

MONTHLY REVIEW

LIBRARY

JUL 19 1966

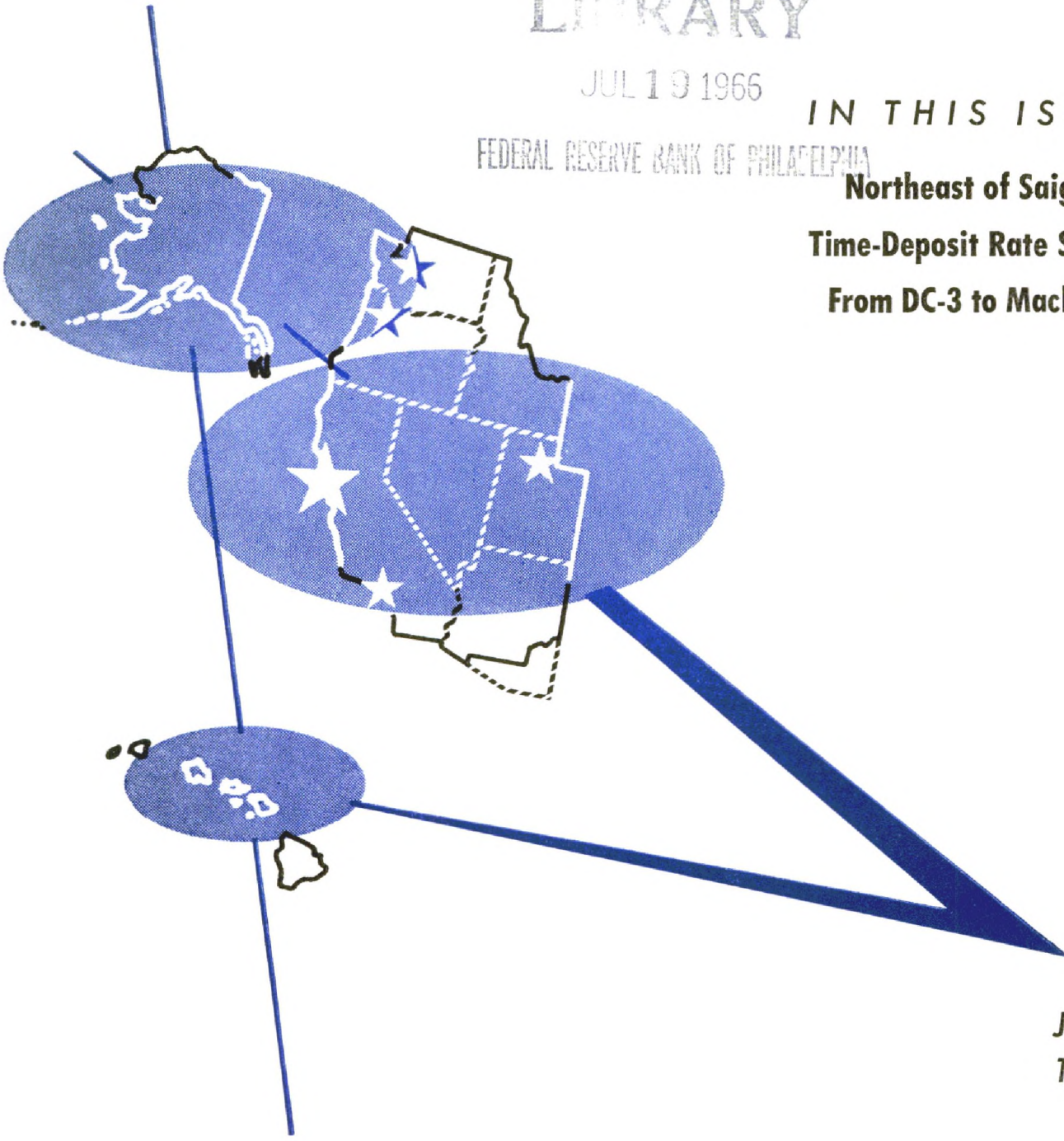
FEDERAL RESERVE BANK OF PHILADELPHIA

IN THIS ISSUE

Northeast of Saigon

Time-Deposit Rate Survey

From DC-3 to Mach 2.7



JUNE
1966

Northeast of Saigon

... The Vietnam war stimulates defense-manufacturing and shipping activity, and commercial-aircraft orders add steam to the boom.

From DC-3 to Mach 2.7

... With jumbos and supersonic jets, Western-based firms continue to pioneer in commercial-aircraft manufacturing.

Editor: William Burke

Northeast of Saigon

IN MID-1950, American troops went into action on the rim of the Asian continent, and the economic repercussions were soon felt on the North American continent too. In mid-1965, the scenario was repeated. Last year's commitment of substantial ground forces to the conflict in Vietnam suddenly increased the pressures on defense-related sectors and accelerated the pace of activity throughout the entire U.S. economy. And the impact will continue, as resources are strained by the cost of perhaps \$20 billion or more associated with a buildup to 400,000 troops in Vietnam. The troop commitment, which was about 50,000 a year ago, has been increased by increments of roughly 100,000 in each succeeding six-month period.

Costs of the war

The Federal budget buildup paralleling the troop buildup began in May 1965 with a supplemental budget request for \$0.8 billion, and this was followed by later requests for \$14 billion more. But the costs of the war so far have shown up partly in reduced combat readiness; for example, by the diversion of equipment and spare parts from other sectors to Vietnam. So as deliveries of recently ordered equipment roll in, and as the armed forces expand further, expenditures will begin to catch up with the heavy costs already incurred.

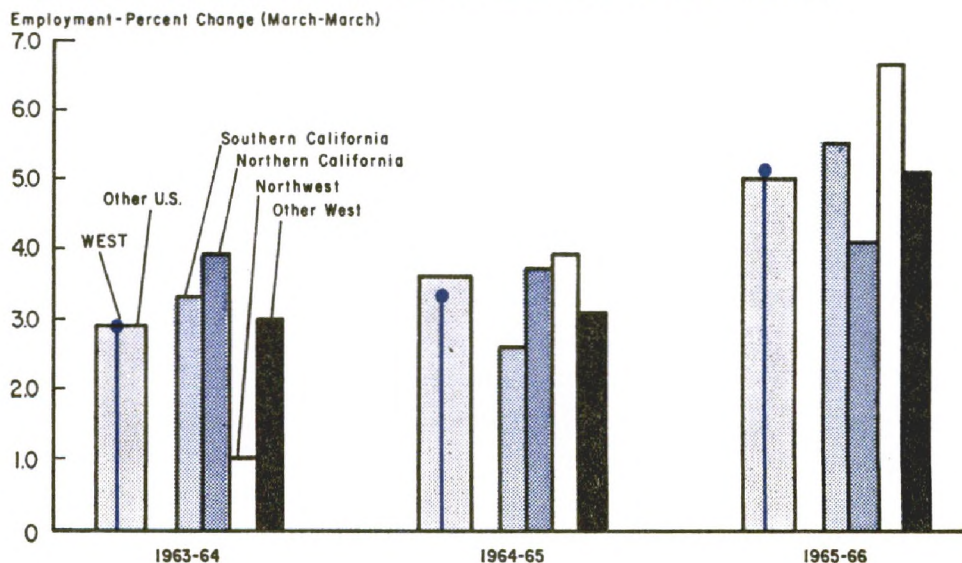
New orders, not expenditures, thus are the best key to future spending trends. In fiscal

1951, defense expenditures increased about one-tenth above the preceding year's level, but new defense obligations increased about two-thirds. Similarly, in fiscal 1966 to date, expenditures have risen about one-sixth but new procurement obligations have jumped more than two-fifths above the 1965 level.

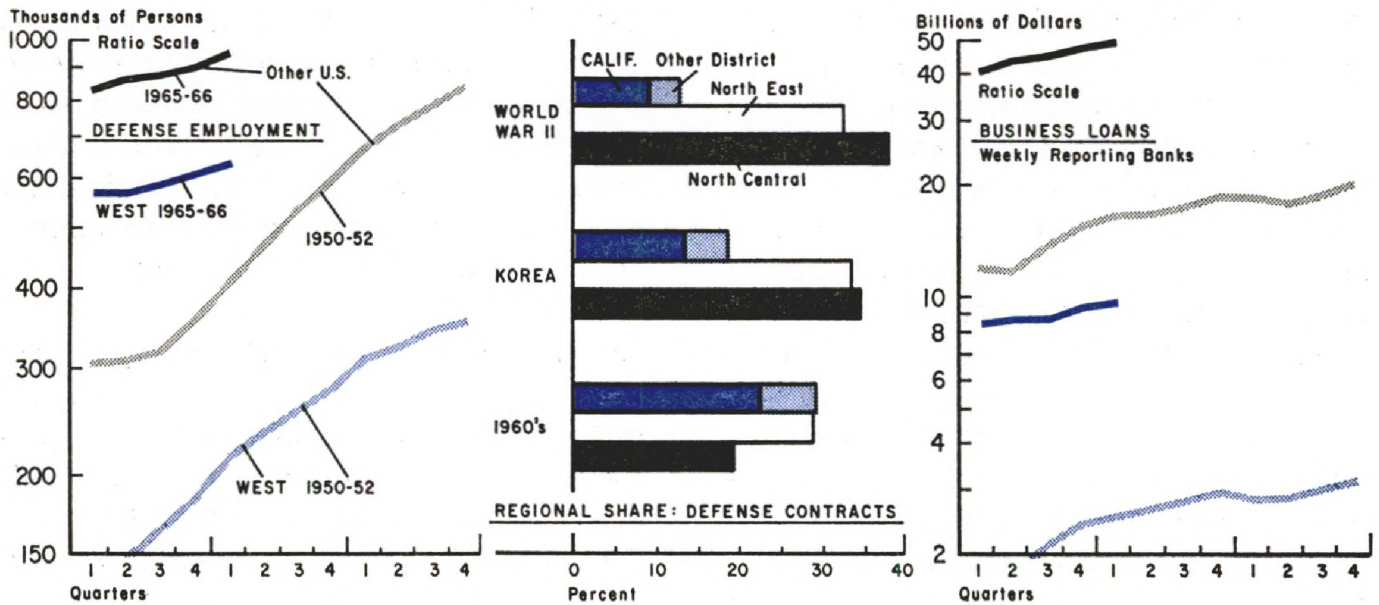
Although the troop commitment does not yet match Korean-war levels, troop costs per man are much more expensive than in that earlier period. Average military pay is 40 percent higher than during Korea; today's F-4C fighter costs six times as much as the earlier F-86 model; and ammunition usage is much higher, especially since today's M-16 rifle shoots five times as many rounds per minute as the earlier standard M-14. Moreover, each B-52 sortie from Guam to Vietnam costs \$13,000 in operational costs plus \$30,000 for each planeload of 60 750-pound bombs.

Support of the Vietnamese civilian economy and U. S. military construction in Vietnam have also created substantial demands on the nation's (and the region's) producing and shipping facilities in recent months. Pacific Coast ports, which experienced an export

Employment growth accelerates over past year as result of defense and commercial-aircraft boom



Business gains in past year parallel gains in early-Korea period, but conventional-war emphasis may lower West's share of defense awards



boom in the Korean period, from \$0.8 billion in 1950 to \$1.3 billion in 1952, are again bursting with activity. Exports grew from \$3.0 billion to \$3.8 billion (annual rates) in a comparable two-year period between the first quarter of 1964 and the first quarter of 1966. This performance was supported by the boom in civilian exports (including commercial aircraft exports of \$477 million last year), but Vietnamese demand undoubtedly provided a very strong stimulus too. For example, Pentagon purchases of Northwest lumber, scheduled at \$50 million in fiscal 1966, are roughly double the amount purchased a year ago.

Costs to Vietnam

Federal budget allocations for the support of the Vietnamese economy have accelerated sharply. Almost the entire amount obligated for fiscal 1966 was spent in the first half of the fiscal year (\$235 million), and foreign-aid authorities thereupon returned to Congress with a \$275-million supplemental request to tide them over the remainder of the fiscal year. According to AID Administrator Bell, resources of this magnitude are necessary to mop up the inflationary problems created by the dislocation of Vietnam's wartorn

economy and the increasing American expenditures in that country. (U. S. military construction and troop spending this year may equal almost half of Vietnam's total income for 1964.)

The Agency for International Development is now financing imports (especially rice), supporting crash programs to expand port facilities and shipping, and taking cargo ships out of the mothball fleet for trans-Pacific service. Meanwhile, as a means of minimizing the problem of congestion in Vietnam's crowded ports, AID is also concentrating cargoes in stateside depots, including the large marshaling yard at Clearfield, Utah.

American rice-growers have played an increasing role in supporting the Vietnamese economy. Vietnam formerly exported 300-400,000 tons of rice annually, but it is now forced to import about that much every year, and U. S. growers have helped to fill the breach.

U. S. rice exports to Vietnam began with shipments of about 45,000 tons in 1964. Last year AID shipped in 175,000 tons of U. S. rice and 50,000 tons of Thailand rice, and in

the first half of this calendar year it is scheduled to ship 175,000 tons more. The rice crisis is attributable partly to 1964's heavy floods, but mostly to the general dislocation of the war; about 700,000 refugees moved from the ricefields into refugee camps last year alone. Not only has the country shifted from an export to an import status, but internal shipments have also declined sharply. Between 1963 and 1965, rice shipments from the Mekong delta to Saigon dropped from 725,000 tons to 430,000 tons.

Heavy requirements for military construction have also strained the Vietnamese economy. Military construction units are heavily engaged in this activity; moreover, a four-firm consortium of U. S. contractors is building facilities around Saigon, plus a complete port city at Cam Ranh Bay north of Saigon, at roughly a million-dollar-a-day pace. These construction projects have created a major market for U. S. lumber firms and for Oriental cement manufacturers, and they have also generated a large labor demand for both U. S. and Oriental construction workers.

Co-prosperity sphere?

Indeed, Vietnam war requirements have accelerated business activity throughout the Far East. Japanese, Korean, Filipino, Taiwanese, and Thaiandese firms have all felt the impact of the war. For example, U. S. offshore procurement in Japan, at \$323 million in 1965 and at a higher rate in early 1966, has been at least partly dependent on the requirements of Vietnam. Moreover, direct Korean exports to Vietnam are scheduled to increase from \$20 million in 1965 to at least \$60 million in this calendar year.

U. S. procurement officers in Japan have contracted for substantial purchases of Diesel engines, lumber, auto parts, and steel airport-landing mats, along with substantial amounts of ship-repair work. They have also contracted for about 400,000 tons of Japanese ce-

ment in order to supplement Taiwan's cement facilities, which have been unable to keep up with Vietnam's construction demands. Japanese firms have also shipped directly to Vietnam a wide variety of goods—from tents and mosquito nets to jeeps and beer. Some observers, in fact, contend that the war could be fought entirely with made-in-Japan products.

Undoubtedly, the Vietnam war has generated a substantial increase in business activity in all of the areas east of Saigon, including these Western United States. At the same time, the District economy has benefited from the general ebullience of the U. S. civilian economy and, more recently, from a new boom in a major regional industry, commercial-aircraft manufacturing.

Stimulus to the West

Over the past six months, nonfarm employment in District states has increased at close to a 6-percent annual rate, as against a 3-percent growth rate in the preceding year or so. The West, which had lagged behind the rest of the nation in several preceding years because of large reductions in defense employment, thus has recently edged ahead of other regions in the growth competition.

Moreover, the areas hardest hit by 1963-64 defense cutbacks have rebounded the fastest in the recent past. Since last spring, total employment in Southern California has increased about 5½ percent on the heels of an 11-percent increase in defense jobs, and employment in Washington has increased almost 9 percent because of a sharp 47-percent jump in aerospace and other defense-related employment. The boom in these areas reflects a sharp uptrend in commercial-airline orders for jet transports, but it also reflects defense requirements attributable to the Vietnam war.

The similarity with the Korean-war buildup shows up in a number of major business indicators. In defense employment, the West re-

corded an increase from 567,000 to 636,000 over the past year, and the rest of the nation chalked up a comparable gain, from 832,000 to 946,000. (The numerical gains were roughly the same as in 1950, although the percentage increases were smaller.) In bank lending to business, the substantial recent gains also paralleled the Korean-war increases. Between the first quarter of 1965 and the first quarter of 1966, District weekly reporting banks raised their outstanding business loans from \$8.5 billion to \$9.8 billion, and banks elsewhere increased their loans from \$40.9 billion to \$48.8 billion. These gains, of course, reflected much more than the financial demands stemming from the Vietnam buildup, but the latter nonetheless was a major factor in the growing monetary squeeze.

As a defense-dependent region, the West may certainly experience a substantial impact on its economy from the Vietnam war. But since this region is more closely involved with the production of sophisticated aerospace systems than with the manufacture of conventional-war equipment, it may also expect to occupy a less central position in the defense

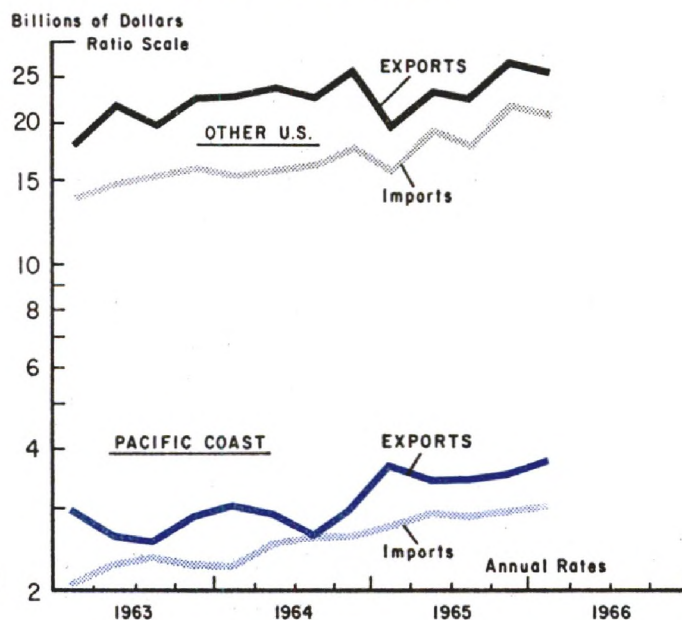
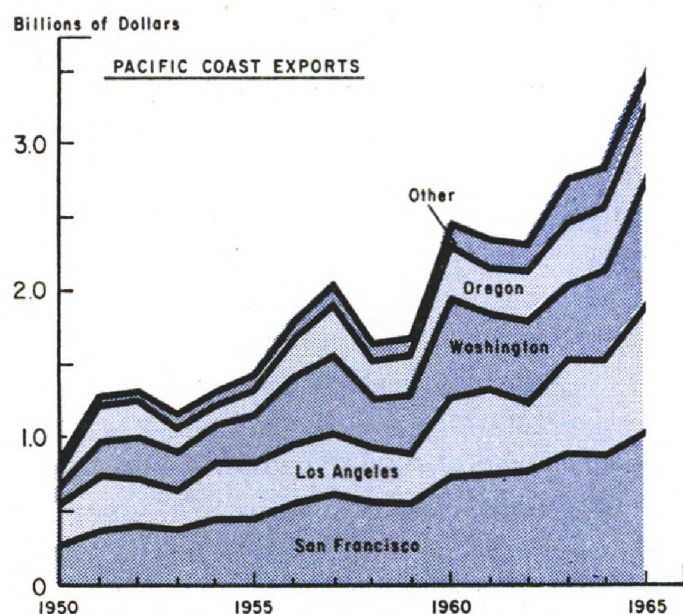
picture in the near future than in the recent past.

In the Korean period, procurement officers concentrated their purchases on conventional weapons, such as combat vehicles, surface ships, artillery and small arms. After Korea, however, they concentrated on strategic weapons systems. This changing procurement pattern meant that purchases shifted from tanks and trucks to electronics and advanced propulsion systems. This changing pattern also meant that contracts and job opportunities shifted from those firms making land and sea vehicles to those (predominantly Western) firms making sophisticated aerospace systems. Thus, the Western percentage of defense-contract awards rose from 18 percent in the Korean period to 29 percent in the 1960's. (The share was only 13 percent during World War II.) By way of contrast, the share of the North Central states dropped from 34 percent in Korea to 19 percent in the 1960's.

Conventional war budget

But the 1967 defense budget resembles the conventional-war budgets of the early 1950's

Pacific Coast ports exhibit long-term uptrend in export trade, and shipping now booms with military and civilian support of Vietnam



more closely than it does the aerospace-oriented budgets of the early 1960's. The Western-dominated sectors of the Federal budget— aerospace procurement, research and development, and the civilian space agency—should cost \$21.2 billion in fiscal 1967 as against a peak of \$22.1 billion in fiscal 1964. But the sectors where the West plays a strong but not predominant role—defense spending for personnel, operations and maintenance, and non-aerospace procurement—are scheduled at \$39.6 billion in the coming fiscal year as against \$30.5 billion in 1964.

The impact on the West of this conventional-war emphasis may be seen in the contract-award data for the first three quarters of fiscal 1966. In that period, District states accounted for only 23½ percent of total defense awards—down substantially from their 28½-percent share of the preceding fiscal year. And the contracts obtained recently by Western firms, in addition to the usual round of aerospace items, included a large number of conventional-war items — for example, \$40 million for stevedoring services and \$45 million for production of steel landing mats for airport runways.

Exogenous equals multiplier

The final impact on the Western economy from either the Vietnam war or from the defense-related jet-transport boom will be difficult to measure.

To assess the impact of defense demand on this region, it is not sufficient to measure defense income as a percentage of the total. Instead, the stimulus must be measured by comparing income from defense and other "exogenous" (outside) demand with income generated locally, since only the former exerts a significant multiplier effect on a region's business activity.

Exogenous (outside) income results from the demand for Western products from other regions. Such income is generated by exports to other regions, especially defense exports, but it also includes property income from outside sources and some transfer payments. In contrast, local income comes from the production of goods and services for local use. Local income, being generally passive, responds to the active changes in outside income. Thus, when a defense-plant worker is newly hired, he spends some wages on local products and indirectly supports new local income, until the multiple effects of this injection of outside income are felt throughout the entire economy.

In recent decades, the regions which have benefited most from defense spending have grown more rapidly than other regions of the country. According to a recent study by Harvard Professor Roger Bolton, Western income between 1952 and 1962 grew almost 6½ percent annually as against a less-than-5-percent gain elsewhere. But all District states (except Oregon, Idaho, and Nevada) looked to the defense sector for more than one-fifth of their income during this period. In 1962, for example, California and Washington depended on defense for about one-third of total income, and Utah, Hawaii, and Alaska depended on defense for more than two-fifths of their total income.

The West certainly could base its growth on some other sector of exogenous demand, such as the new industries generated by its ever-fruitful aerospace technology. Nonetheless, the recent experience of the Vietnam war suggests that the defense sector will continue to exert a strong influence on the Western economy for some time to come.

—William Burke.

Time-Deposit Rate Survey

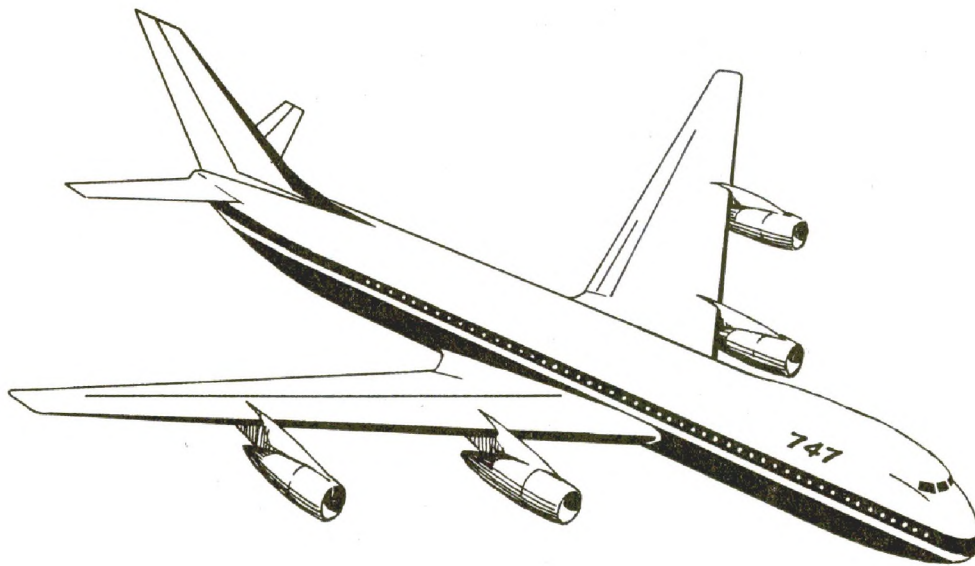
Only 4 of the 223 member banks in the Twelfth District pay less than the permissible 4-percent maximum on their passbook-savings accounts, according to a recent Federal Reserve survey of interest rates paid on private time deposits. On non-passbook types of private time deposits—ranging from the savings bonds and certificates favored by small individual savers to the large-denomination (\$100,000 and over) certificates favored by corporations—the survey disclosed a wide range of maximum rates and a wide variety of minimum maturities and minimum denominations.

As of the May 11 survey date, savings bonds, a popular instrument elsewhere, were offered by only 7 District banks (all in California), but savings certificates were offered by 116 banks located in every District state except Arizona. The most common rate paid on these certificates was 5 percent, although maximum rates varied between $3\frac{1}{2}$ and $5\frac{1}{2}$ percent; the minimum maturity on which banks offered their highest rates ranged from 3 to 60 months; and the minimum denomination available to savers at the highest offered rate ranged from zero to \$100,000.

A number of banks (45) offered other types of non-negotiable certificates to attract individual savings. But since many of these instruments—and many of the small-denomination negotiable certificates as well—were offered to businesses as well as to individuals, it is difficult to measure the response of individual savers to the rate differentials offered on these instruments.

In the category of negotiable CD's, 122 District banks offered small-denomination certificates, and 61 banks offered CD's in denominations of \$100,000 and over. Negotiable CD's were available in every District state, at rates as high as $5\frac{1}{2}$ percent in California, Arizona, Nevada, and Utah.

Almost all of the 33 banks offering more than 5 percent on non-negotiable instruments were small or medium-sized California banks. (They were distributed about evenly between Northern and Southern California.) Their deposit experience contrasted sharply with that of the major California banks, which did not post rates in excess of 5 percent for non-negotiable certificates. Both types of banks recorded substantial increases in time deposits IPC (other than savings), but the major banks generally obtained these increases at the expense of their own passbook savings, while the smaller banks—with their higher rate differential—increased their total private time-deposit inflow at the expense of other commercial banks, savings institutions, or other investment outlets.



From DC-3 to Mach 2.7

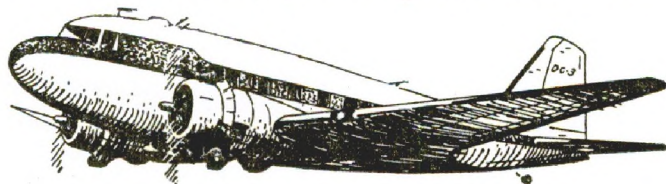
New orders for civilian aircraft expanded from \$3.0 billion in 1962 to \$7.6 billion in 1965. Backlogs thus jumped from \$2.6 billion to \$6.7 billion over the three-year time-span, and most of the business went to the major firms headquartered in the Pacific states. Better still, industry observers expect commercial airlines to purchase \$11 billion of transport planes over the next decade—double the high level of spending which occurred in the preceding decade because of the transition from propeller to jet transports.

Airline traffic has followed a parabolic growth curve for the last four decades, with a spurt in travel following the introduction of each significant innovation in transport equipment. The first generation of transport planes was centered around the Ford trimotor of the 1930's, a 14-passenger plane with a 122-miles-per-hour cruising speed. The second generation was centered around the history-making DC-3, a 28-passenger plane with a 167-mile-per-hour speed. When this aircraft first appeared in 1936, its total market was estimated at a maximum of 25 planes, but 10,000 DC-3's were built by the time produc-

tion lines closed down in 1946—and roughly half of those planes are still flying, some of them in Vietnam. Along U. S. domestic routes, DC-3's accounted for over three-fourths of the 400 transport planes flying in 1941, and they still account for about 10 percent of the 2,100-plane fleet of 1965.

The last generation of propeller transports was built around the DC-6/7, a 58-passenger plane with a 313-mile-per-hour cruising speed. This was then followed by the first generation of jets, typified by the 707, a 181-passenger plane with a 525-mile-per-hour speed. But the second generation is now being heralded by the announcement of production plans for several massive subsonic jets as well as a speedy supersonic jet.

Three Western firms already hold the center of the stage for the expensive jet race of the 1970's. The new generation of jets was initiated with a \$1.3-billion competition for the C-5A military jet transport, and both the

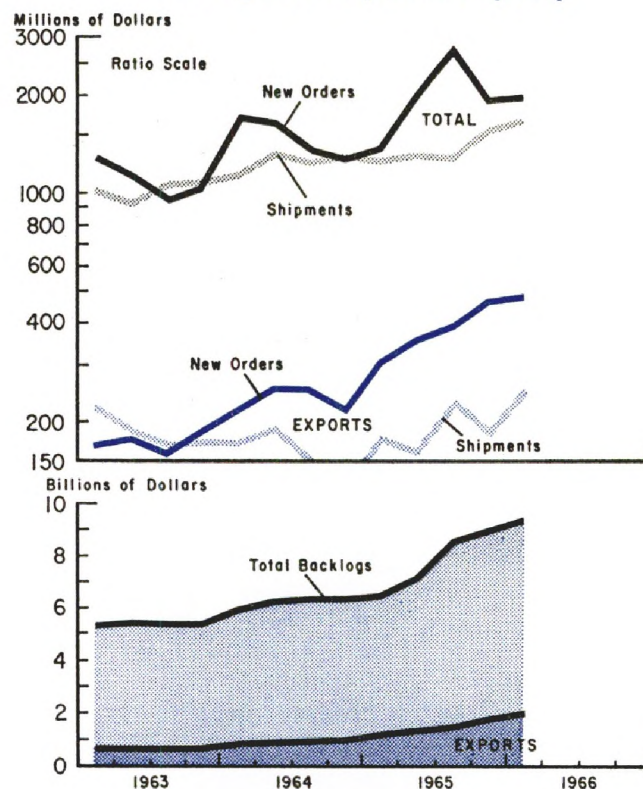


winner and the two losers in the competition are now planning jumbo transports based on the models they submitted for that contest. The L-500—the commercial version of the winning C-5A model—may appear in the early 1970's with a 900-passenger capacity but with no greater speed than the jets already flying. But a competitive version, the 747, has already landed a \$525-million contract for 25 planes to be flown along international routes. The maker of this 490-passenger airbus is planning for a 400-plane market by 1975.

Supersonic jets, which may carry about 250 passengers at a mach 2.7 speed (1800 miles per hour) will very likely be a strong factor in the transport market by the mid-1970's. The supersonic jets may cost \$30 million per plane as against \$15-\$18 million for each of the jumbo jets. In addition, their operating costs may be almost double those of the jumbos although their speed will be three times as great. But all cost estimates are rather fragile at this stage—witness the \$4-billion price tag now placed upon development costs of the American supersonic jet as against the \$2-billion figure estimated by the Federal Aviation Authority several years ago.

The competition for future traffic will depend on such factors as flight frequency and fares. The supersonic jets will boast higher frequency of flights and a significant drop in travel time; the jumbo jets will offer significantly lower fares but fewer flights and no

Sharp uptrend in aircraft orders causes backlogs to expand rapidly



improvement in present speeds. The latter will also offer large savings in cargo-transport costs, since they will be the first planes large enough to handle the standard 8x8 containers now used in piggyback (rail) and fishyback (sea) transport. But whatever the results of this competition, Western-based firms will benefit, since they are the key contractors for all entrants in this second generation of jets as well as the leaders in the still-prosperous first generation.

Publication Staff: R. Mansfield, Chartist; Phoebe Fisher, Editorial Assistant.

Single and group subscriptions to the *Monthly Review* are available on request from the Administrative Service Department, Federal Reserve Bank of San Francisco, 400 Sansome Street, San Francisco, California 94120

Western Digest

Banking Developments

Business loans of District weekly reporting banks rose by \$97 million in May—\$20 million more than in the comparable year-ago period—as banks reported increases in almost every loan category. However, the District's 1-percent April-to-May increase failed to match the 2-percent gain recorded elsewhere. . . . Real estate, farm, and consumer loans also increased, although by relatively small amounts. District gains exceeded national gains in each of these categories except real estate. . . . District bank holdings of U. S. Government securities dropped by \$334 million in May, mostly in bills and short-term notes, but this decline was offset by a \$514-million increase in holdings of other securities. . . . Demand deposits adjusted declined \$631 million—roughly in line with last May's decrease—but time and savings deposits rose \$310 million during the month. Passbook savings dropped by \$80 million, but this was far less than the preceding month's decline and, besides, it was more than offset by a \$290-million increase in time deposits IPC in denominations under \$100,000.

Unemployment Situation

Employment continued to expand throughout the nation during May, but a heavy influx of jobseekers into the labor market halted the decline in unemployment. California's jobless rate rose from 4.6 to 4.7 percent over the month, and the national rate jumped from 3.7 to 4.0 percent. But these figures represent a significant improvement over six months ago, when 5.6 percent of California's labor force and 4.2 percent of the nation's work force were unemployed. (All rates seasonally adjusted.)

Lumber Market

Lumber and plywood prices began to decline as the housing market weakened, as Pentagon orders for Vietnam levelled off, and as the boxcar shortage eased—and then they declined sharply in early June as a labor-contract settlement ended a potential strike threat. . . . Between late April and early June, Douglas fir prices dropped from \$78 to \$70 per thousand board feet, and quotes on standard plywood plummeted from \$86 to \$62 per thousand square feet. The new quotations were roughly in line with year-ago price levels.

Copper Situation

The Administration raised defense set-asides of domestically produced primary copper from 10 to 13 percent of current output in late May. . . . In order to stimulate increased copper production, the General Services Administration initiated an output-incentive plan in early May. The agency offered the industry premium prices on set amounts of copper under long-term contract arrangements, in an effort to increase output by 50,000 tons this year and by several times that amount over the next five years.

