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BANKING

Taxes, Savings Are Keys to Stability

THE record peacetime quarterly deficit of $2.6 billion reported by the Treasury for the first three months of the new fiscal year (ending June 30, 1952) points up once again the problems associated with large scale deficit finance. Not since 1945 has the Treasury been faced with such a large deficit.

The joint committee on the Economic Report estimated in August that under then existing legislation budget expenditures would exceed receipts by $7 billion.

On October 20 President Truman signed a tax bill designed to add $5.6 billion to Treasury revenue over a 12-month period. The joint committee's estimated deficit will be reduced by a lesser amount, since four months have already elapsed in the present fiscal year.

The prospect for continued Treasury deficits raises some questions with regard to the relative desirability of alternative methods of Treasury finance. Basically, there are three sources of Treasury revenue:

(1) Receipts from taxes;

(2) Receipts from sale of securities to nonbank investors;

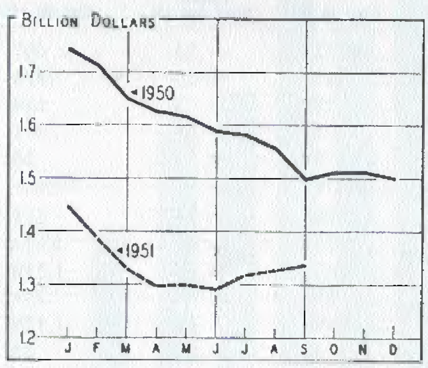
(3) Receipts from sale of securities to the banking system.

Inflation being the chief economic problem in America today, it seems appropriate to consider the alternative methods of Treasury finance with a view to appraising the inflationary consequences of each.

Although popularly thought of simply as rising prices, inflation in the technical sense refers to an increase in the level and use of the money supply relative to the stock of goods and services available for purchase (by government, business, consumers, and the rest of the world); this being the case they are inflationary to the extent that various methods of government finance increase the money supply or decrease the stock of goods and services.

Receipts from taxes: Taxes do not add to the money supply; they only change the ownership of money already in existence. Taxes are inflationary only to the extent that high tax rates discourage production that otherwise would have occurred (including the decline in the value of production arising from the misallocation of resources by businessmen in an effort to reduce excess profits tax liability). It is possible that taxes even encourage production by people anxious to maintain "take home pay."

GOVERNMENT SECURITY HOLDINGS OF 9TH DISTRICT MEMBER BANKS, 1950 AND 1951



LIQUIDATION of government securities at Ninth district member banks, which had continued throughout 1950 and early 1951, halted in March when government securities declined to less than par. (See Banking Developments, Page 223.)

- ***Two sources of revenue afford least inflationary mechanism for diverting goods and services to military.***
- ***Civilian economy must temporarily forego consumption of goods at pre-Korean rate.***
- ***Treasury reports record peacetime deficit for first quarter of 1952.***
- ***Wartime level of taxation not yet reached.***

In the final year of World War II, net* federal tax receipts amounted to 21% of total production in the economy. A return to this level of taxation calls for an increase of approximately $3 billion in federal taxes.

Receipts from sale of securities to nonbank investors: The purchase of government securities out of savings, either directly or through savings institutions such as insurance companies, savings banks, etc., is not inflationary. The money supply is not increased (only ownership changed), nor is there any destruction of incentive to produce.

Conceivably, in the long run, the flow of savings to government rather than to business for the improvement of plant might cause the productivity of labor to improve less rapidly, but this is a remote consideration. Granting a constant money supply, it means only that there would be less deflation than otherwise.

Receipts from sale of securities to the banking system: The sale of

*Exclude appropriations to trust funds and refunds.

securities to the banking system is of course inflationary. These sales add to the money supply. At the banks, the increase in the asset item "government securities" is offset by an increase in deposit liabilities, which deposits constitute most of the money supply.

Also of great importance is the distribution of government securities within the banking system—distribution, that is, with respect to Federal Reserve banks and commercial banks. For instance, in the year subsequent to June 30, 1950, transactions in government securities by the banking system were distinctly inflationary in spite of the fact that, on balance, government securities were shifted out of the banks.

The reason for this apparently paradoxical situation lies in the relationship between Federal Reserve bank holdings of government securities and bank reserves. When the Federal Reserve banks buy governments, commercial bank reserves are increased. An addition to bank reserves permits an expansion in commercial bank credit (loans and investments) between four and five times as great as the increase in reserves.

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Receipts from Agriculture Swell Ninth District Bank Deposits

Deposits at Ninth district member banks increased faster in September than in any other month this year. This to a large extent reflects the seasonal increase in cash farm income arising from the marketing of agricultural commodities. Department of Agriculture estimates indicate that Ninth district farm income reaches the peak for the year in September and October. In contrast, a seasonal decline in Ninth district bank deposits occurs in the early part of the year as farmers withdraw deposits in order to finance crop production.

Demand and time deposits increased $67 million and $2 million respectively. Most of the increase in demand deposits occurred at country banks, whereas the addition to time deposits was evenly divided between city and country banks.

Government security holdings in the aggregate were increased during September at Ninth district member banks. While country banks added $12 million to their holdings, city (weekly reporting) banks liquidated $2 million in governments.

Permitting a substantial increase in all types of assets at country banks was a large inflow of deposits. At the city banks, a lesser increase in deposits together with considerable borrowing provided funds for an expansion of loans and an addition to balances at other banks.

The loan breakdown for the city banks indicates that the increase in loans represents an addition of $16 million to the commercial, industrial, and agricultural type of credit. This was only partially offset by a decline of $7 million in other (largely consumer) types of loans.

Borrowing by banks, all of which were city banks, was at $37 million at the end of September, up $24 million from the end of August. Credit extended to banks in the form of discounts and advances at the Federal Reserve Bank of Minneapolis increased $15 million during the period. END

Assets and Liabilities of Member Banks in the Ninth Federal Reserve District

(In Millions of Dollars)

ITEM	All Member Banks Sept. 26, 1951	All Member Banks Change Since Aug. 29	City Banks (weekly reporting) Sept. 26, 1951	City Banks (weekly reporting) Change Since Aug. 29	Country Banks (non-weekly reporting) Sept. 26, 1951	Country Banks (non-weekly reporting) Change Since Aug. 29
Loans and Discounts	$1,222	+ 23	$ 607	+ 8	$ 615	+ 15
U. S. Government Obligations	1,335	+ 10	493	— 2	842	+ 12
Other Securities	278	+ 4	134	+ 2	144	+ 2
Cash and Due from Banks	927	+ 56	491	+ 42	436	+ 14
Other Assets	34	— 1	16	— 1	18	....
Total Assets	$3,796	+ 92	$1,741	+ 49	$2,055	+ 43
Due to Banks	366	+ 25	315	+ 17	51	+ 8
Other Demand Deposits	2,234	+ 42	1,024	+ 6	1,210	+ 36
Total Demand Deposits	2,600	+ 67	1,339	+ 23	1,261	+ 44
Time Deposits	896	+ 2	235	+ 1	661	+ 1
Total Deposits	3,496	+ 69	1,574	+ 24	1,922	+ 45
Borrowings	37	+ 24	37	+ 25	....	— 1
Other Liabilities	29	....	21	+ 1	8	— 1
Capital Funds	234	— 1	109	— 1	125	....
Total Liabilities and Capital Accounts	$3,796	+ 92	$1,741	+ 49	$2,055	+ 43

Reporting bank data are from balance sheets submitted weekly. Non-reporting bank data are in part estimated. Data on loans and discounts, U. S. government obligations, and other securities are obtained by reports directly from the member banks. Balances with domestic banks, cash items, and data on deposits are largely taken from semi-monthly reports which member banks make to the Federal Reserve bank for the purpose of computing reserves. Reserve balances and data on borrowings from the Federal Reserve banks are taken directly from the books of the Federal Reserve bank. Data on other borrowings are estimated. Capital funds, other assets, and the other liabilities are extrapolated from call report data.