Financing Local Government Expenditures

There are many state and local governmental units operating in the Eighth Federal Reserve District. They have been spending more and more money to provide a wide range of services, many of which require large capital investments. The demand for state and local governmental expenditures will probably continue to expand.

The rapid increase in expenditures has posed financial problems for state and local governments. They have had to increase taxes and other revenue substantially during the postwar period. Overlapping jurisdictions and antiquated tax structures have complicated the situation in many cases. Borrowing has become more difficult because the amount of debt outstanding has increased sharply and in the last few years capital market flotations have been somewhat more difficult.
Financing Local Government Expenditures

There are many state and local governmental units operating in the Eighth Federal Reserve District.

There are an astonishing number and variety of local government units. Because of the many types of services demanded, legal limitations, political empire building and the spilling over of population across fixed boundary lines, a myriad of governmental organizations has been established.

According to the Census of Governments, in January 1957 there were 102,352 state and local government authorities in the United States. In addition to the 48 states, there were 3,047 counties, 17,167 municipalities, 17,214 townships, 50,453 school districts and 14,423 special districts.

The Eighth Federal Reserve District has a relatively large number of local governmental units, but most of them are comparatively small. Though the district contains less than 7 per cent of the population and less than 6 per cent of the area of the nation, it can claim about 8 per cent of the local governmental units. Outlays of these units are only about 3 per cent of the total expenditures of all state and local authorities in the nation. The district covers all or parts of 7 states, and 363 counties are located within its borders. There are about 1,800 municipalities and nearly 6,000 other governmental units functioning within the district. The number of governmental units contained in each of the district states is shown in Table I.

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The number of governmental units contained in each of the district states is shown in Table I.

Expenditures by state and local governments have been rising sharply. Both within the district and nationally, it is estimated that during 1957 local authorities will spend over four times the amount they spent in 1945. In real per capita terms outlays have approximately doubled during the postwar period.

State and local governments located within the Eighth District purchase goods and services at the rate of over $1 billion a year, or approximately 7 per cent of the district's gross product. Nationally, these authorities are now spending at an annual rate of $36 billion, absorbing over 8 per cent of the gross national product. State and local governments have also become major employers, furnishing work for about 10 per cent of the nonfarm labor force.

The upward trend of outlays by state and local governments has been evident for many years, although there has been a marked increase in the rate of expansion since World War II. It is estimated that from 1900 to 1956 spending by state and local authorities jumped thirtyfold. During the same period, the

TABLE I

NUMBER OF STATE AND LOCAL GOVERNMENTAL UNITS
JANUARY 1957

Source: Department of Commerce, Bureau of the Census, Governments in the United States in 1957.
Gross national product rose only about twenty times. The nation’s employment (and population) is now slightly less than 2½ times the level it was at the turn of the century, but state and local governments employ more than five times as many people as in 1900.

Many factors have contributed to the sharp expansion in the duties and expenditures of local authorities. Population has grown and has become concentrated in urban and, more recently, in suburban areas. More and more automobiles have brought about a need for better streets, roads, bridges, improved traffic control and related services. Wider recognition of the advantages of education and the financial ability to stay in school longer has expanded the demand for schools, colleges, libraries and museums. Higher standards of living, increased specialization and changing views on the proper functions of government have contributed to the expanding responsibilities assigned to local authorities.

... to provide a wide range of services, many of which require large capital investments.

State and local governments engage in a broad assortment of activities, yet spending on education and highways accounts for more than half the total of general expenditures (excluding outlays by utilities). Expenditures presently devoted to education amount to about 35 per cent, and outlays for highways and streets constitute a fifth. Health, recreation, libraries, housing, community redevelopment and natural resources together account for about one-seventh of the spending, while expenditures for police and fire protection and sanitation amount to 10 per cent. Most of the remaining one-fifth is used in relief and other public assistance, in “overhead” costs of government operations and in interest payments on outstanding debt.

Despite the substantial rise in the general outlays of state and local governments, it is interesting to note that the distribution of expenditures among major uses has changed only moderately since 1913. Education accounts for a larger portion (35 per cent as compared to less than 28 per cent), and “overhead” takes a smaller part. Most other categories of expenditures have expanded at about the same rate as the total.

Looked at in another way, about three-fourths of the total expenditures (including utility outlays) of state and local governments are devoted to operating expenses, about one-fourth to capital outlays. Capital outlays include construction of streets and highways, bridges, schools, water and sewer systems, hospitals, and sometimes municipal power plants. During 1957 expenditures on capital goods will probably add up to $12 billion, or seven times the 1946 total. After adjustment for both price changes and population growth, outlays are still running at roughly three times the 1946 rate. Local governments need more and more land, equipment, schools, offices and roads to produce services requested by residents.

During 1955 highways and streets accounted for nearly 40 per cent of the capital outlays of states and their political subdivisions. Building and equipping schools took 29 per cent, and utility construction absorbed 11 per cent. The remaining 20 per cent of capital outlays of state and local governments went for items like housing, parks, natural resources, sanitation and hospitals.

The demand for state and local government expenditures will probably continue to expand.

It seems likely that the huge backlogs of projects already planned and the pressure of future population growth will continue to push state and local...
spending upward. Just to maintain current rates of per capita expenditures, these governments would have to increase their outlays by approximately $50 million each month. For state and local authorities domiciled within the Eighth Federal Reserve District, the growth would have to be about $1 million per month. The movement from farm to city and the migration from city to suburbs will likely continue, tending to increase per capita expenditures. In addition, some experts claim that the current backlog of needed public works runs to well over $100 billion.

In some suburban sections, school enrollments have trebled or quadrupled in recent years, and buildings and equipment are inadequate. As a temporary solution, some pupils attend only half days and others are herded into classes that are much too large for proper instruction. It has been estimated that there is an urgent need for about 10,000 new classrooms in the district. In addition, the growth in the school age population has been, and for the next few years will continue to be, relatively sharp. Enrollment in the district’s public schools jumped about a fourth from 1950 to 1956, and by 1965 is expected to grow by another third.

Highway crowding has worsened because vehicle use has increased faster than highway capacity. The number of cars, trucks and buses has nearly tripled since the 1930’s and these vehicles are traveling about four times as many miles per year.

Highway construction expenditures of state and local governments are presently running around $5 billion per year. The Federal interstate highway program has provided a stimulus to state and local expenditures. Outlays on federally aided highway construction (accounting for roughly one-third of all highway building) rose by a fifth from 1955 to 1956. They are scheduled to double the 1956 rate by 1965, and to expand even further through 1972. Construction will be carried out by the states, but the bulk of the cost is expected to be financed by the Federal highway-user taxes.

The rapid increase in expenditures has posed financial problems for state and local governments.

In most communities the need for more public facilities is generally recognized. In those areas where population has been growing rapidly in recent years, the needs are evident although there is frequently considerable difference of opinion regarding priorities. The main problem faced by many state and local governments is how to raise funds to provide the new roads, schools and other facilities that the community needs.

How can state and local governments finance the sizable and, apparently, rising expenditures? Primarily the answer depends on the ability of these agencies to increase current tax revenues and to create debt. For a short time larger outlays by a few authorities could be made from cash and other liquid asset balances, and some authorities may meet larger budgets by obtaining aid from other governments.

They have had to increase taxes and other revenue substantially during the postwar period.

About two-thirds of the revenues of state and local governments come from taxes at the present time; the remainder is obtained from charges, utility income, intergovernmental revenue and miscellaneous sources. Since 1945, expenditures have been rising at an unprecedented rate, as pointed out above. To meet the rise in operating expenses, tax receipts of these governments have jumped from less than $11 billion in 1945 to an estimated $27 billion during 1957.

During the postwar years total revenues of Eighth District state and local governments have been expanding at about the same rate as in other areas of the nation. However, on a per capita basis total revenues of local authorities within the district amount to
less than three-fourths of the national average. In none of the seven district states has per capita revenue matched the United States average in recent years. However, as Table III shows, state and local taxes take, on the average, only slightly less of total personal income in the district than in the United States.

In final analysis, funds to meet any expansion in current operating expenditures of state and local governments must come primarily from increased tax revenue. A portion may come from additional Federal aid, but it is not likely that such grants will meet the growing needs of most communities. Ultimately, the bulk of Federal aid must also come from tax receipts, although through this device the tax burden may be shifted. State and local governments might also raise fees for services, such as utility rates, toll road charges or rentals on municipal auditoriums. However, such fees ordinarily cannot meet a major part of the financial need. Some governments have even resorted to borrowing to meet increased operating expenses, but it is generally agreed that borrowing should be reserved for capital improvement or emergencies.

The ability of local governments to raise tax receipts fast enough to meet rising operating expenses is limited. No one enjoys having to pay higher taxes even when the need for larger revenue has been clearly demonstrated. Tax systems of state and local governments are hemmed in by constitutional and legislative restrictions. The tax systems are further complicated by the normal workings of partisan politics, organized pressure groups, and struggles between various governmental units over division of the tax base.

Overlapping jurisdictions and antiquated tax structures have complicated the situation in many cases.

As mentioned above, there are numerous local governments, the majority of which operate within a small area or provide only limited services. In some sections of metropolitan areas, residents may be served by five or more separate authorities while neighbors only a few blocks away look to still other public agencies for services. Along with the fragmentation of governmental machinery goes a division of the tax base. Thus, communities which otherwise might readily provide the needed services run into troublesome financial problems. The critical areas of need for government expenditure do not always correlate with readily available sources of revenue, and many economies of scale are lost.

Some form of consolidation of the smaller governmental units within a metropolitan area would help to reduce financial difficulties in many cases. One approach to this has been to assign a bigger job to the central city by extending both its boundaries and functions. Another plan has been to establish metropolitan area governments for activities that can be more economically and efficiently handled on an area-wide basis. A third method might be to integrate the core city and county governments.

In addition to the need for more revenue to provide improved services, tax rates of some governmental units have had to be raised because of economic growth and inflation. Unless tax rates are marked up, state and local tax receipts generally respond sluggishly to economic development and to rising prices. At the same time, cost items have been quick to increase. Property taxes, which at the present time bring in a third of total receipts of state and local government units, have been quite unresponsive to changing conditions, largely because appraised values lag changes in real values. Even sales and excise taxes, which account for about one-fifth of total receipts, have not risen proportionately to income. Corporate and personal income taxes which rise more in proportion to income bring in only about 10 per cent of total state and local revenues; the remainder (over a third) is derived from such sources as Federal grants, license fees and miscellaneous taxes.

Borrowing has become more difficult because the amount of debt outstanding has increased sharply . . .

As mentioned earlier, major capital improvements, as distinguished from current operations, are frequent-
ly financed through the issuance of bonds by the governmental unit involved. To erect a hospital or a bridge with an expected life of over 30 years out of current taxes would generally impose so heavy a burden upon taxpayers as not to be economically feasible. Likewise, the desire for facilities is frequently so strong that construction cannot be postponed until the funds are saved from current revenues. Hence securities are issued to finance sewage systems, town halls, university classrooms, roads and other improvements of a permanent nature.

The chief buyers of municipal bonds are individuals in the higher income groups and commercial banks. Individuals, partnerships and personal trusts buy about two-fifths of the state and local government securities. Commercial banks purchase about a third of the new offerings; district member banks have increased their holdings of these securities from $149 million at the end of 1945 to $380 million in October 1957. Two other relatively large buyers of state and local government securities (taking about 10 per cent each) are local authorities themselves and insurance companies. The remaining 6 or 7 per cent is divided among many institutions, such as nonfinancial corporations, savings banks, savings and loan associations, pension funds and dealers and brokers.

During World War II, the financial position of most state and local governments improved considerably, primarily because construction outlays of these agencies were limited while revenues increased. The aggregate debt of these institutions was reduced roughly $4 billion, and liquid assets rose by over $8 billion. The end of the war found most local governments in fine shape financially but relatively poor in capital goods.

In most postwar years expenditures of state and local governments have exceeded revenues, although the difference in totals amounts to only $5 billion since the end of World War II. Yet, from 1946 through 1956 the outstanding debt of these authorities jumped about $32 billion. This paradox is largely explained by the fact that some authorities, especially those engaging in major public works programs, have borrowed heavily while others (considerably fewer in number) have run surpluses over the entire postwar period. Thus, the cash and other liquid assets of local authorities in the aggregate have been rising as steadily, although not as rapidly, as their debts.

... and in the last few years capital market flotations have been somewhat more difficult.

During the past several years interest rates generally have been increasing, reflecting substantial overall credit demands. Rates paid on municipal securities are now higher than they have been for many years.

Interest rates on state and local securities, however, are lower relative to other interest rates now than they were in the early 'thirties. This situation results from the fact that there are more investors, both institutional and individual, in position to benefit from the exemption of earnings on municipal securities from Federal income taxes. Federal income tax rates have been increased. In addition, in investors' judgment the risk involved in municipal securities has apparently declined.
During the last few years, however, the widened interest rate differential between corporate and municipal bonds has been narrowing, in response to both demand and supply conditions. Some individual investors have reportedly shifted from tax exempt securities toward stocks. Commercial banks, normally important buyers, have had to liquidate some of their holdings of municipals under increasing pressure for loan funds. Major savings institutions that have grown sharply in recent years, such as life insurance companies, savings and loan associations and mutual savings banks, do not benefit as much from investing in the tax exempt securities. On the supply side, a greater volume of new municipal issues has tended to saturate the market.

Despite these difficulties local authorities have been able to market nearly all of the securities offered during the current period of "tight" money. As for nearly all other borrowers, of course, the funds have been obtained at the expense of some increase in interest cost. Even though public attention has been focused on the occasional offering which has received no bids, most state and local obligations have been quietly and successfully issued during the recent period of capital market pressure.

The Investment Bankers Association estimates that roughly 93 per cent of the nearly $4.4 billion of municipal bonds offered for sale during the nine months ended March 31, 1957 were sold on initial offer. The bulk of the remaining 7 per cent have subsequently been re-offered with slightly altered terms and sold. Most of the originally unsuccessful issues were highway or bridge bonds, whereas nearly all school issues were successful on the initial offer. Unfortunately, it is impossible to obtain figures on the volume of securities that were contemplated but not offered because the potential borrowers considered the market adverse. Reportedly, the restrictive effect of the tight money situation upon the sale of state and local securities was also moderate in the Eighth Federal Reserve District.

NORMAN N. BOWSHER
Revised Indexes of Department Store Sales and Stocks

Indexes of department store sales and stocks in the Eighth Federal Reserve District have been revised for the period 1949 to date. Revised indexes have also been prepared for sales in five district metropolitan areas: St. Louis, Louisville, Memphis, Little Rock and Evansville. At the same time, revisions were made in the series published by the Board of Governors of the Federal Reserve System and other Federal Reserve Banks.

The indexes, which are based on reports from a sample of department stores, have been adjusted to agree with the trend of sales of all such stores as determined by the Censuses of Business for 1948 and 1954. Seasonal adjustment factors have been reviewed for the period 1949 to date and have been revised where necessary. Prior to this revision, if the month had five Saturdays, one-third of a day was added to the number of trading days for calculating daily average sales. This adjustment has been dropped and indexes now indicate the level of daily average sales with each trading day given equal weight. The greater weight given to Saturdays in the old indexes was based on the greater volume of sales on that day than on other days. In the postwar period, however, the institution of night openings and the development of branch stores has reduced the relative importance of Saturdays.

The adjustment of indexes to Census benchmarks was accomplished in accordance with techniques described in the Federal Reserve Bulletin, December 1951 and December 1957. Seasonal factors were determined by the standard ratio-to-moving-average method. This procedure is described specifically in the Federal Reserve Bulletin, June 1941, or may be found in many standard textbooks on statistics.

Reprints of the article on the revision in the Federal Reserve Bulletin, December 1957, district sales and stocks indexes and sales indexes for five district metropolitan areas, with revisions for the period from 1949 to date, may be obtained by writing the Research Department, Federal Reserve Bank of St. Louis, Post Office Box 442, St. Louis 3, Missouri.
Evidence of a decline in the nation's economic activity became apparent from reports appearing in November. Industrial production, retail sales and employment declined on a seasonally adjusted basis from September to October. Construction activity, on the other hand, expanded somewhat to a new record.

In November, the trend of business activity showed little further deterioration. Steel production continued to ease, but automobile output rose rapidly. Electric power output, after allowance for seasonal changes, showed a modest improvement from October. Insured unemployment, while significantly higher than a year earlier, rose relatively about the usual amount in early November. Department store sales in the first three weeks of November rose more rapidly than usual from the low level reached in October. Most of the available measures, however, indicated a lower level of manufacturing activity this year than last.

The decline in activity was accompanied by abatement of inflationary pressures and an easing of demand for bank credit. In light of these developments, the discount rate at the Federal Reserve Banks was lowered from 3 1/2 to 3 per cent in November.

The easing of inflationary pressures was apparent in the recent trend of prices. The general level of wholesale commodity prices was relatively stable from mid-October to mid-November, following a slight decrease in the preceding month. The consumer price index, which had been rising almost steadily since early 1956, remained basically unchanged from September to October as lower food prices and transportation costs offset increases in other prices.

In the Eighth Federal Reserve District business conditions in November were mixed. Increases from October levels were registered by department store sales and by some manufacturing activities. On the other hand, the demand for bank credit expanded less than seasonally, and adverse weather conditions reduced crop prospects.

Output of automobiles increased in November, following model-changeover shutdowns in the preceding month. In Louisville, automobile assembly was interrupted by a work stoppage which began November 5 and ended November 29. Household appliance production also increased a little during November. These increases were largely responsible for the decline in insured unemployment from mid-October to mid-November in the four largest district cities. In the latter part of November, however, insured unemployment turned up again, following seasonal layoffs in some industries and reduced employment in aircraft plants.

Despite the slight upturn recently, manufacturing activity in the district was apparently less than a year earlier. In October, manufacturing employment was below year-earlier levels in St. Louis and Louisville and about the same in Memphis, Evansville and Little Rock. In November, output of steel ingots, lumber, crude oil and meat was also less than a year earlier.

District construction activity, as indicated by construction contracts awarded, was somewhat greater than a year ago. For the first nine months of the year total contracts were 4 per cent greater than in the corresponding period last year compared with an advance of 2 per cent in the United States. The district gain resulted entirely from greater residential construction, primarily because of large contracts awarded early in the year for housing military personnel at Fort Knox, Kentucky, and Little Rock Air Force Base. Nonresidential, public works and utilities construction contracts were slightly less than a year ago.

The overall district gain was not evenly distributed. In St. Louis and Louisville, construction contracts awarded for residential and nonresidential construction were substantially less than a year ago. In Memphis, Little Rock and Evansville, however, contracts were a little larger. In Memphis and Evansville, the
increase resulted from greater nonresidential building activity.

Consumer buying at district department stores increased less than the usual amount in October and was lower than a year earlier. The seasonally adjusted index of district department store sales fell sharply in October to the lowest level since June 1955. In the first three weeks of November sales rose somewhat more than the usual amount, indicating a little improvement, but continued to fall short of year-earlier levels. The lag in consumer buying was attributed to a number of factors. The largest district declines from a year ago occurred in Memphis, where deterioration of cotton crop prospects affected consumer buying attitudes, and in Louisville, where much of the decline was attributed to reduced employment and work stoppages.

District department store sales also mirrored the selective shifts in consumer buying. So far this year sales of house furnishings have lagged, while sales of clothing have been somewhat greater than a year ago.

Reflecting a somewhat smaller rise in personal incomes in the district than in the nation so far this year, district sales have shown less strength. For the year to date, the nation’s department stores sold 1 per cent more than in the corresponding period a year ago, while district department store sales declined 1 per cent.

During late October and the first three weeks of November, loan expansion at district weekly reporting banks fell short of the seasonal growth. Total loans, except interbank, rose $8 million, about one-fifth the usual expansion at this time of year. The weakness centered in the business loan area; however, this was somewhat alleviated in the week ended November 20, as loans to commerce and industry rose strongly. Advances to commodity dealers were smaller than usual for this time of year, and sales finance companies continued to repay bank loans. On the other hand, trade concerns and public utilities added more to their outstanding indebtedness than the average increase during the like weeks of recent years. Also, manufacturers of textiles, apparel and leather added on balance to their borrowings (primarily in the last week under review) in contrast to usual net repayments at this season. Loans to brokers and dealers for purchasing or carrying securities and on real estate declined moderately, and “other”, largely consumer, loans were virtually unchanged in the four weeks.

Adverse weather conditions in October and the first half of November reduced district crop prospects. In October, freezing temperatures occurring one to four weeks earlier than usual terminated growth and reduced yields of some cotton stands. In November heavy rains throughout much of the district, accompanied by floods in some areas, hindered harvesting operations, cutting corn and soybean yields, and further reduced cotton yields and quality. Damage to these crops was reported to be substantial in many areas, although estimates of the exact amount had not yet been determined. The unfavorable developments in October and November further aggravated the previous weakness in the farm sector of the district’s economy. For the first nine months of the year cash farm income in the Eighth District was 9 per cent less than in the comparable period of 1956, although it was still 3 per cent higher than in the first three-quarters of 1955. The decline in agricultural income reflected primarily lower marketings as farm product prices continued to average higher than a year earlier.
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**FEDERAL RESERVE BANK OF ST. LOUIS**

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Steel Ingot Rate. St. Louis area (Operating rate, per cent of capacity) .... 89.1 89.8 88.0 88.1 90.4 89.9
Coal Production Index— 8th Dist. (Seasonally adjusted, 1947-49=100) .... 100.8 101.3 100.6 100.7 100.9 101.0
Crude Oil Production— 8th Dist. (Daily average in thousands of bbls.) ... 96.4 98.4 96.3 96.6 97.3 97.7
Lumber Production— 8th Dist. (Daily average in thousands of bd. ft.) ..... 211.7 212.6 212.6 212.6 213.7 214.1
Lumber Production— 6th Dist. Operating rate, per cent of capacity) ..... 81.5 81.3 81.2 81.1 81.3 81.5
* Percentage change is shown in each case. Figures for the steel ingot rate, Southern hardwood rate, and the coal production index show the relative percentage change in production, not the change in index points or in per cents of capacity.

INDEXES OF DEPARTMENT STORE SALES AND STOCKS

EIGHTH DISTRICT WEEKLY REPORTING MEMBER BANKS

CASH FARM INCOME

CONSTRUCTION CONTRACTS AWARDED

INDEXES OF DEPARTMENT STORE SALES AND STOCKS

8TH DISTRICT* 

DEPARTMENT STORES

1 In order to permit publication of figures for this city (area), a special sample has been constructed which is not confined exclusively to department stores. Figures for any such nondepartment stores, however, are not used in computing the district percentage changes or in computing department store indexes.

2 Fayetteville, Pine Bluff, Arkansas; Harrisburg, Mt. Vernon, Illinois; Vincennes, Indiana; Danville, Hopkinsville, Mayfield, Owensboro, Kentucky; Chillicothe, Missouri; Greenville, Mississippi; and Jackson, Tennessee.

Omitting orders of reporting stores at the end of October 1957 were five per cent less than on the corresponding date a year ago.