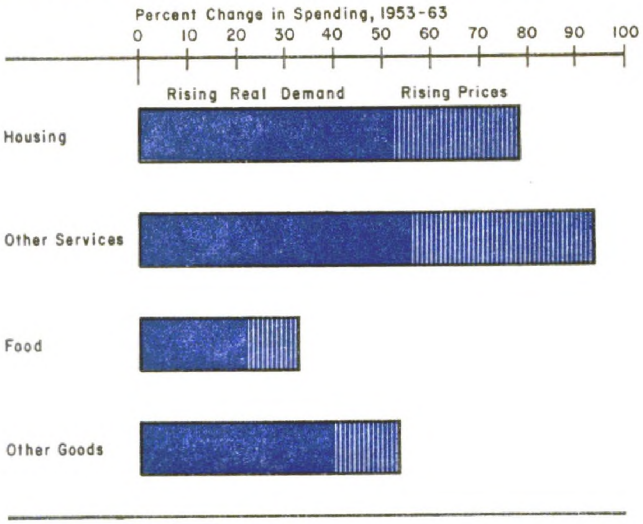
Some analysts have attributed the postwar spurt in service spending and prices chiefly to an explosion in demand for housing. Actually, rents have not been primarily responsible for the increase in service prices, nor has housing accounted for as much of the shift toward services as commonly supposed. Even during the period of their most rapid ascent—the 1947-53 period of relaxation of Federal controls—the annual increase in rents of 7 percent hardly surpassed the advance in other service prices. Then, in the following decade, rents rose 20 percent, while other service prices rose 30 percent.

In the last five years, moreover, there have been further signs of lessening pressure on rental rates. The average annual increase in rents has dropped to about 1.3 percent, vacancy rates have risen, and the share of housing in total consumer spending has stabilized. Few analysts expect that housing demand will surge upward in the near future as it did in the early postwar era, since (with backlog demand satisfied) its growth will depend on changes in such long-run factors as household formation and population growth. Rents carry a substantial weight in the consumer price index (roughly 6 percent of the total index and 20 percent of the service component), so moderation in their rate of increase would help considerably in holding the increase in service prices below the earlier postwar rate.

The price of one service item, household operation, has risen less over the decade than any other service component. The 24-percent increase in the total, however, conceals wide differences among the individual components. Laundry and domestic services, postage, and water have risen more than the average, while gas, electricity, telephone, and dry cleaning services have risen less.

Different price-expenditure relationships have developed in several of these categories. For example, consumers have spent less for laundry and domestic services as their prices have shot upward; they have meanwhile allocated increasing portions of their budgets for relatively inexpensive gas and electricity, partly to operate washers, dryers, and other appliances that help to reduce consumer outlays on services. In addition, differential rates of productivity growth have, of course, been reflected in this phenomenon. Costs in domestic, cleaning, and laundry services have been pushed up by the low rate of productivity growth achieved in these industries; on the other hand, costs in the utility industries have

Rapid rise in service spending caused by price, demand increases



Source: U. S. Department of Commerce.

been held in check by the large strides attained in the efficiency of electric power production and distribution and in the transmission of natural gas.

Health, transport costs zoom

Medical care has accounted for the greatest increase in any category of service prices over the last decade. Nonetheless, the 45-percent increase in the over-all index conceals wide variation among the components. Hospital daily-service charges and costs of hospitalization insurance have almost doubled—rising more than three times as fast as physicians and dentists' fees, which in themselves have advanced considerably. No matter what the time period of comparison, no other item in the consumer price index—either service or commodity—has moved up as sharply or persistently as hospital rates.

With population growth, more and more people have become potential patients, and at the same time more and more people have become increasingly conscious of health problems and eager to share in the advance of medical science. Expenditures for medical care have almost doubled over the decade and now approach $25 billion a year. Outlays for hospital care and medical and hospitalization insurance have grown at an even greater rate. Yet in spite of progress in medical science, the supply of available medical care (in terms of personnel and facilities) has not kept up with population growth and rising health consciousness. Pressure on prices has been made more acute by the longer training and increased specialization required for medical personnel and by utilization of expensive hospital equipment and procedures requiring additional personnel.

Higher standards of living, rising levels of education, and widespread progress in medical science can be expected to continue to stimulate a growing demand for medical care, but the shortage of supply will not be solved overnight. Throughout this decade, therefore, consumers may have to pay higher prices for the progressively larger share of medical care they include in their budgets.

Transportation services have risen in price over the last decade more than any other major service group except medical care. Local transit, with a 57 percent price increase, has led the other transportation items by a wide margin, but all have recorded considerable gains. Expenditure patterns reveal a spending decline for the very items that have become most expensive. Spending for the care, repair, and insurance of automobiles has increased markedly with the rapid growth in the stock of automobiles and the shift to "do-it-yourself" transportation, while expenditures for local and intercity transportation have been affected unfavorably.

The public-transportation phenomenon of rising prices and declining expenditures reflects the price-setting mechanism in these industries. The prices charged for these utilities are subject to regulation by government agencies, which are required to permit a "fair return on the fair value" of utilities' property. By assuring certain minimum rates of return, the regulatory agencies make costs a major factor in price determination; thus, price in-

creases frequently have resulted from a willingness on the part of those agencies to offset reduced revenues with higher prices. Yet these very increases often have set in motion a vicious circle: higher prices have led to a decline in volume and revenue, and the resultant decline in return on assets has occasioned further rate increases to restore profits to a satisfactory level.

"Other services," which include a variety of homeowner costs for mortgage interest, insurance, and repairs, as well as personal care and recreational services, have recorded a 26-percent price increase over the last decade, approximately the same as the gain for all services. But aside from first-mortgage interest rates and property-insurance rates, most items in this price list have risen more rapidly than the average.

Reality or illusion?

If service prices should continue mounting, the consumer index will continue to exhibit an upward drift in relation to those yardsticks —for example, the wholesale index—which measure only the (at least recently) slower-moving commodity prices. But in view of the increased weight given to services in the revised consumer index—a shift which reflects the fact that services account for about 41 percent of the consumers' budget now as opposed to 35 percent a decade ago—a continuation of this disproportionately rapid rise in service prices will also cause the new CPI to rise at a slightly more rapid pace than the old CPI. The consequences could be quite interesting, for many union members and pensioners, as well as for most consumers.

If service prices should continue upward at their recent jaunty pace, their increased weight in the index could raise the total index slightly more than before, the two million workers who are still covered by escalator clauses could receive a small bonus (except in those cases where adjustments are continued on the basis of the old index), and the two million workers who have dropped escalator clauses from their contracts during the last several years would be tempted to reexamine these earlier decisions. Military and civil-service pensioners, who are now receiving escalator increases for the first time, would be made happy for the same reason, but the Federal budget officials who would be required to find the money for these increases undoubtedly could be expected to view the situation somewhat differently.

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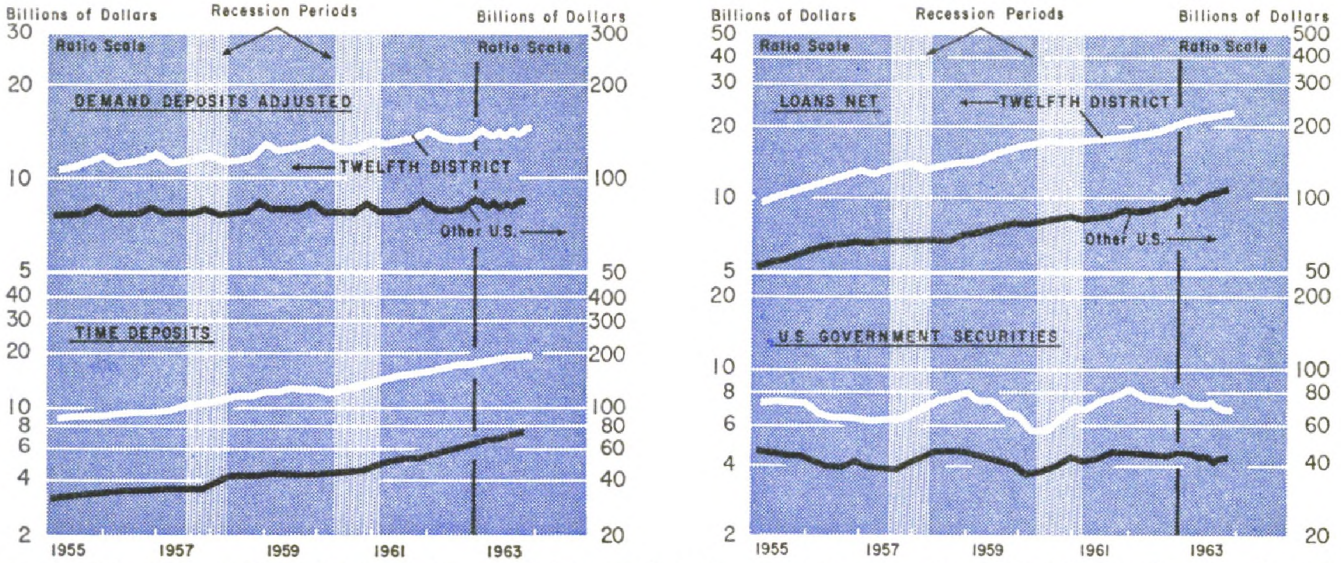
Condition Items of All Member Banks—Twelfth District and Other U. S.



Source: Federal Reserve Bank of San Francisco. (End-of-quarter data shown through 1962, and end-of-month data thereafter; data not adjusted for seasonal variation.)

BANKING AND CREDIT STATISTICS AND BUSINESS INDEXES—TWELFTH DISTRICT[1]

(Indexes: 1957-1959 = 100. Dollar amounts in millions of dollars)

Year and Month	Condition items of all member banks[2] Seasonally Adjusted				Bank debits Index 31 cities[5, 6]	Bank rates on short-term business loans[7, 8]	Total nonagri-cultural employ-ment	Dep't. store sales (value)[6]	Industrial production (physical volume)[6]		
	Loans and discounts[3]	U.S. Gov't. securities	Demand deposits adjusted[4]	Total time deposits					Lumber	Refined[8] Petroleum	Steel[8]
1950	6,951	6,245	8,864	6,251	50	3.35	73	65	100	80	83
1951	7,751	6,370	9,512	6,713	57	3.66	80	68	99	87	97
1952	8,703	6,468	10,052	7,498	59	3.95	84	73	101	90	92
1953	9,090	6,577	10,129	7,978	69	4.14	86	74	102	95	105
1954	9,264	7,833	10,194	8,680	71	4.09	85	74	101	92	85
1955	10,827	7,162	11,408	9,130	80	4.10	90	82	107	96	102
1956	12,295	6,295	11,580	9,413	88	4.50	95	91	104	100	109*r*
1957	12,845	6,468	11,351	10,572	94	4.97	98	93	93	103	114
1958	13,441	7,870	12,460	12,099	96	4.88	98	98	98	96	94
1959	15,908	6,495	12,811	12,465	109	5.36	104	109	109	101	92
1960	16,628	6,764	12,486	13,047	117	5.62	106	110	98	104	102
1961	17,839	8,002	13,676	15,146	125	5.46	108	115	95	108	111
1962	20,344	7,336	13,836	17,144	141	5.50	113	123	98*r*	111	100
1962											
November	20,115	7,354	13,670	17,066	144	...	114	128	105*r*	113	91
December	20,344	7,336	13,836	17,144	146	5.50	115	127	103	113	100
1963											
January	20,609	7,333	13,725	17,407	146	...	116	127	104*r*	113	98
February	20,837	7,344	13,831	17,585	149	...	116	128	106*r*	111	123
March	21,165	7,427	13,868	17,831	152	5.46	116	130	107*r*	110	123
April	21,246	7,097	14,063	17,850	147	...	116	118	93*r*	108	134
May	21,246	7,262	13,828	17,967	152	...	116	129	96*r*	112	141
June	21,604	7,293	13,959	18,101	152	5.53	116	127	97*r*	116	129*r*
July	21,761	7,059	14,044	18,290	159	...	116	128	95*r*	115	109*p*
August	21,890	6,958	13,990	18,334	164	...	117	132	102*r*	116	105*p*
September	22,236	6,968	14,102	18,409	167	5.47	117	125	105*r*	113	109*p*
October	22,387	6,698	14,106	18,727	165	...	118*r*	127	106*r*	112	104*p*
November	22,673	6,730	14,272	18,923	171	...	118*p*	130	...	110	114*p*
December	22,915	6,651	14,179	18,942	165	5.47	...	...	...	...	...

[1] Adjusted for seasonal variation, except where indicated. Except for banking and credit and department store statistics, all indexes are based upon data from outside sources, as follows: lumber, National Lumber Manufacturers' Association, West Coast Lumberman's Association, and Western Pine Association; petroleum, U.S. Bureau of Mines; steel, U.S. Department of Commerce and American Iron and Steel Institute; nonagricultural employment, U.S. Bureau of Labor Statistics and cooperating state agencies. [2] Figures as of last Wednesday in year or month. [3] Total loans, less valuation reserves, and adjusted to exclude interbank loans. [4] Total demand deposits less U.S. Government deposits and interbank deposits, and less cash items in process of collections. [5] Debits to demand deposits of individuals, partnerships, and corporations and states and political subdivisions. Debits to total deposits except interbank prior 1942. [6] Daily average. [7] Average rates on loans made in five major cities, weighted by loan size category. [8] Not adjusted for seasonal variation. *p*—Preliminary. *r*—Revised.