

Economic Review



FEDERAL RESERVE BANK OF ATLANTA

OCTOBER 1985

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PLANNING Impact on Profitability

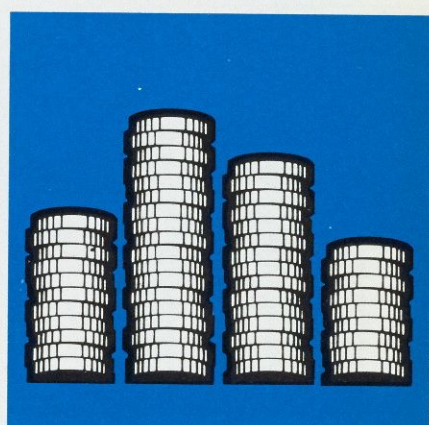
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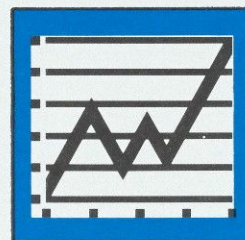
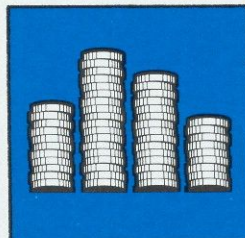
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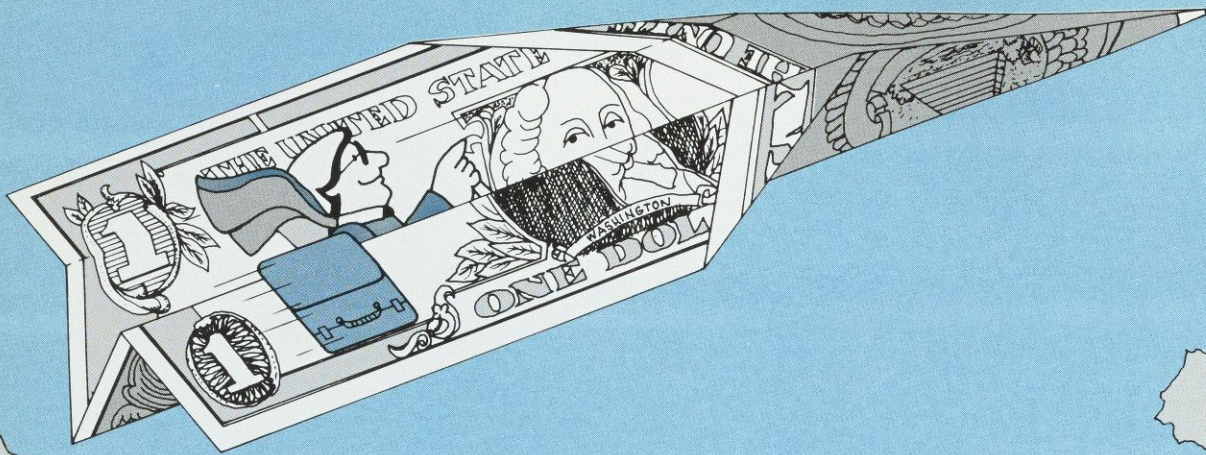
4 **The Dollar and the U.S. Travel Deficit** How has the soaring dollar affected U.S. travel and the nation's travel deficit?

14 **Bank and Thrift Profitability: Does Strategic Planning Really Pay?** With the banking environment awash in change, can a formal planning process buoy profits?

26 **The Thrift Charter: A Valuable Alternative for Commercial Banks?** Why are most commercial banks not using their option of converting to thrift institutions? What might happen to the financial system if they did?

38 **Economic Brief**
The Cattle Cycle: A Pattern Gone Awry

42 **Statistical Summary** Finance, Construction, General, Employment



The Dollar and the U.S. Travel Deficit

Jeffrey A. Rosensweig

While causing the number of U.S. travelers abroad to soar, the dollar's strength has sent our travel balance into a nosedive. An economist looks at this worrisome trend.

The economic consequences of the dollar's strength are commanding heightened attention. Among these effects, record U.S. trade deficits have been especially highlighted, but the parallel deterioration of our international travel balance has been given short shrift. The "travel balance" is the balance on foreign travel and passenger fares—our "exports" or receipts from foreigners in the United States, minus our "imports" or expenditures abroad for travel and fares. We import travel services if we spend money abroad or pay passage on foreign airlines and passenger ships. Just as with goods trade, our imports of travel services are far outstripping our stagnant travel exports. In 1983 and again in 1984, deficits on travel reached record highs.

The adverse impact of the dollar on the travel balance deserves emphasis for two reasons.

The author is an international economist on the Research Department's macropolicy team. The author thanks Christopher P. Beshouri for providing valuable comments and research assistance.

First, many travel-related service industries (particularly the Southeast's tourist trade) are suffering from the strong dollar, which refutes the frequent claim that the dollar's ascent hurts only manufacturing. Second, travel deficits are becoming massive enough to add significantly to our international current account deficits and thereby to our growing net foreign debt.

Our investigation of the travel deficit yielded several interesting findings. Since 1981 the travel deficit has widened dramatically, chiefly owing to the strengthening dollar. This headlong growth in the travel deficit has contributed heavily to the shrinkage of our surplus on services, which traditionally has helped to offset U.S. merchandise trade deficits. As the services surplus plunges, present and prospective current account deficits rise.

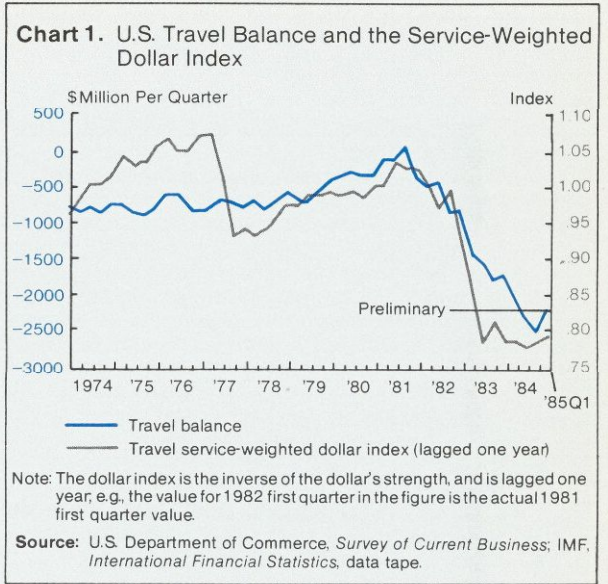
The travel deficit climbed from under \$500 million in 1981 to \$8.67 billion in 1984, yet this serious upset in the U.S. travel balance has not been analyzed thoroughly. Jane S. Little made a detailed study of U.S. travel accounts prior to 1980; there is scant other econometric work

on the U.S. travel balance.¹ However, some studies have explored the marked influence of exchange rates on travel service earnings.²

Our Massive Travel Deficit: The Facts

How did the travel deficit worsen by over \$8 billion in just three years? Of the non-goods component's contribution to the decline in the current account since 1981, travel is responsible for 30 percent. Last year's deficit of \$8.67 billion eclipsed the record \$5.58 billion travel deficit in 1983, and a new record is expected this year. Flourishing travel service imports are the mainspring for the travel deficit's growth. From 1981 to 1984, Americans increased their spending abroad by 41 percent, from under \$16 billion to \$22.5 billion dollars, and the number of Americans visiting overseas (excluding neighboring Mexico and Canada) rose 50 percent, to over 12 million travelers.³ During the same period, foreigners decreased their spending in the United States and on its carriers from \$15.5 billion to under \$14 billion. Clearly, our travel services imports have thrived while our exports have languished.

Chart 1 suggests a principal reason for the gaping travel deficit—the strong dollar. The chart plots the U.S. travel balance against an effective exchange rate index adjusted for

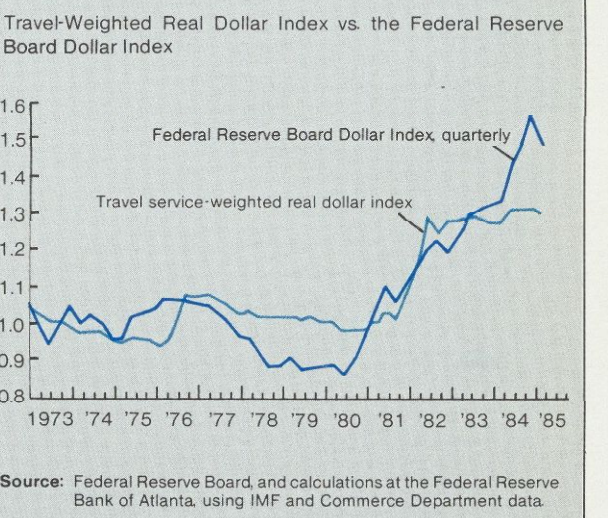


inflation. This index was specially constructed to capture the price of consumption abroad relative to consuming in the United States. Since travelers respond to exchange rate or relative price changes with substantial delay—they plan trips and book them well in advance—the relative price index is lagged one year in the figure. The accompanying box explains the

CONSTRUCTING A DOLLAR INDEX

We created a dollar index specifically for this article, aiming to capture the effect of dollar movements on the U.S. travel balance. Our measure differs from standard dollar indexes in two major ways. (For a summary of standard indexes see David Deephouse, "Using a Trade-Weighted Currency Index," *Economic Review*, Federal Reserve Bank of Atlanta, vol. 70 (June/ July 1985), pp. 36-41.) First, ours is a real, rather than merely a nominal exchange rate index. Second, we use a country's share in U.S. foreign travel (as opposed to goods trade), imports as well as exports, to weight its currency. The result is an index useful for our purposes, although it differs from the conventional Federal Reserve Board index (see figure).

We constructed our own index because we need a measure of the dollar as it affects travel services, not goods, trade. The weighting scheme behind any index should reflect its purpose, and ours involves the U.S. travel balance. Conventional trade-weighted indexes are suitable only for studying trade balance determination. We extend the literature by studying a major



service balance, and by offering a (travel) service-weighted dollar index.

A real exchange rate index corrects a nominal index for differential rates of inflation in the various countries. Relative prices, expressed in any common currency, are crucial to economic competition. If a devaluing country has rapid inflation, its dollar price relative to competitors' may rise, and it loses competitiveness despite its devaluation. For instance, assume Mexico has 30 percent inflation and the United States only 5 percent. If Mexico devalues 20 percent against the dollar in a year, then dollar costs still would rise faster there than in the United States despite Mexico's large nominal devaluation. A real exchange rate (*re*) between the U.S. and Mexico could be defined as $re = \frac{e \times P_a}{P_m}$

Here P_m is the Mexican price level, P_a the U.S. price level, and e is the Mexican peso cost of a dollar. Higher "re" values correspond to a lower relative price in Mexico, or a stronger (appreciated) real value of the dollar. Our travel real exchange rate uses the consumer price index (CPI) as the price index relevant for travel, under an assumption that travelers or tourists purchase the "CPI basket" when they visit a country. True tourist consumption baskets probably differ from that used to weight a domestic CPI, but since tourists consume in a country, and tourism price indexes are not routinely calculated, the CPI is the best proxy available.

The second stage in constructing our index was to aggregate the real exchange rates versus various "travel trading partners" into one aggregate dollar (or relative price) index. We chose a geometric average of the real exchange rates of the U.S. against its 10 major travel trade partners. Weights are bilateral, meaning they use the total travel spending between the country and the U.S. as the numerator, and the sum of all travel trade between the U.S. and the 10 countries in the denominator. Finally, for extra accuracy we calculate the shares or weights in 1977, 1980, and 1983, and then use the average share for each country over the three years. The terminology used above, and theory of exchange rate indexes, is explained more fully in Deephouse (1985).

The 10 major U.S. travel partners, and their shares in our real exchange rate index for travel, are shown below. These 10 account for over 70 percent of total U.S. foreign travel trade and they are geographically disparate; therefore, they should serve as a good proxy for our total travel trade. Canada and Mexico, our neighbors, are our dominant travel partners, each receiving a weight of nearly one third in the index. Thus, our index will be highly sensitive to movements of the U.S. dollar against the Mexican peso or Canadian dollar. This is a desirable quality of our index, since our travel balance is substantially affected by prices in Canada and Mexico relative to those in the United States.

Country	Weight in dollar index for travel
1. Mexico	.3267
2. Canada	.3167
3. United Kingdom	.0871
4. Japan	.0694
5. Germany	.0534
6. France	.0418
7. Australia	.0326
8. Italy	.0317
9. Bahamas	.0256
10. Jamaica	.0150
Sum	1.0000

European currencies receive much smaller weights in our index than in merchandise trade-weighted indexes, especially multilateral weighted ones (the Fed index). The data for our weights appear in various annual travel articles in the *Survey of Current Business*. The exchange rate and CPI data come from the International Monetary Fund's *International Financial Statistics*. We also incorporate parallel or black market exchange rates in Mexico and Jamaica when they apply to tourism.

The figure shown on p. 5 helps us contrast our index to the dollar index published by the Federal Reserve Board. Recall that differences are attributable either to our correcting for inflation differentials or because we weight by bilateral travel service shares, whereas the Board weights by multilateral (world) trade shares. The practical effect of the multilateral weighting scheme is an increased emphasis on European currencies (see Deephouse). Our bilateral travel weights place a much greater emphasis on Canada and lead us, unlike the Board, to include Mexico. A few major periods of contrast stand out in the figure. Our index rises (the dollar appreciated) in 1976 when Mexico devalued. The Board index falls more steeply from 1977 through mid-1980 because it places greater weight on the European currencies, which appreciated against the dollar. The opposite occurs when the dollar rises in late 1980 and 1981. In 1982 our index rises more steeply than does the Board index, as only our index weights Mexico, which had its maxi-devaluations then. From 1983 to the present our index has flattened because of the heavy weights we accord Mexico and Canada. Canada has depreciated far less than the European currencies, which pull the Board index up in this recent period, and Mexico had a large inflation that appreciated its real exchange rate after 1982. Our index is less volatile than that of the Board in 1985, as our substantial weight on Canada dampens the spike that European currencies caused in the Federal Reserve Board index.

theory and construction of this new dollar index, and contrasts it with existing indexes of the dollar's average exchange value.

The close fit in Chart 1 illustrates that as the dollar has advanced in the 1980s, making foreign prices cheap relative to ours, it has been instrumental in the rising travel deficit. We will amplify this point by estimating the determinants of the travel balance and then subdividing its decline into several factors: a piece caused by strong dollar, a piece caused by faster recovery in GNP here than abroad, and other factors. We find that the dollar's strength predominates over the other factors, suggesting that various service industries, not just goods manufacturers, are vulnerable to foreign competition and the vagaries of the dollar.

How Does the Travel Deficit Fit In?

In international balance of payments accounts the travel balance is part of the service balance. This service balance adds to the merchandise trade balance for what we know as the "balance on goods and services." Adding net transfer receipts to the latter yields the current account.⁴ Despite the popular emphasis on the merchandise trade balance, the current account is the most economically crucial balance because it equals the change in our net foreign asset position (ignoring changing values of existing net assets). As our balance on all continuing operations, the current account is equivalent to our net foreign investment. A surplus means that we invest abroad, whereas deficits imply that we borrow abroad to square our international payments. A recent consequence of our borrowing to finance huge current account deficits is that the United States has become a net debtor nation, a dubious distinction. The travel deficits have contributed to our present net debtor status, albeit as a junior partner to the trade deficits.

Importance of the Travel Deficit

The mushrooming U.S. deficit on travel (including fares) demands more attention for two major reasons. First, travel deficits imply harm to our travel-related service industries, because they indicate that these industries are losing out to foreign competitors and are being

affected adversely by the strong dollar. Second, as discussed above, the travel deficits worsen our status as an increasingly indebted nation, as they help pull our international current account down. Let us examine the travel deficits' impact on our economy.

Effect on Travel-Related Industries. Vast travel deficits point to substantial lost business for our travel-related service industries. The surge in American travel abroad means fewer U.S. vacationers patronizing out hotels, rental cars, airlines, restaurants, and tourist attractions. These same industries, and their allied service workers, also suffer from the loss of potential foreign visitors who are priced out of our markets by the dollar's steep exchange rate.

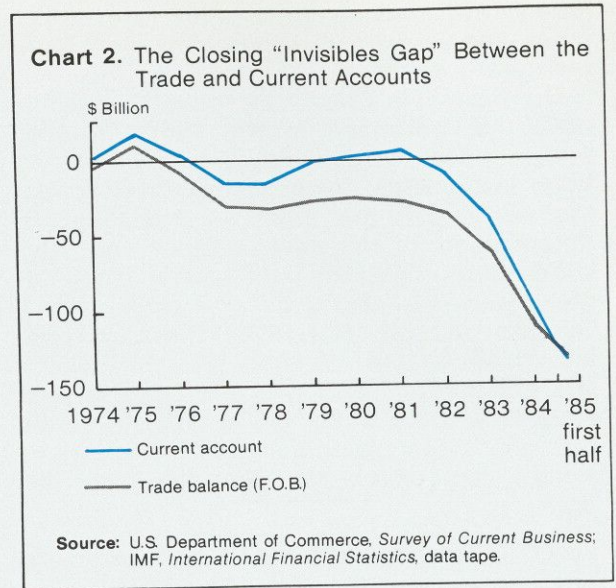
Certainly, the strong dollar has damaged these travel-related industries, and yet the financial press abounds with commentary distinguishing "booming service sectors" from "goods-producing sectors suffering from the strong dollar." Rather than goods versus service industries, the economically meaningful distinction is tradable sectors, which are open to foreign competition, versus non-tradable sectors, which are not. Sectors can be non-tradable (also called "home" or "sheltered" sectors) because of obstacles such as prohibitive transportation costs, tariffs, or quotas. Of course, these obstacles can apply to some goods and not to various services—for instance, electronic banking. Whereas the strong dollar does not directly affect non-tradable services (for example, haircuts), it can handicap tradable service sectors. Thus, it is erroneous to say all services are burgeoning. Tradable services such as economic consulting and travel-related industries may suffer more from a strong dollar than do certain goods-producing sectors such as defense industries and cement producers.

Employment shares are shifting toward services from manufacturing, but this shift represents secular trends and productivity, and probably not an effect of the strong dollar. Indeed, in the period of dollar strengthening since 1980, our gross national product has not veered toward services as opposed to goods production. On the contrary, in constant dollar terms goods output was 46.5 percent of GNP in the first quarter of 1985 versus only 45.3 percent in 1980.⁵ Pressure has been applied to all industries subject to intense foreign competition, and travel services fit this bill.

What is the effect of the more than \$8 billion increase in the travel deficit since 1981? Had this change not occurred, we could have created many more jobs in travel-related industries such as hotels, tours, and souvenir retailing. If an estimated \$80,000 in travel spending supports one job on average, then the decline in the travel balance since 1981 has cost us over 100,000 jobs. The Southeast's travel-related service industries would have claimed many of these potential jobs lost to the strong dollar. The impact of exchange rate changes on travel-related service jobs is quite strong in the Sixth Federal Reserve District. Because of large devaluations in Mexico and Jamaica, among other nations, sun-seekers have turned from Florida beaches to foreign locations. Also, the precipitous fall of European currencies against the dollar has hurt Florida, New Orleans, and other southeastern destinations that had penetrated the European tourist market significantly by 1981.

Effect on External Deficits and Debt. Aside from the lost business it entails, the widening U.S. travel deficit also deserves attention because of its impact on our current account. Until very recently, the current account balance was more favorable than the trade balance, since the U.S. was running substantial surpluses on the non-merchandise current account, often called the "invisibles" balance. These surpluses on invisibles resulted from a large positive net investment income component, which dominated our negative net transfer receipts and small deficits on travel.

The problem today is that the U.S. net invisible earnings provide a steadily shrinking offset to the growing deficits on visible (goods) trade.⁶ The dwindling non-merchandise gap between the goods trade balance and the current account is portrayed in Chart 2. Note that goods trade has been in deficit every year since 1975, and that services (invisibles) have helped pay for these merchandise deficits—until now. Observers frequently explain the shrinking (or reversing) invisibles gap by pointing to the rapid decline in our net investment income. The reason for this decline is that our large current account deficits imply increasing net foreign debt. This new debt must be serviced—we will ignore principal repayments when we say servicing—and these outlays reduce our surplus on investment income. Deficits lead to debt, the



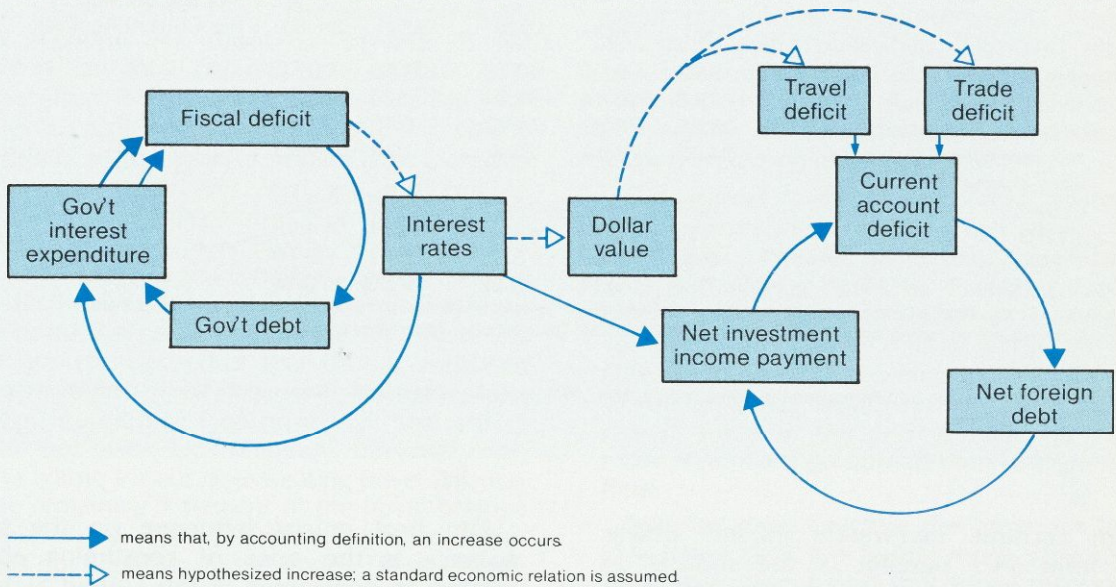
servicing of which contributes to future deficits, hence future debt.

The dynamics for government (fiscal) deficits and debt are the same as for the external accounts, and the two are related. The strong dollar is the major link between the deficits, but underlying the dollar's value is our borrowing abroad (the counterpart is current account deficits) and foreign lenders' willingness to help finance massive fiscal deficits. If the deficits cumulate into debt rapidly, we could enter dual vicious circles of deficits, the dollar, and debt. Chart 3, a schematic drawing of the linkages that form the dual circles, depicts the travel deficit as the second major non-merchandise force ballooning the current account deficit. In this role the travel deficit contributes to the net foreign debt, the servicing of which pulls our net investment income down. This decline is the primary force eroding our non-merchandise balance.

Our simplified view of the intertwined deficit and debt circles is one that the majority of economists, given a set of assumptions, would accept. The solid-lined arrows are chains of influence that are true by accounting definition; the broken-lined arrows represent causal influences that most economists believe usually hold. Expanded fiscal deficits raise government debt and interest rates higher than they otherwise would be, and both of these effects

Chart 3. The Dual Vicious Circles of U.S. Deficits, the Dollar, and Debt

After a large fiscal deficit increase all items in the boxes increase.



feed back through larger interest expenditures to increase future deficits.

Higher interest rates attract capital inflows from abroad, driving the dollar up. (Continued capital inflows support the strong dollar even after it causes current account deficits.) Following the inevitable lags, the trade deficit and the travel deficit rise with the dollar. Conventional empirical evidence suggests that a permanent 1 percent dollar rise increases the trade deficit by over \$2 billion, and we estimate that it also increases the travel deficit by \$275 million (see Appendix).⁷ These boosts to the trade and travel deficits combine to increase the current account deficit.⁸ Current account deficits cumulate into net foreign debt, which implies servicing flows abroad that feed into the current account deficit and constitute the second vicious circle. For example, if we assume a 10 percent interest rate, the added foreign debt created by a \$10 billion travel deficit means \$1 billion extra in servicing payments in every future year. Including a projection of greater than \$9 billion for 1985, travel deficits the past three years total over \$23 billion.

Components of the Current Account's Decline

The U.S. international current account turned from a surplus of over \$6 billion in 1981 to a deficit exceeding \$100 billion in 1984. Which components of the current account can be blamed for this deterioration? Table 1 answers this question by singling out the (goods) trade balance as the main culprit. The trade balance accounts for \$80 billion out of the nearly \$108 billion deterioration, or almost three fourths of it; non-goods or "invisibles" accounts comprise 25.6 percent of the total decline. This "gap" between the current account deficit and the trade deficit has shrunk from a surplus over \$34 billion to one under \$7 billion in 1984 and is turning negative, as Chart 2 projected.

Table 1 illustrates that the two main players in this shrinking of the invisibles "gap" are the \$15 billion fall in net investment income and the widening travel deficit. The growth of this deficit since 1981 accounts for 7.6 percent of the deterioration in the current account, and about 30 percent of the decline in the invisibles

Table 1. The Deteriorating Current Account: A Decomposition
(\$ billion)

	1981	1982	1983	1984	'84-'81	As a Percent of the Change in the Current Account
Current Account	6.29	-8.05	-40.79	-101.53	-107.8	100
Goods trade balance	-28.0	-36.44	-62.01	-108.28	-80.28	74.4
Non-goods current account	34.29	28.39	21.22	6.75	-27.54	25.6
Net investment income from abroad	34.05	29.49	25.4	19.1	-14.95	13.9
Other*	0.24	-1.10	-4.18	-12.35	-12.59	11.7
NTR	-6.83	-8.13	-8.85	-11.41	-4.58	4.2
Travel	-0.48	-2.08	-5.55	-8.67	-8.19	7.6
O.S.&M.	7.55	9.11	10.22	7.73	0.18	-0.2

*Includes the "invisibles" or non-merchandise current account minus net investment income. It comprises NTR (net transfer receipts), Travel (the balance on foreign travel and passenger fares), and O.S.&M. (other services and military transfers).

Source: All data from table 3.10, *Federal Reserve Bulletin*, vol. 71 (Sept. 1985), except for travel data, which come from the *Survey of Current Business*, various issues.

current account. Investment income downturns form 54.3 percent of the shortfall in invisibles, and increased net transfer payments abroad comprise the remaining one sixth.

In summary, the current account balance deteriorated by over \$100 billion in just three years following 1981. Record trade deficits were the main causal factor, followed by the decline in investment income as the U.S. serviced the borrowing implied by widening deficits. We have identified a third major drag on the current account, the travel and fare deficits, which are approaching \$9 billion a year.

Explaining the Rising Travel Deficit

In order to estimate the influence of crucial economic forces responsible for the decline in the travel balance, we constructed a simple model. This travel balance model takes three variables into account. First, if U.S. income (as measured by GNP) rises, we will want to consume more luxuries, including foreign travel. Thus, fast growth in this country adversely affects our travel balance. Second, the opposite occurs if the major foreign sources of visitors to the United States experience a rapid climb in GNP. (We constructed an index to measure effective foreign GNP. For details of the index and of the econometric work underlying this section, see Appendix).

The final crucial influence on the travel balance is the price of consuming abroad relative to consuming in the United States. A vigorous dollar lowers this relative price, hurting our travel export earnings as foreigners are priced out of the United States, and increasing our imports of travel services as we rush abroad for our vacations. In sum, the U.S. travel deficit would widen if a rising dollar increases the relative price of our output, or if income (GNP) and hence demand for foreign travel grows faster in this country than in our major markets. Note the similarity of our model for the travel balance to many models of merchandise trade balance determination. For tradable products, be they goods or services, relative incomes and prices should largely determine the balances.

The results of our econometric exercise support the strong dollar's dominant role in explaining the worsening of the travel balance since 1981. We estimate that a permanent 10 percent strengthening or appreciation of our travel-weighted real dollar index erodes the travel balance by about \$2.75 billion annually. This sensitivity of the travel balance to the dollar is an interesting finding. It is well known that foreign travel, as a luxury, is income elastic; that is, it increases more than proportionally with an increase in income. Our empirical work also uniformly found travel to be highly price elastic. A variant of the dollar index adjusted to account

for lagged effects (a moving average of past and current values; see Appendix) appreciated just over 25 percent from 1981 to 1984. Therefore, we estimate that the rise of the dollar contributed almost \$7 billion to the decline of the travel balance since 1981. The enhanced dollar thus accounts for about 85 percent of the \$8.19 billion travel balance deterioration.

The effect on the travel balance of the relatively fast U.S. recovery since 1981 is clearly subsidiary to the dollar's impact. We estimate, somewhat imprecisely, that an additional 1 percent of U.S. GNP harms our travel balance by about \$144 million. Hence, between 1981 and 1984 close to \$500 million, or 6 percent of the decline in the travel balance, was attributable to the 3.4 percentage points by which U.S. GNP growth exceeded that of our weighted average index of GNP growth in eight major foreign countries. Consequently, the strong dollar, not faster U.S. recovery, deserves most of the blame for our deteriorating travel balance.

The remaining 9 percent of the travel balance decline since 1981 is attributable to other factors not explicitly in our model. These include foreign exchange crises and resultant exchange controls, especially in Mexico (a key source of visitors to the United States), as well as changing tastes for travel, special package tour features and promotions, and measurement errors. We have merely tried to capture the major economic variables influencing the travel balance, and feel confident that we have identified the crucial role of the dollar in the recent record travel deficits. Even our simple model, with only three explanatory variables, was able to explain over 92 percent of the variation in the travel deficit for our sample of 44 quarterly observations spanning the years 1974-84.

Our econometric results were sensible, as all three variables received coefficients with the anticipated signs or direction of influence. We found that rising foreign income reduces our travel deficit, whereas an increase in the dollar or U.S. income produces the opposite outcome. The estimated coefficient for the effect of U.S. income is somewhat imprecise statistically, but the overall results justify using the model to project the 1985 travel balance.

Projected Travel Deficit

For 1985, we project a record travel deficit of about \$9.2 billion. Given the imprecise nature

both of economic forecasting and of travel data, a deficit in the range of \$8.8 to \$9.6 billion would not be surprising. In any case, we are likely to experience a third consecutive record annual deficit. Our projection was formed by fitting our model on quarterly data for 1964-84; then, using published data and publicly available market forecasts for the exogenous variables (the dollar index and GNP here and abroad) for the rest of 1985, we extrapolated from the past relationships.

Our model is strictly economic. Political or other non-economic factors can always upset economic forecasts, particularly of intensely personal matters such as foreign travel. For instance, the spate of airline disasters in the summer of 1985 may induce some tourists to stay at home. The resulting general shrinkage of foreign travel would reduce the U.S. travel deficit, because the strong dollar has meant more Americans go abroad than foreigners visit here.

Ignoring special factors, the prognosis for the U.S. travel deficit is barely more sanguine for 1986. We have found that travel responds to exchange rates with lags as long as six quarters, and so the dollar's peak in 1985 still will have a residual depressing effect on our travel balance next year. Furthermore, the course of the dollar in the near term is unpredictable. Finally, the travel balance will benefit from faster growth abroad than in this country, but we have estimated that these effects are weak compared with the overwhelming role of the strong dollar. The United States has been an engine for world growth recently, so it is unlikely that foreign growth will outstrip ours enough to improve the travel balance appreciably.

Conclusion

The strong dollar has proven a boon to foreign industries servicing U.S. travelers, who are venturing abroad in record numbers. It has been less kind, however, to service industries in the United States that cater to tourists. Faced with intense foreign competition, these industries often are priced out of the market, as our unprecedented travel deficits of over \$8 billion demonstrate. The travel deficits, and especially the trade deficits, have led to record current account deficits that have rendered us net foreign debtors.

The current account deficits have cumulated into net debt, the servicing of which has eroded our net investment income. This erosion of income from capital services has combined with the deteriorating travel balance we have described to negate our traditional surplus on the non-merchandise current account. We have lost this convenient offset to merchandise trade deficits, and the net investment income and debt levels can only get worse unless our current account is restored to balance.

How can we hope to balance the current account? The literature is replete with studies showing the strong dollar's impact on the U.S. trade balance. Our research contributes estimates of the sensitivity of the travel balance to

the dollar. A 10 percent fall in the value of our real dollar index eventually will improve the travel balance by close to \$3 billion. The current account balance will respond perhaps ten times as vigorously. Even so, the dollar must decline substantially if we are to narrow significantly our current account deficits, now climbing toward \$150 billion.

A dollar decline of the magnitude required to correct the travel and current account imbalances surely would be more likely in the presence of a policy to shrink the fiscal deficit considerably. Reduced government spending may be the only way to brake the momentum of the dual vicious circles of deficits, the dollar, and debt.

ECONOMETRIC RESULTS, A TECHNICAL APPENDIX

Our model of travel balance determination was tested and estimated using econometric analysis. In the main text we postulated that three economic variables affect the travel balance: U.S. real GNP, foreign real GNP, and the real effective dollar index for travel. The construction of the dollar index has been explained in a separate box. Here we will explain the index of foreign real GNP before turning to the econometric results.

Foreign real GNP, or income, is important to the travel balance because increased income should lead foreigners to import more U.S. travel services. Therefore, we should include the biggest importers of U.S. travel services in our index, and weight them by their shares of the total imports of U.S. travel services they collectively account for. We include eight of the ten countries that composed the dollar index, leaving Jamaica and the Bahamas out of the foreign GNP index because they export but do not import substantial travel services. As in the dollar index, Canada and Mexico again dominate, in that order, but Japan is also noteworthy. A quarterly GNP series for Mexico was interpolated from that country's published annual GNP series as well as its quarterly industrial production series.

The model was estimated over the period 1974, first quarter, to 1984, fourth quarter, and with quarterly data this yielded 44 observations. The period was

chosen because it fits within the floating exchange rate era. Preliminary tests suggested that lagged values of the exchange rate index, up to six quarters back, have an impact on the travel deficit. Wishing to estimate the effect on the travel balance of a permanent 1 percent change in the dollar index, we created a smoothed moving average version of the dollar index, to incorporate lagged effects. The new variable is an average of the current value of the index and its six preceding quarterly values. The full lag structure was not estimated because we are interested in the permanent, and not the near term (or the timing), effects of dollar movements. Only contemporaneous real GNP values were used, because relying on moving averages would have increased collinearity between the foreign and U.S. series. Logs of all explanatory variables were used in order to capture the effect on the travel deficit of a 1 percent change in any variable, and a constant term was included in regressions.

The econometric testing resulted in the final regression reported below. We used a Cochrane-Orcutt (AR1) procedure to correct for first order autocorrelation in the error terms. Therefore, we report the estimate of first order autocorrelation, ρ , in lieu of the Durbin-Watson statistic, which would be inappropriate after an AR1 correction. Units are millions of U.S. dollars at an annual rate in the travel balance per 1 percent change in the variables.

Constant	U.S. GNP	Foreign GNP	Dollar Index	rho
-2004.0	-143.80	211.44	-274.42	.74
(3.51)	(1.16)	(2.04)	(5.67)	(6.46)

$R^2 = .921$ $\bar{R}^2 = .913$ T-statistics are in parentheses.

Increasing foreign real GNP helps the travel balance, whereas advances in U.S. real GNP or the indexed real value of the dollar hurt the travel balance. All the estimated coefficients have the hypothesized signs

or direction of effect, and all are statistically significant except for the one on U.S. real GNP. The low t-statistic on U.S. GNP may be ascribable to the unavoidable collinearity between U.S. and foreign GNP. The collinearity can be avoided by using only the differential in income growth rates here and abroad, but this implicitly assumes that the coefficients (propensities to spend on foreign travel) on income are identical, and we do not make this strong assumption. The AR1 correction was needed, as rho received a .74 estimated value. The overall fit is clearly adequate, as shown by the .913 value of the corrected \bar{R}^2 measure.

NOTES

¹Jane S. Little, "International Travel in the U.S. Balance of Payments," *New England Economic Review* (May/June 1980), pp. 42-55. Ironically, at the time she conducted her study the dollar was weak and she could begin: "The notorious U.S. travel deficit is narrowing."

²See, for instance, Jacques Artus, "An Econometric Analysis of International Travel," *IMF Staff Papers* (1972), pp. 579-614; and Jeffrey A. Rosensweig, "Elasticities of Substitution in Caribbean Tourism," Federal Reserve Bank of Atlanta Working Paper #85-1 (September 1985).

³The data on foreign travel and passenger fares come from the Commerce Department's Bureau of Economic Analysis. The numbers are revised frequently and, because they are based on surveys of travelers, are subject to measurement error. Therefore, despite their consistent source the data must be interpreted with some caution. See the Commerce Department's *Survey of Current Business* for annual surveys of international travel and fares as well as for quarterly international accounts.

⁴Net transfer receipts (NTR) are the balance of receipts minus payments abroad of aid, including government grants, other transfer payments, pensions paid to retirees living abroad, and remittances.

⁵Robert Solomon points out that despite many reports indicating that the manufacturing sector "is languishing while services and construction continue to flourish... the aggregate data on the composition of U.S. output indicates very little, if any, weakening of manufacturing relative to

total output... goods output as a proportion of GNP has been remarkably stable over the years. In the first quarter of 1985, it was near the upper end of its normal range." Robert Solomon, "Effects of the Strong Dollar," paper presented at the Federal Reserve Bank of Kansas City conference at Jackson Hole, Wyoming, August 1985.

⁶See, for instance, M.S. Mendelsohn in *American Banker*, July 29, 1985, p. 17.

⁷"A 10 percent sustained depreciation would benefit the trade deficit by about \$20 billion within two years." Morgan Guaranty Trust Company, *World Financial Markets*, August 1985, p. 3. Eventually, as opposed to within two years, a 1 percent dollar rise would increase the trade deficit by well over \$2 billion.

⁸Stephen Marris reports "the widely used rule of thumb that a 1 percent decline in the dollar... leads to a \$3 billion improvement in the current account balance." S. N. Marris, "The Decline and Fall of the Dollar: Some Policy Issues," *Brookings Papers on Economic Activity* 1 (1985), pp. 237-44. Henry Wallich states a more conservative estimate: "A rule of thumb says that a 10 percent drop in the dollar improves the current account, with a lag, by \$20-30 billion." H. C. Wallich, "International and Domestic Aspects of Monetary Policy" (speech to the Money Marketeters of New York University after receiving their Distinguished Achievement Award), May 28, 1985, p. 6.

Bank and Thrift Profitability: Does Strategic Planning Really Pay?

David D. Whitehead and Benton E. Gup

Commercial banks and savings institutions that have used strategic planning in recent years have shown no increase in profitability, according to this study, which analyzes possible reasons.

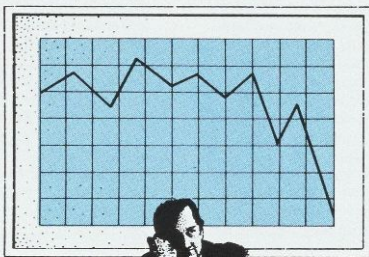
Over the past decade, the competitive environment for financial institutions in the United States has changed dramatically. This period experienced uncommonly high inflation and interest rates, both rapid economic growth and severe recession, and domestic and international financial shocks brought on by global recession and declining energy prices. From the legislative side, the Monetary Control Act of 1980 and the Garn-St Germain Depository Institutions Act of 1982 set in motion a wave of deregulation that has virtually eliminated Regulation Q, or the

interest ceiling on deposits, and brought thrifts into more direct competition with banks by expanding their lending and borrowing powers. At the state level, many legislatures have moved to permit reciprocal interstate banking, again intensifying competitive pressures on financial institutions. Moreover, banks and thrifts have found themselves competing head-to-head with nonbank financial services suppliers such as Sears, American Express, and Merrill Lynch, as

these firms augmented their roles in the financial services industry.

The pace of many of these changes in the competitive environment was neither orderly nor expected by many of the market participants. Thus the intensity of deregulation and the 1979 change in monetary

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policy allowing interest rates to be established by the market caused unanticipated shocks to the competitive environment.

Against this shifting backdrop of economic threats and opportunities, managers of some financial institutions recognized the need to understand and adapt to the new milieu — the need to plan. “Planning permits organizations to react quickly in a dynamic environment, to explore more alternatives and to develop new techniques,” as one observer described it. “Planning is a key to survival, profits, improved decision-making, and avoiding mistakes.”¹ Studies show that only six of the 50 largest banks engaged in strategic planning in 1968, but by 1983 about 75 percent of these largest institutions did so.²

The rapidly changing environment in which financial institutions now operate has encouraged planning, but to what extent has planning resulted in success? Overall, our study did not find that planning significantly increases a bank’s profitability. Furthermore, the various levels of planning sophistication appeared to have little bearing on a bank’s success in reaching its planning goal. Where increasing market shares was a goal, their effect was minimal. This article examines the relationship of planning to profitability and market shares. The nature of our information, though, prohibits definite conclusions about the quality of the planning itself and limits us to the general nature of strategic planning at banks and savings and loan associations.

Planning Defined

“Managing” and “planning” denote different functions. Managing refers to carrying out the traditional objectives of operating an organization, whereas planning includes those activities that lead to a change in corporate goals or strategies.³ In the 1960s, “long-range planning” referred to the process through which firms set their long-term goals and objectives; over time, “strategic planning” evolved. Today, it is generally understood that strategic planning comprises the following: (1) establishing the corporate mission and objectives, (2) assessing competitive threats and opportunities, and (3) developing an operational plan for action, executing that plan, and reviewing the results.⁴ Unlike long-range planning, strategic planning recognizes the necessity for

constant revision of these elements as competitive and market environments develop.

Previous Studies

Relatively few studies have attempted to determine the impact of strategic planning on the profitability of firms in general and banks in particular. One major problem is the lack of a consistent and meaningful definition of what constitutes strategic planning. All firms engage in planning, but they differ greatly in the degree to which they implement these plans, revise as the environment changes, and use planning tools. For example, a firm may have a written plan but pay only lip service to it, or it may follow a plan blindly without adjusting for environmental changes. Thus, the fact that a firm “plans” may tell us little about its actual behavior, the quality of the plans, or the firm’s competitive advantages.

To overcome this impediment, some investigators have attempted to classify firms by their sophistication in planning. Stanley W. Thune and Robert J. House (1970), examining 36 firms in six industries, evaluated sales, stock price, return on equity, and return on capital for both planners and nonplanners. They concluded that planners outperformed the nonplanners. However, their study has been criticized because of the small number of firms involved.

Having examined 386 firms, Robert M. Fulmer and Leslie W. Rue (1974) concluded there was no meaningful difference between planners and nonplanners with respect to sales, earnings, and return on equity. Robley D. Wood, Jr. and R. Lawrence LaForge (1979) evaluated 32 banks that planned. They found that the average changes in net income and return on equity were higher for the planners than for the nonplanners; however, they concluded that some of their data revealed no difference between the return on assets for planners and nonplanners. Their study, like Thune and House’s, suffers from a small sample size.

Ronald J. Kudla (1980) tested two hypotheses: firms that planned have abnormal stock returns and their betas differed from nonplanners’. He found no support for the first hypothesis, but did discover a transitory reduction in the betas for firms that planned.

Richard W. Sapp and Robert Seiler (1981) examined 302 commercial banks. Of that sample, 203 were considered nonplanners, 60 were

Table 1. Existence of Formal Planning Process at Respondent Institutions
(by asset size)

Formal Planning Process					
Asset Size	Banks	Savings and Loans	Multibank Holding Companies	One-Bank Holding Companies	Total
\$0-50 million	26	15	0	2	43
50-100	33	6	0	4	43
100-500	29	38	4	8	79
500-1 billion	32	2	7	8	49
1 billion and over	19	2	54	27	102
Total	139	63	65	49	316

No Formal Planning Process					
Asset Size	Banks	Savings and Loans	Multibank Holding Companies	One-Bank Holding Companies	Total
\$0-50 million	22	25	0	0	47
50-100	22	10	0	1	33
100-500	21	16	0	0	37
500-1 billion	11	0	0	0	11
1 billion and over	2	0	3	0	5
Total	78	51	3	1	133

Note: Unless otherwise noted, all tables use the 316 respondents that reported a formal planning process.

Source: Federal Reserve Bank of Atlanta.

regarded as beginning planners, 27 as intermediate, and 5 as sophisticated planners. It was unclear from their definitions if they were recording strategic planning, long-range budgeting, or asset/liability management systems. Their investigation found significant positive relationships between planning and deposit growth, loan yields, and capital to risk assets, but the relationship between planning and return on equity was weak at best. Given the small number of intermediate or sophisticated planners in their study, their findings are of questionable value.

S. Benjamin Prasad (1984) looked at the results of 35 medium- to large-size banks and, using his own scoring procedure, determined that 18 had become sophisticated planners over the 1976-1980 period. He also shows that the returns on equity for four of the banks studied improved

over the five-year period. However, it is unclear whether the four banks were "sophisticated planners," or if the improvement in profitability was due to other factors, such as geographic advantage. In short, this study added little to our knowledge of the relationship between profitability and planning.

To state that strategic planning increases profitability is quite different from saying that it is associated or correlated with higher profits. The first statement implies causation, whereas the second does not. Unfortunately, statistical analysis generally does not assert causation—only close association or correlation among events. One may argue that causation runs in either direction; that is, strategic planning causes higher profits, or lower profits encourage strategic planning. Statistical tests of these relationships, therefore,

generally do not suggest a unique interpretation. They empirically determine a statistically significant association between the two events, but do not prove that one causes the other. Accordingly, the reader should be cautioned to view the findings in previous work and the results of our statistical analysis in light of this limitation.

Study Design

The data we used in this study are based on a 1983 mail survey of banking organizations and savings and loan associations located throughout the United States.⁵ The Federal Reserve Bank of Atlanta conducted that survey to determine the extent to which banking organizations (including S&Ls) engaged in strategic planning, as evidenced by a formal (written) plan. The banking organizations were divided into banks, one-bank holding companies, multibank holding companies, and savings and loan associations. The survey was designed as a stratified random sample to reflect organizations of all asset sizes and wide geographic distribution. Each of the 50 states is represented, with no state contributing more than 10 percent of the total responses. The results of this survey, published in the Federal Reserve Bank of Atlanta's December 1983 *Economic Review*, are highlighted here as background for the analysis to follow.

Financial institutions engage in the process of strategic planning to widely varying degrees. Some organizations only profess to do so, while others take planning seriously. In our attempt to segregate sophisticated planners from the others, we made a number of alternative assumptions concerning the behavior of planners. For example, we defined sophisticated planners as organizations that had formal written objectives. We then assumed that the more sophisticated planners had planning departments that used econometric models and regression analysis to make projections or analyze alternative courses of action. Moreover, we considered how often the plans were revised, to whom the planners reported, and other factors. We examined these factors individually and collectively to ascertain which organizations were sophisticated planners.

Number of Organizations. Table 1 shows that 316 banking organizations and savings and loan associations indicated they had a formal planning process, and 133 indicated otherwise. The data

Table 2. Respondents' Length of Time in Planning Process* (by asset size)

Asset Size	Less than 1 Year	1-3 Years	3-5 Years	5-10 Years	Over 10 Years
\$0-50 million	9	9	7	3	1
50-100	7	9	10	5	2
100-500	20	22	16	5	3
500-1 billion	10	15	14	7	1
1 billion and over	11	32	27	21	7
Total	57	87	74	41	14
Percent of Respondents	21	32	27	15	5

*The number of responses to this question (273) is less than the total respondents doing formal planning (316) because not all respondents answered this question. This also applies to other tables.

Source: Federal Reserve Bank of Atlanta.

revealed that the use of formal planning was related to organization size: 95 percent of institutions with assets of \$1 billion or more planned while only 48 percent of those with assets of \$50 million or less planned.

Length of Time. Table 2 relates the length of time in the planning process for the respondents by asset size. Only 14 organizations stated that they had been involved in planning for more than 10 years. Fifty-three percent indicated an involvement of three years or less. This response implies that the rapidly changing competitive environment may have fostered the use of strategic planning.

Other Factors. The survey also determined who in the organizations was responsible for the planning process, how often the plans were revised, and various techniques (for example, portfolio analysis and econometric models) that the planners used.

Degree of Commitment. The detailed information derived from the survey gave us a number of ways to measure the degree to which organizations engaged in strategic planning. Because we posed questions that identified the organizational level where planning was undertaken, the title of the individual to whom the planning group reports, reasons for planning, focuses of the planning effort, types of tools used, and how long the organization has been engaged in planning, we were able to define planning at high and

Table 3. Profitability and Deposit Growth of Planner and Nonplanner Banks

	Cases	Mean	Separate Variance Estimate	
			t	Probability*
Deposit Growth				
Planners	231	35.16		
Nonplanners	71	11.06	1.26	.21
ROA				
Planners	231	.87		
Nonplanners	71	1.18	-3.80	.00
ROE				
Planners	231	7.47		
Nonplanners	71	8.72	-3.91	.00

*Significant level = 1.00 - Probability

Source: Federal Reserve Bank of Atlanta.

low levels of sophistication. Of course, ambiguity of the term planning necessitated such definition.

Attempting to differentiate among firms that pay lip service to the planning process and those that are in fact committed to it, we established various criteria for the level of planning sophistication and designated all institutions that responded positively to the survey as planners or nonplanners. This step allowed us to remove some of the ambiguity from the term planning.

Having defined what we believed to be a satisfactory array of planning criteria, we proceeded to performance measurements. Firms may differ in the objectives they formulate in their planning process. Although the profit objective is perhaps the most prevalent, increased market share also is a reasonable end. In order to gain market share, a firm probably will have to sacrifice some profits. Recognizing this fact, we relied on three performance yardsticks: return on assets and return on equity were used to measure profitability while absolute growth in deposits measured deposit growth.

In the present study, we use regression analysis and analysis of variance to assess the impact planning has on the profit and growth measures. Regression analysis isolates the performance impact of given variables across all banking organizations, that is, planners and nonplanners, banks and savings and loan associations. The analysis of variance statistically tests the significance of the difference in performance between two identified groups (planners and nonplanners,

banks and S&Ls). Given our data base, we also were able to control for length of time in the planning process, geographic location of the institution, its deposit size, and certain other characteristics identified through the survey. Our primary objective was to identify any statistically significant linkage between planning, however defined, and a firm's profitability or deposit growth.

The original survey also enabled us to identify firms that claimed they undertook no formal planning procedures. Therefore, we could test—with interesting results—for a significant difference in profits and growth for all firms that professed to plan relative to those that maintained they did not.

The Results

The basic purpose of our analysis, to test for a relationship between planning and profitability or planning and deposit growth, allowed us to structure a simple first test. Our aim here was to draw a distinction between two groups of firms—those that have a formal written plan and those that do not. We conducted a regression analysis using only a planning dummy and our three performance measures. For all three, the planning dummy variable proved statistically insignificant at the 90 percent level of significance. Even when the size of the firm was added as an independent variable, the planning dummy variable still proved statistically insignificant.

Table 4. Profitability and Deposit Growth of Planner and Nonplanner Banks
(by deposit size)

0 – \$50 Million in Deposits				
	<u>Cases</u>	<u>Mean</u>	<u>Separate Variance Estimate</u>	
			<u>t</u>	<u>Probability*</u>
Deposit Growth				
Planners	26	12.09	0.20	0.84
Nonplanners	16	11.16		
ROA				
Planners	26	1.22	-0.48	0.64
Nonplanners	16	1.31		
ROE				
Planners	26	9.07	-1.28	0.21
Nonplanners	16	10.18		
\$50 – \$100 Million in Deposits				
	<u>Cases</u>	<u>Mean</u>	<u>Separate Variance Estimate</u>	
			<u>t</u>	<u>Probability*</u>
Deposit Growth				
Planners	36	15.64	1.58	0.12
Nonplanners	20	10.26		
ROA				
Planners	36	1.00	-0.86	0.39
Nonplanners	20	1.17		
ROE				
Planners	36	8.37	-1.40	0.17
Nonplanners	20	8.93		
\$100 – \$500 Million in Deposits				
	<u>Cases</u>	<u>Mean</u>	<u>Separate Variance Estimate</u>	
			<u>t</u>	<u>Probability*</u>
Deposit Growth				
Planners	37	19.91	1.10	0.28
Nonplanners	23	11.39		
ROA				
Planners	37	0.86	-2.17	0.03
Nonplanners	23	1.16		
ROE				
Planners	37	7.56	-1.18	0.25
Nonplanners	23	8.12		
\$500 Million – \$1 Billion in Deposits				
	<u>Cases</u>	<u>Mean</u>	<u>Separate Variance Estimate</u>	
			<u>t</u>	<u>Probability*</u>
Deposit Growth				
Planners	42	11.25	-0.09	0.93
Nonplanners	12	11.61		
ROA				
Planners	42	0.66	-2.17	0.04
Nonplanners	12	1.07		
ROE				
Planners	42	7.03	-0.53	0.62
Nonplanners	12	7.56		

*Significant level = 1.00 – Probability

Source: Federal Reserve Bank of Atlanta.

Table 5. Relationship of Size and Sophistication of Planning Process to Profitability

Performance	Variable	Savings and Loans		Banks	
		Regression Coefficient	Significance	Regression Coefficient	Significance
Deposit Growth	PL Dum	12.04	0.940	13.740	0.250
	Size	0.96	0.220	16.460	0.760
ROA	PL Dum	-0.27	0.995	-0.230	0.987
	Size	-0.02	0.360	-0.080	0.993
ROE	PL Dum	-0.47	0.660	-0.510	0.930
	Size	-0.64	0.990	-0.630	0.999

Source: Federal Reserve Bank of Atlanta.

Given these findings, we decided to separate the banks from the S&Ls and test the relationship between planners and nonplanners and the performance variables. Again, the criterion for planning was a formal written plan. An analysis of variance we performed for the full sample of banks, divided into those that planned and those that did not, revealed a statistically significant difference between the two groups. The banks defined as planners showed lower returns on assets (ROAs) and returns on equity (ROEs) than did the nonplanners and the difference was statistically significant. Planners tended to have higher, but not significantly higher, growth in deposits than did the nonplanners (see Table 3).

This unexpectedly negative relationship between planning and profitability called for further analysis. Because size may be related to decentralized decision making, which some suggest results in better performance, we divided the banks into four deposit size groups (\$50 million or less, \$50-\$100 million, \$100-\$500 million, and \$500 million-\$1 billion). We had too few observations to evaluate nonplanners above \$1 billion in deposits (see Table 4).

The third category of banks, those in the \$100-\$500 million category, show no significant difference in deposit growth or ROE, but planners showed significantly lower ROA than nonplanners. The same finding applied to banks in the fourth size category, \$500 million - \$1 billion. The finding of this negative relationship for the two size categories of banks is consistent with the results obtained when the analysis is performed on all banks. One possible explanation for this negative relationship is that banks in these size categories that plan may have more financial leverage

(relatively less equity capital) than nonplanners. The relationship between ROE, ROA, and a financial leverage ratio (LR) is explained by the following equation.

$$\text{ROE} = \text{ROA} \times \text{LR}$$

or

$$\frac{\text{Net income}}{\text{Total equity}} = \frac{\text{Net income}}{\text{Total assets}} \times \frac{\text{Total assets}}{\text{Total equity}}$$

If the ROE for both planners and nonplanners is similar and the ROA is lower, the difference between the two groups must be accounted for by financial leverage.

Along this same line, large commercial banks have relatively less equity capital than small commercial banks. Possibly some of this "size effect" also is showing up in these categories which cover banks that range from \$100 million to \$500 million, and \$500 million to \$1 billion.

Any touchstone used to distinguish planners from nonplanners may be questionable owing to the imprecision of the term "planning." To ensure that the negative relationship between planning and ROA did not simply result from our using a formal written plan to separate the two groups, we redefined the planning and nonplanning groups based on several criteria. As a first attempt to distinguish among degrees of planning, we categorized planners as high and low. High planners included all organizations that revised their plans quarterly or continuously and in which a planner or executive planning committee was responsible for strategic planning.

Controlling for size of the organization, we ran regressions for the high and low planning groups.

Table 6. Performance of Organizations by Major Planning Emphasis

<u>Product and Service Development</u>	<u>Cases</u>	<u>Mean</u>	<u>Separate Variance Estimate</u>	
			<u>t</u>	<u>Probability*</u>
Deposit Growth				
Planners that emphasized	138	52.29	1.23	0.22
Those that did not	122	13.27		
ROA				
Planners that emphasized	138	0.68	-2.07	0.04
Those that did not	122	0.85		
ROE				
Planners that emphasized	138	6.43	-1.44	0.15
Those that did not	122	6.96		
<u>Market Extension</u>	<u>Cases</u>	<u>Mean</u>	<u>Separate Variance Estimate</u>	
			<u>t</u>	<u>Probability*</u>
Deposit Growth				
Planners that emphasized	53	28.36	1.89	0.06
Those that did not	122	13.27		
ROA				
Planners that emphasized	53	0.60	-1.66	0.10
Those that did not	122	0.85		
ROE				
Planners that emphasized	53	6.13	-1.95	0.05
Those that did not	122	6.96		
<u>Corporate Development</u>	<u>Cases</u>	<u>Mean</u>	<u>Separate Variance Estimate</u>	
			<u>t</u>	<u>Probability*</u>
Deposit Growth				
Planners that emphasized	158	49.89	1.31	0.19
Those that did not	122	13.27		
ROA				
Planners that emphasized	158	0.65	-2.24	0.03
Those that did not	122	0.85		
ROE				
Planners that emphasized	158	6.51	-1.27	0.21
Those that did not	122	6.96		
<u>Social, Economic, and Political Considerations</u>	<u>Cases</u>	<u>Mean</u>	<u>Separate Variance Estimate</u>	
			<u>t</u>	<u>Probability*</u>
Deposit Growth				
Planners that emphasized	146	51.55	1.27	0.21
Those that did not	122	13.27		
ROA				
Planners that emphasized	146	0.68	-1.87	0.06
Those that did not	122	0.85		
ROE				
Planners that emphasized	146	6.66	-0.81	0.42
Those that did not	122	6.96		

*Significant level = 1.00 - Probability

Source: Federal Reserve Bank of Atlanta.

Table 7. Comparative Performance of Planner Organizations
(by planning objective)

<u>Competitive ROA and ROE</u>	<u>Cases</u>	<u>Mean</u>	<u>Separate</u>	
			<u>Variance Estimate</u>	<u>Probability*</u>
			<u>t</u>	
Deposit Growth				
Planners that focused on ROA or ROE	228	38.27	1.29	0.20
Those that did not	122	13.27		
ROA				
Planners that focused on ROA or ROE	228	0.70	-1.85	0.06
Those that did not	122	0.85		
ROE				
Planners that focused on ROA or ROE	228	6.96	0.03	0.97
Those that did not	122	6.96		
<u>Growth in Market Share</u>	<u>Cases</u>	<u>Mean</u>	<u>Separate</u>	
			<u>Variance Estimate</u>	<u>Probability*</u>
			<u>t</u>	
Deposit Growth				
Planners that focused on market share	153	18.59	1.82	0.07
Those that did not	122	13.27		
ROA				
Planners that focused on market share	153	0.63	-2.04	0.04
Those that did not	122	0.85		
ROE				
Planners that focused on market share	153	6.26	-1.97	0.05
Those that did not	122	6.96		
<u>Achieving Competitive Advantage</u>	<u>Cases</u>	<u>Mean</u>	<u>Separate</u>	
			<u>Variance Estimate</u>	<u>Probability*</u>
			<u>t</u>	
Deposit Growth				
Planners that focused on competitive advantage	89	18.71	1.62	0.11
Those that did not	122	13.27		
ROA				
Planners that focused on competitive advantage	89	0.79	-0.43	0.67
Those that did not	122	0.85		
ROE				
Planners that focused on competitive advantage	89	6.40	-1.43	0.15
Those that did not	122	6.96		
<u>Use Technology Internally</u>	<u>Cases</u>	<u>Mean</u>	<u>Separate</u>	
			<u>Variance Estimate</u>	<u>Probability*</u>
			<u>t</u>	
Deposit Growth				
Planners that emphasized technology	72	80.46	1.10	0.27
Those that did not	122	13.27		
ROA				
Planners that emphasized technology	72	0.69	-1.52	0.13
Those that did not	122	0.85		
ROE				
Planners that emphasized technology	72	6.75	-0.51	0.61
Those that did not	122	6.96		

Table 7. (cont'd.)

Providing New Technology to Customers	Cases	Mean	Separate Variance Estimate	
			t	Probability*
Deposit Growth				
Planners that emphasized technology	66	21.90		
Those that did not	122	13.27	2.06	0.04
ROA				
Planners that emphasized technology	66	0.79		
Those that did not	122	0.85	-0.33	0.74
ROE				
Planners that emphasized technology	66	6.26		
Those that did not	122	6.96	-1.78	0.08

*Significant level = 1.00 - Probability

Source: Federal Reserve Bank of Atlanta.

Table 5 shows the results for both banks and S&Ls. The banks showed a negative and statistically significant relationship between planning and profits (measured as ROA or ROE). The S&Ls exhibited the same negative and significant relationship between planning and ROA but the relationship between planning and ROE was insignificant. In addition, the S&Ls showed a positive and statistically significant relationship between planning and deposit growth. These results generally confirmed our previous finding. When the analysis of variance incorporated these distinctions for high and low planners, it showed the same negative relationship between high planning and profitability. A statistically significant difference existed between the two groups of planners with respect to both deposit growth and ROE, and the relationship between planning and ROA was negative with respect to the high planning category. High planners continued to show a positive and statistically significant relationship with deposit growth. Thus, this new definition of high and low planners essentially confirms our earlier results.

Planning differs among organizations according to the results that each considers important. Some firms structure their planning efforts toward product and service development, others pursue market extension or corporate development, and still others desire to monitor changes in their business environment (social, economic, and

political). While all of these planning approaches are useful, we wanted to see if a difference in performance was associated with each. Therefore, we redefined our sophisticated planners as all those organizations that revised their plans quarterly or continuously and placed heavy emphasis on (1) product and service development, (2) market extension, (3) corporate development, or (4) social, economic, and political considerations. All other organizations fell into the less sophisticated planning group.

Once again, we performed analyses of variance using our three performance measures as the dependent variable (Table 6). Those sophisticated planners that emphasized product or service development displayed no statistically significant differences in deposit growth or ROE, but their ROA was significantly lower than that of their less sophisticated counterparts. For those sophisticated planners that emphasized market extension, the results showed significantly lower ROA and ROE and significantly higher deposit growth. This is a logical relationship, as a firm trades off higher profits against greater deposit growth through market extensions. Sophisticated planners that emphasized corporate development exhibited significantly lower ROAs than their less sophisticated counterparts, which again is consistent with our earlier finding. Finally, that group of sophisticated planners that emphasized monitoring their social, economic, and political environment

also showed no statistically significant difference regarding deposit growth or ROE. But with respect to ROA, the sophisticated group showed statistically significant and lower ROAs. Thus, even when we redefined sophisticated planning, the result was unchanged: where a statistically significant difference occurred it consistently showed more sophisticated planning associated with low ROA performance.

We redefined the planning effort once more to ensure accuracy of our results. Recognizing that firms may have different objectives, we categorized planners into five additional groups, clustering those that revised their plans quarterly or continuously and placed major emphasis on (1) providing a competitive ROA or ROE, (2) growth in market share, (3) achieving competitive advantages, (4) cost reductions through use of new technology for internal functions, and (5) competition and cost advantages through application of new technology for customers' use. An analysis of variance was run using each of these five categories of planners against those institutions that planned but did not emphasize that particular planning objective (Table 7). Again, the relevant dependent variables were market growth, ROA, or ROE.

The group of planners whose objective was a competitive ROA or ROE showed no significant difference in market growth or ROE. They did, however, show a statistically significant and lower ROA than the group of planners that did not emphasize ROA or ROE. Apparently, these planners failed to meet their objectives. By contrast, planners that emphasized growth in market share seem to have been successful, for the results showed a statistically significant and higher deposit growth. The costs of this achievement are painfully obvious—statistically significant and lower ROA and ROE than that group of planners that did not share their objective. This finding is consistent with the proposition that some organizations are willing to surrender a degree of profitability to gain market share.

No statistically significant difference was found for those planners who focused on new technology for internal use and those with different targets. For the group whose objective was to achieve an advantage over their competitors, performance results are no different from those of planners that did not attempt this. Our finding is especially reasonable in the financial services industry, where new products can be copied quickly and at low cost. Planners that concentrated on providing new technology for customers' use

are shown to have a statistically significant and higher growth in market share and statistically significant and lower ROE than counterparts that did not pursue this objective. Such a situation seems consistent with an emphasis on market growth; that is, by promoting use of new technology a firm may make it easier for a segment of the population to obtain banking services. To a large extent, planners who focused on technology for customer use and those who sought to increase market share may be measuring the same thing. The latter group apparently completed their objective relative to other planners.

Next, we categorized organizations into more or less sophisticated groupings dependent upon their use of given types of planning tools. Our assumption was that those organizations that were serious about planning would use the most sophisticated tools and would show higher performance as a result. We structured a regression equation that used independent variables to indicate whether firms use simulation techniques, PIMS, external data bases, econometric analysis, or regression analysis in their planning efforts. The equation was run separately using each of the three performance measures as dependent variables. None of these variables proved to be significant (at the 90 percent level of significance) in explaining ROA differences among the planners, and only the use of external data bases was statistically significant and positively related to ROE. In terms of explaining deposit growth, we found that only the use of simulation techniques and external data bases proved statistically significant and the simulation variable was negatively associated with deposit growth. Geographic location and institution size were included as independent variables and appeared not to be statistically significantly associated with the variation in the performance measures. Therefore, over the observation period only the use of external data bases proved to be positively associated with performance. The more sophisticated tools either were not statistically significantly associated with performance or were negatively associated with performance measures (the case of simulations). Thus, the degree of sophistication or commitment to the planning process as measured by the use of refined planning tools was insignificantly associated with performance.

As a final effort, we tested the hypothesis that planning pays off but only after a period of time. To do so, we looked at the relationship between length of time an organization has been involved

in planning and the firm's ending year profits (1983). Our regression equation used location (state), deposit size, and length of time engaged in planning as independent variables. We were unable, however, to identify a statistically significant relationship between profits (ROA and ROE) and length of time the organization was engaged in planning. Organization size and location proved insignificant in explaining deposit growth or ROA, and only size proved to be significantly (though negatively) related to ROE. This weak but still significant negative relationship runs counter to intuition and is less than satisfying. But overall we found no evidence to support the proposition that length of time engaged in planning is positively associated with the organization's profit performance or deposit growth.

Conclusion

Our purpose in this study was to determine if strategic planning made a measurable contribution to the profitability of banking organizations and savings and loan associations. We examined 316 banking organizations that planned and 133 that did not, categorizing the data by size, type of organization, and degree of sophistication in the planning process.

In spite of the large volume of data we analyzed, the study does have several shortcomings. First, the respondents may define strategic planning in different ways. Second, we do not know anything about the "quality" or use of the plans. We attempted to adjust for these flaws by using several definitions for planners, by differentiating

the degree of sophistication in the planning effort, and by focusing on various objectives of the planning effort. Even so, our results yield no consistent statistical evidence that strategic planning increases the profitability of the organizations studied. They produce limited evidence that sophisticated planners may have greater deposit growth than unsophisticated planners and nonplanners; however, this deposit growth did not seem to enhance their profitability. In fact, the evidence shows a negative relationship between planning and profitability.

The discovery that planning is not associated with increased profitability is not surprising. Firms that show strong profits probably feel less pressure to engage in sophisticated planning than those with weak profits. Hence, our findings may be interpreted to mean that low profitability encourages more planning. And in light of our finding that length of time in the planning process has little bearing on profitability, if planning pays off it takes a long time to do so—apparently longer than our observation period. Another explanation for the negative association between planning and profits is that new products or services developed and offered by one organization are quickly adapted by competitors, thereby reducing differences in profitability.

The fact that strategic planning showed no positive relationship to profitability should not be considered a condemnation of planning per se. The questions we have raised about the quality of planning and competitive advantage must be answered. Equally important, we must analyze the effect of planning on stockholder wealth. Only then will we have the answers we began to seek here.

NOTES

¹See Benton E. Gup (1980).

²See D. Robley Wood, Jr. (1980), Giroux and Rose (1984), and Gup and Whitehead (1983).

³Robert Mainer (1973).

⁴See Gup (1980), George Steiner (1979), and Thompson and Strickland (1983).

⁵See Gup and Whitehead (1983) for details.

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*Thrift
Commercial Bank Charter*

The Thrift Charter: A Valuable Alternative for Commercial Banks?

Sylvester Johnson, Jr.

Since the Garn-St Germain legislation went into effect in 1982, only two commercial banks have taken advantage of one of its options—converting to a thrift institution. But recent developments could increase this number soon.

The Garn-St Germain Depository Institutions Act of 1982 sought to help financial regulators deal with troubled institutions, to increase competition for financial services, and to revitalize the thrift industry. Among its provisions, the act gave thrift institutions new powers similar to those of commercial banks. It also enabled a commercial bank to convert to a savings institution or to a federal savings bank. In the latter case, the institution could maintain the word "bank" in its title yet not be subject to the restrictions imposed by the Bank Holding Company Act—an important advantage. Passage of Garn-St Germain facilitated bank charter conversions, even though some states already permitted such transformations prior to 1982.¹

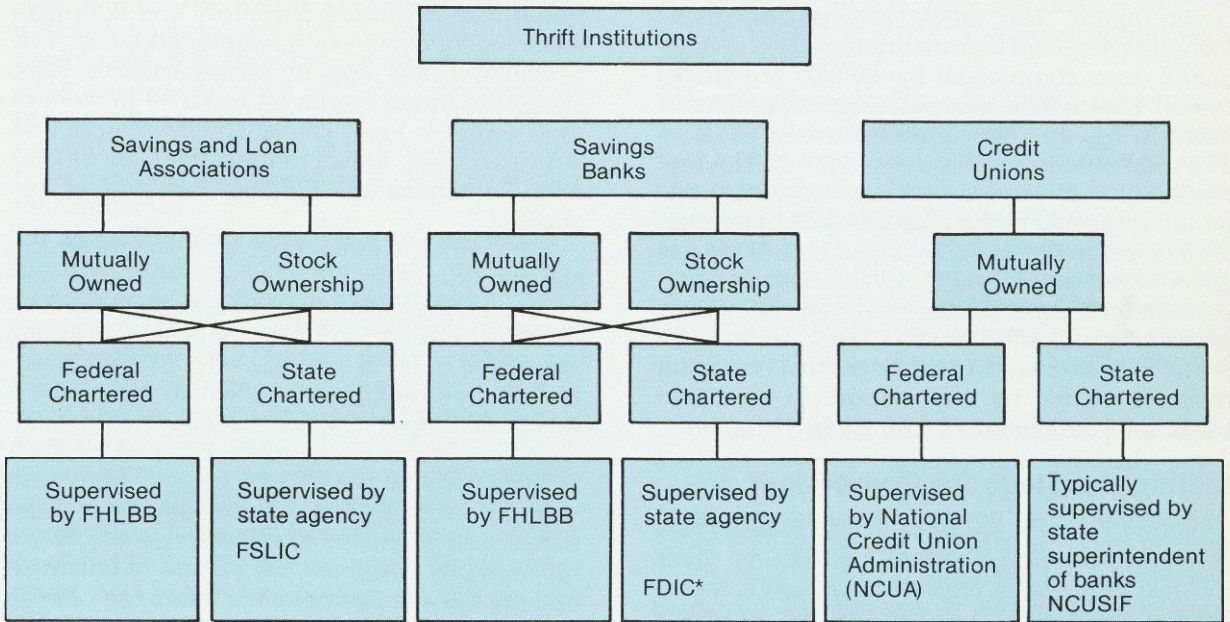
To date, only two commercial banks have completed conversion from a bank to a savings institution, but recent developments could increase this activity. First, the Federal Home Loan Bank Board (FHLBB) recently adopted a ruling change that makes it easier for commercial banks to obtain federal thrift charters. With this

change, depository institutions may engage in purchase and assumption (P&A) conversions with federal stock associations, an option we will discuss later. The ruling was designed to alleviate some of the financial pressures on the insurance fund of the Federal Savings and Loan Insurance Corporation by providing the FSLIC with an alternative to costly deposit-payouts—seeking an acquirer for a failing thrift.

The FSLIC can attempt to make troubled thrifts attractive acquisition targets for banks that wish to convert to thrift charters. Such banks must hold a relatively high level of mortgage loans in their portfolios if they are to meet the FHLBB's qualified thrift lender standards.² By purchasing operating thrifts, converting banks can achieve the requisite levels while at the same time unburdening the FSLIC's insurance fund. By clarifying the previous law, the FHLBB's move also will facilitate decisions on pending charter transactions and hasten resolution of the thrift industry's problems. A second new development that may foster bank conversions is the growing popularity of seminars on the advantages of becoming a thrift and the steps involved in doing so.³

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Chart 1. Thrift Industry Members



*Mutual savings banks are the only intermediaries cross-regulated by federal authorities serving commercial banks and savings associations.

Source: Federal Reserve Bank of Atlanta.

Weighing the pros and cons of thrift charters for commercial banks also highlights competition among regulators. According to William J. Brown, "one of the historic objectives of dual banking has been to provide alternative supervisory frameworks under which commercial banks may choose to operate, thereby safeguarding against the extension of harsh, oppressive, and discriminatory supervision to institutions without recourse to alternative arrangements."⁴ The possibility of a commercial bank's converting to a federal savings institution places the FHLBB in direct competition for banks with bank regulatory agencies. Regardless of whether one views this situation as a "competition in laxity" in bank supervision, empowering banks to adopt thrift charters eventually may force changes in bank regulation.

The Garn-St Germain legislation permitted conversions to help assure financial stability, but in large numbers such activity would have a far wider, and perhaps unintentional, impact on the banking and thrift industries. For example, bank-to-thrift conversions would shift the balance of

regulatory power, change required capital in depository institutions, and alter the mix of allowable activities for depository institutions.

We will discuss the pluses and minuses of bank-to-thrift conversions for both state and federal chartered institutions, examine current levels of conversion, and comment on the likelihood of a future wave of bank-to-thrift conversions. In the process, we will review thrifts' asset and liability powers and discuss what converting from a commercial bank to a savings institution entails.⁵ Despite the obvious advantages of conversion—ability to own and operate interstate automated teller machines (ATMs), relaxed capital requirements, tax benefits—few have occurred and no substantial increase in activity is in sight. However, changes in public and regulatory policy can alter this trend.

In our discussion, we will use the term "thrift" interchangeably with "savings institution." Thrifts usually include savings and loan associations, which largely channel their deposits to the home mortgage market; both stock-owned and mutual

savings banks, which originally were founded to encourage thriftiness and provide a source of funds for workers with modest incomes; and credit unions. This article emphasizes stock-owned savings and loan associations and savings banks since commercial banks also are stock-owned. Prior to deregulation savings banks differed from savings and loan associations, or S&Ls, in that they possessed broader service and investment authority. For example, savings banks contributed valuably to the country's growth through their investments in municipal, state, and federal government bonds and in America's early transportation networks. Today, however, distinctions between savings banks and S&Ls are less important. Both may be either mutual, meaning they are owned by their depositors, or stock-owned, by stockholders (see Chart 1).

Setting the Stage for Conversions

In the 1930s, the savings and loan industry was revived to promote the housing industry. Over the next half-century, regulations virtually limited a savings institution's asset portfolio to home mortgages and U.S. government securities, while its liabilities consisted mainly of savings deposits. The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) loosened these restrictions considerably by allowing federal savings institutions to invest up to 20 percent of their assets in consumer loans, commercial paper, and corporate debt securities.⁶ It authorized mutual savings banks to make commercial, corporate, and business loans up to 5 percent of their assets. DIDMCA also established the Depository Institutions Deregulation Committee to supervise the phase-out of interest rate ceilings over a six-year transition period.

Enactment of the Garn-St Germain Depository Institutions Act of 1982 further expanded thrifts' powers. On the asset side, Garn-St Germain allowed thrifts to diversify their loan portfolios by extending commercial and similar loans. Unlike a commercial bank's unlimited commercial lending authority, however, a thrift's commercial loans could not exceed 10 percent of its assets. Although this restriction places thrifts at a comparative disadvantage, the limit can be circumvented since it applies only to a volume of loans outstanding at one time. Theoretically, a thrift could generate a virtually unlimited volume of loans if it sells off the excess to a third party, such as a nonfinancial subsidiary.⁷ In addition, the

entire loan portfolio, as a percentage of assets, could consist of 40 percent loans secured by non-residential real property, 30 percent consumer loans including inventory and floor-plan financing for dealers in consumer goods, and 10 percent personal property leasing activities. Thus, altogether thrifts can invest up to 90 percent of their assets in loans similar to commercial and industrial loans, which renders the Garn-St Germain limitations less binding than they at first appear.

The Garn-St Germain Act also enhanced the liability side of thrifts' balance sheets by permitting savings institutions to accept all types of demand, savings, and time deposits, including negotiable order of withdrawal (NOW) accounts. Unlike commercial banks, which can offer a demand deposit checking account to any individual or corporation, thrifts can provide such services only to persons or organizations with whom they have a loan relationship, or in order to facilitate payments to a business entity from a nonbusiness customer.⁸ As a result of DIDMCA and the Garn-St Germain Act, thrifts can offer an array of services ranging from commercial loans to accepting demand deposit accounts.⁹

Pros and Cons of Thrift Charters

Currently, the thrift charter provides significant advantages over a commercial bank charter in some crucial areas—incentives that a commercial bank would consider when debating a charter conversion.

Branching. The McFadden Act, enacted in 1927, prohibits nationally chartered banks from branching across state lines. The Douglas Amendment to the Bank Holding Company Act allows holding companies to acquire institutions on an interstate basis if the target state passes legislation permitting out-of-state holding companies to acquire banks within its boundaries.¹⁰ In contrast, no federal laws prohibit interstate branching of savings institutions. The FHLBB may authorize federally chartered thrifts to branch anywhere, intrastate or interstate, regardless of the headquarters states' restrictions on commercial banks or state chartered thrift institutions.

As a matter of self-imposed policy, the FHLBB has permitted federally chartered thrifts to establish branches across state lines only through an acquisition of a financially troubled thrift. However, if a thrift desires to operate interstate but is restricted by policy or the cost of expansion,

it can pursue the alternative of owning or operating ATMs and point-of-sale (POS) terminals across state lines.¹¹ The statute conferring this power differs from laws affecting banks, as national banks are prohibited from owning or renting an ATM across state lines, although they may participate in shared networks.¹² The ability to expand by establishing ATMs nationwide constitutes a distinct advantage thrifts hold over commercial banks.

Capital Requirements. As a consequence of industry troubles in recent years, the current trend in bank regulation is toward raising capital requirements. The Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board, and Office of the Comptroller of the Currency (OCC) have similar capital standards for commercial banks, requiring that banks maintain primary capital of at least 5.5 percent of adjusted total assets.¹³ In addition, the Federal Reserve Board's current guidelines for multinational and regional bank holding companies (BHCs) call for a minimum of 5.5 percent primary capital to total assets.

The weakened condition of the thrift industry has rendered it difficult for the FHLBB to raise the net worth requirements for savings associations by a significant amount, though it recently moved to tighten some requirements.¹⁴ The FHLBB requires that all FSLIC-insured institutions maintain net worth, for regulatory purposes, equal to at least 3 percent of liabilities. In their first full fiscal year, newly established (*de novo*) institutions must maintain a minimum net worth level of 7 percent of liabilities; the requirement subsequently declines to 5 percent and may be reduced to 3 percent with proper approval. Thrift holding companies are not subject to regulatory net worth requirements.

A great disparity exists between the capital adequacy requirements for commercial banks and net worth requirements for thrift institutions.¹⁵ Much of the difference results from the thrift industry's financial troubles over the past few years. During that period the net worth of many thrifts, especially older ones, deteriorated because their asset portfolios were dominated by long-term, low interest rate mortgages while their liabilities were affected by soaring interest rates.

Even prior to the 1980s, thrifts received somewhat more lenient capital treatment. One plausible explanation for this bias is the thrift industry's

historically limited access to the capital markets. Since a large percentage of savings institutions are mutually owned, they are unable to raise capital by selling stock, a popular option with most companies.¹⁶

A second explanation for thrifts' preferential capital treatment involves loan risk. Some argue that higher loan loss levels are associated with commercial loans than with those secured by residential real estate.¹⁷ If capital requirements are used to absorb shocks from losses, they contend, then thrifts' capital or net worth requirements should be less stringent than those for commercial banks, since thrifts have a greater portion of their asset portfolio in residential real estate.

Although capital and net worth requirements are not directly comparable, we can state overall that the regulatory requirements for FSLIC-insured institutions are more liberal than those for commercial banks. First, FSLIC-insured institutions are not required to reduce net worth by the amount of goodwill. Bank regulators generally require that intangibles, including goodwill, be subtracted from equity to obtain primary capital.

Another thrift advantage is the ability to amortize losses incurred in connection with the sale of mortgages over the average life of the mortgages sold. Banks generally are required to recognize such losses immediately.

A final comparative advantage is that financially troubled thrifts receive special capital treatment. At least until October 1985—Congress is considering an extension—the Garn-St Germain Act provides that thrift institutions beset by significant operating losses may use "net worth certificates" in meeting their net worth requirements. Troubled institutions may issue these certificates, which are purchased by the FSLIC and FDIC with promissory notes. The net worth certificates are then counted as part of the institution's net worth. Once the institution returns to profitability, it redeems its net worth certificates.

A capital-deficient bank considering conversion cannot use net worth certificates to bolster its position. However, once a bank converts to a thrift, the net worth certificate program—if extended in present form—would be an available option should the institution experience a net worth deficiency.

Old Stone Bank of Providence, Rhode Island illustrates how the differences in capital treatment can affect an institution. In 1983, the Federal Reserve Board's capital guidelines stood at 5 percent. Old Stone's capital amounted to only 3 percent of its assets, which made it an undercapitalized bank. However, when Old Stone exchanged its commercial bank charter for a thrift charter, it immediately met the FHLBB's requirement of 3 percent. In addition, since thrifts are not required to reduce net worth by the amount of goodwill, Old Stone Bank suddenly found itself capital-rich with a ratio of approximately 6 percent.¹⁸

Taxes. Depending on the structure of its portfolio, a savings institution may qualify for substantial tax benefits that were designed to encourage investment in the housing sector. Section 593 of the Internal Revenue Code (12 U.S.C. subsection 593) allows qualifying thrift institutions to deduct 40 percent of taxable income as an addition to reserves for bad debts. For an S&L to receive the full 40 percent deduction, at least 82 percent of its assets must be "qualifying assets," which include cash, taxable government obligations, and real residential property loans.¹⁹ A savings bank, because of its slightly different regulatory history, can qualify for the full 40 percent deduction with only 72 percent of its assets meeting the code's definition of qualifying assets.

This tax advantage vis-a-vis alternative tax shelters may not be as significant to the thrift industry as it at first appears. For example, since 1980 savings institutions have had the power to hold general obligations of state governments. Although these instruments are classified as nonqualifying assets, thrifts, like commercial banks, can use them and other tax-exempt nonqualifying assets to shelter net income. This option achieves a result similar to holding the required percentage in qualifying assets.²⁰

Nonbanking Activities. Two main concerns of law makers in separating banking and commerce were financial safety and efficient allocation of credit.²¹ Some observers argue that further bank expansion into new activities will increase bank risk and threaten individual bank and financial system safety. In addition, a business entity directly linked with a commercial bank might receive favorable credit treatment from the bank, leading to reduced competition, artificial restriction of supply with possible price

increases, and further misallocation of resources. In comparison, the thrift industry's traditional involvement in the housing industry and exclusion from commercial loans led to separate, more liberal treatment for savings and loan holding companies.

To maintain a separation between banking and commerce, section 4(c)(8) of the Bank Holding Company Act prohibits BHCs from engaging in activities too closely related to their primary banking functions. Similarly, multiple thrift holding companies are subject to regulatory limitations on their activities and ownership of other businesses. Federally chartered multiple thrift holding companies may invest in all types of personal property, for lease or sale, and through subsidiaries engage in real estate development and management, securities activities, life and casualty insurance agency operations, the ownership of other federally chartered thrift institutions, and other savings and loan-related functions.²² If a holding company owns only one thrift (a unitary thrift holding company) and its federally insured institution meets the qualified institution standards, the parent company and its non-insured affiliates may undertake a virtually unlimited array of activities.²³ Examples of unitary thrift holding companies include Household International, ITT, National Steel, and Sears, Roebuck and Company. Unlike commercial banks, which must receive approval from the Federal Reserve on 4(c)(8) activities, unitary thrift holding companies require no approval process. However, if a unitary thrift holding company cannot meet the qualifications of a domestic savings and loan association, the firm and its affiliates become subject to the restrictions placed on multiple thrift holding companies.

Regulatory Considerations. Commercial banks may be regulated by the OCC, FDIC, Federal Reserve Board, and state banking departments. In contrast, federal thrift institutions generally have only one federal regulator, the FHLBB, and they are examined only by the FSLIC, which the FHLBB governs. (An exception occurs for thrifts that are insured by the FDIC.²⁴) The FHLBB therefore possesses considerable regulatory flexibility since it maintains the supervisory, insuring, and lending processes under common control.

The thrift industry's special treatment does not always work to its advantage. First, much of

the industry's unique environment is the result of congressional legislation, which can be eradicated quickly, especially if additional federal revenues are needed.

Although thrifts enjoy some powers that are more liberal than powers for commercial banks, they must continue their commitment to housing finance and remain in compliance with other thrift regulations. This emphasis may be treacherous during periods of volatile interest rates. Floating rate mortgages and financial hedging instruments, such as financial futures and options, reduce interest rate risk, but their effectiveness is limited by consumer acceptance of the former and management's ability to exploit the latter. Compliance with other thrift regulations also requires management to juggle with skill such variables as loan limits, demand deposit restrictions, and tax considerations.

Final sources of relative disadvantage are the stability of the thrift industry and the FSLIC insurance fund, and the problems experienced recently by privately insured institutions. These problems, by reflecting poorly on the thrift industry as a whole, may diminish individual institutions' attraction for new customers.

Converting from Bank to Thrift Charters

Regulatory flexibility, favorable tax treatment, exemption from BHC Act prohibitions, and more lenient capital requirements may induce a commercial bank to surrender its charter in favor of a thrift charter. Although Garn-St Germain does not provide for the direct conversion of a commercial bank into a federally chartered thrift, it does authorize the *de novo* establishment of federal savings banks and the conversion of existing S&Ls to federal savings banks chartered by the FHLBB. Additionally, the act permits a savings bank to convert to an S&L.

A commercial bank wishing to convert to a federally chartered thrift may choose from three conversion methods: state law charter, purchase and assumption, and supervisory acquisition.²⁵ Where state law permits, a bank may convert to a state chartered stock thrift, which in turn can convert to a federal stock thrift.²⁶ In a purchase and assumption, or P&A, conversion, a bank forms a *de novo* federal

stock thrift that purchases the assets and assumes the liabilities of the commercial bank. To effect a supervisory acquisition conversion, the commercial bank could acquire a failing mutual thrift through a voluntary supervisory conversion, convert to a stock-owned thrift, and purchase the assets and assume the liabilities of the commercial bank.

The FHLBB earlier this year acted to remove a regulatory impediment to its approval of P&A conversions. The board noted that subsection 552.13(c)(1) of the FHLBB regulations prevents a financial institution located in a state that does not allow state law charter conversion from converting to a federal thrift charter. The regulation specifies that a federal stock association may not purchase the assets and liabilities of any institution that is not insured by the FSLIC with the exception of a federal savings bank covered by FDIC insurance.²⁷ To encourage financially strong institutions to enter the thrift industry, and thereby to lighten the FSLIC's financial burden, the FHLBB resolved that even if the Home Owners' Loan Act of 1933 limits the entities with which a federal association may merge, the statute need not apply to reorganizations. (A reorganization denotes a bulk purchase of assets and assumption of liabilities where all or substantially all of one entity's assets are acquired by another.) After reexamining the issue, the FHLBB concluded that it possessed the authority to amend subsection 552.13 so that previously restricted institutions could engage in P&A conversions with federal thrifts. The FHLBB has limited bulk P&A transactions to depository institutions, whether insured by the FDIC, state, or private insurance funds. The ruling became effective on April 23 of this year.

The conversion process can be lengthy and difficult, as is exemplified by the case of Old Stone Bank. With supervisory assistance Old Stone Corporation, the holding company of Old Stone Bank, acquired Rhode Island Federal Savings and Loan Association, which then converted to a federal savings bank. As part of the transaction, the corporation received regulatory approval for the new federal savings bank to purchase all of Old Stone Bank's assets and assume its deposit liabilities. The conversion, completed in September 1984, required more than 18 months and involved seven regulatory agencies: the FHLBB, FSLIC, FDIC, Federal

Table 1. Commercial Banks Converting to Savings Institutions Since 1982

FHLBB District	Current Applications	Number of Approvals	Number of Disapprovals	Applications Withdrawn*
Atlanta	5	1	0	0
Boston	0	1	0	0
Chicago	0	0	0	0
Cincinnati	2	0	0	0
Dallas	0	0	0	0
Des Moines**	1	0	0	0
Indianapolis	2	0	0	0
New York	0	0	0	0
Pittsburgh	0	0	0	0
San Francisco	0	0	0	2
Seattle	0	0	0	1
Topeka	3	0	0	0
Totals	13	2	0	3

*Applications were withdrawn by commercial banks.

**Involves two commercial banks.

Source: Federal Home Loan district banks.

Reserve Board, Securities and Exchange Commission, and two state banking agencies. Although future conversions may be less convoluted than Old Stone's, they still are likely to be time-consuming.

Thirteen applications for conversion currently await FHLBB approval, but to date only two commercial banks have completed their conversion to thrift institutions (see Table 1). The first occurred in April 1984 when Southern Florida Bank, with assets of \$31 million, received final approval to become a state chartered savings and loan association known as Southern Floridabanc Savings Association. The second instance was Old Stone Bank. Once Southern Floridabanc had become a state chartered S&L, it could have converted to a federal savings bank under the provisions of Garn-St Germain. However, Southern Floridabanc chose to retain its state charter because Florida-chartered thrifts are permitted to form subsidiary service corporations that can invest up to 10 percent of their assets or net worth, whichever is less, in businesses related to the thrift industry. Federal chartered thrifts can invest only 3 percent in service corporations. In most of the pending applications, commercial banks are seeking conversion to state chartered S&Ls primarily because state agencies tend to grant expanded powers to the institutions they charter.²⁸

Recently, commercial banks have expressed greater interest in converting to thrift institutions. Apparently, the strongest incentive for conversion is the thrift industry's continued special treatment, notably relaxed capital requirements and branching privileges. This enticement becomes especially compelling when other regulatory agencies deny transactions that may be compatible with FHLBB policy. In addition, the array of services thrift institutions can offer may strengthen a commercial bank's position, enabling it to establish its share in a particular services market.

Obstacles to Conversion

Why have so few banks converted to a thrift charter? Clearly, conversion carries some benefits, which could be expected to generate conversion activity; however, no such boom is imminent.²⁹ Since the benefits have been discussed, we now look at the costs of conversion to explain the sluggish activity.

The transaction cost of conversion varies, depending on such factors as institution size, type of conversion, and legal costs. The cost of the new charter itself is relatively nominal while total legal fees are sizable. The opportunity cost of loss of service to customers seems not to apply, as both Southern Floridabanc and Old

Stone Bank accomplished their conversions without disrupting accounts or impairing major business units. A bank may incur sizable costs in time, however, as was the case in the complicated conversion of Old Stone Bank.

The cost of information may help account for the lack of conversion enthusiasm. Because the history of charter conversions is brief, banks considering such a move cannot weigh and learn from the combined experience of many other firms. Such banks may be the first to encounter particular problems in the conversion process, and so acquiring information to resolve those problems can be costly. Obtaining a federal charter allows the institution to use the term "bank" in its title, which may not be an inconsequential advantage. But some institutions elect to take state charters, even where federal and state chartered institutions have equal power.

The momentum of banking industry deregulation also may contribute to the slow growth of conversions, since the differences between commercial banks and thrifts continue to disappear.³⁰ Banks might judge it too expensive to alter their current asset structure in order to conform to thrift regulations if the benefits are only short-run.

The financial condition of the thrift industry may be retarding the pace of conversions. This decade's relatively high nominal interest rates in the United States have forced many savings institutions to close or merge with stronger entities.³¹ The plight of institutions covered by private or state insurance, as well as the weakness of the FSIC, compound the thrift industry's problems. Private and state insurance funds are vulnerable to a domino effect should a leading member institution encounter financial difficulties. The FHLBB recently noted that the FSIC has incurred significant losses during the last four years, and said further "substantial losses and expenses" are likely in 1985.³² The thrift industry's continued financial problems and consequent marketing concerns may deter some banks from entering the industry.

The misfortunes experienced by other thrifts, private insurance funds' troubles, or marketing considerations have induced some savings institutions to convert to commercial banks with FDIC insurance.³³ Most of these institutions were state chartered and privately insured; their actions were linked directly to the current

Table 2. Federal Savings Institutions Converting to Commercial Banks Since 1982

FHLBB District	Current Applications	Number of Conversions
Atlanta	0	1
Boston	0	0
Chicago	0	0
Cincinnati	0	0
Dallas	0	2
Des Moines	0	0
Indianapolis	0	0
New York	0	0
Pittsburgh	0	0
San Francisco	0	0
Seattle	0	0
Topeka	0	0
Totals	0	3

Source: Federal Home Loan district banks.

private insurance fund crisis. Table 2 indicates that few federally chartered institutions have converted to commercial banks since 1982, but the persistence of thrift industry ailments may prompt more savings institutions to convert.

Regulations have restrained conversion activity further. In particular, the FHLBB's previous prohibition on P&A conversion transactions (unless the financial institution resided in a state permitting state law charter conversions) was a powerful brake. A small- or medium-sized bank in a state that prohibits commercial bank-to-thrift conversions may have lacked the funds to convert by acquiring a troubled thrift. The new FHLBB regulations should remedy this situation and encourage conversion activity.

New Thrift Charters

Owing to the expanded powers the FHLBB has accorded to thrifts, new institutions may be more likely to open as thrifts than as commercial banks. As a result, savings institutions could become more evident in the financial environment, especially if conversion activity accelerates.

Both new thrift institutions (FHLBB members) and commercial banks have grown in number, especially since 1982, but banks have increased

Table 3. New Member Savings Institutions and Commercial Banks, 1976 - 1984

Year	Total New Member Savings Institutions and Commercial Banks	Savings Institutions	Percentage Change	Commercial Banks*	Percentage Change
1976	205	44	21.46	161	78.54
1977	235	78	33.19	157	66.81
1978	198	50	25.25	148	74.75
1979	271	67	24.72	204	75.28
1980	314	109	34.71	205	65.29
1981	250	51	20.40	199	79.60
1982	363	46	12.67	317	87.33
1983	432	71	16.44	361	83.56
1984	543	88	16.21	455**	83.79

*Commercial banks are national banks, state member banks, and state nonmember banks.

**For comments on subsequent growth, see Paul S. Nadler, "Big Boom in New Banks," *Bankers Monthly Magazine*, vol. 102 (March 15, 1985), pp. 8-10.

Sources: Savings institution data are from the Federal Home Loan Bank Board. Most commercial bank data are from various issues of *FDIC Changes Among Operating Banks and Branches*; 1984 commercial bank data are from "Deregulation Spawns a Wealth of Small Banks," *The Wall Street Journal*, May 6, 1985.

more rapidly (see Table 3).³⁴ Their faster growth further emphasizes the apparent attractiveness of commercial bank charters even in the face of some thrift charter advantages.

Conclusion

Conversion to a savings institution, especially a federal savings bank, appears to be an attractive alternative for a commercial bank seeking to diversify or to lessen its regulatory burden. Conversion is particularly attractive for banks whose portfolios are more likely to meet the FHLBB's qualified thrift lender test. Incentives for banks to convert to savings institutions will continue as long as the thrift industry receives special legislative treatment and commercial banks are restricted from effectively competing with nonfinancial entities.

Policy makers must consider the possible unintended effects of the changes they mandate. Should Congress either extend the use of net worth certificates, assist the FSLIC, or offer further tax advantages to thrifts, for example, it may help the thrift industry but affect the rate of conversion. Policy changes that encourage more bank-to-thrift conversions, however, can further aid the thrift industry by allowing stronger institutions to enter. This opens up the additional possibility that healthy entrants will

merge with weaker institutions, benefiting the FSLIC.

While there are arguments for encouraging bank-to-thrift conversion, policymakers should be alert to some potential pitfalls of a wave of conversions. In particular, policymakers should recognize the possibility that a wave of conversions might weaken the financial industry. For example, if all the converting institutions became subject to current regulatory net worth requirements for thrift institutions, it probably would diminish the capital to assets ratio for depository institutions. In addition to reducing the capital to assets ratio in depository institutions, a spate of conversions would transform the balance of regulatory power and increase the latitude of allowed activities for converting institutions. This phenomenon might also affect the soundness of financial institutions and the efficient allocation of credit. Significant changes in policy that could accelerate the number of conversions may need to be accompanied by changes in bank-to-thrift conversion policy to avoid an onrush of conversions.

So far, conversion activity is light. Despite their advantages, few conversions have occurred and no deluge is in sight. Conversion costs, information costs, transaction costs, and the cumbersome process itself probably dam the potential tide of bank-to-thrift conversions.

NOTES

¹The *Federal Register* notes that the following states are believed to permit some type of conversion from a commercial bank to a savings institution: California, Connecticut, Florida, Maine, Missouri, Pennsylvania, Utah, Virginia, and Washington. When contacted, the state regulatory agencies for savings and loans for these states indicated that the possibility of conversion from a state-chartered bank to a state-chartered S&L has existed since the states began to charter S&Ls. See *Federal Register*, April 24, 1985, p. 16071.

²A qualified thrift lender is any insured institution that has an aggregate of not more than 25 percent of its assets (including loans made by any subsidiary) invested in commercial loans, nonresidential real estate loans, tangible personal property leased for commercial purposes, and floor-planning or inventory loans; or, has an aggregate of not less than 60 percent of its assets (including subsidiaries' investments) invested in loans, equity positions, or securities related to domestic residential real estate, or manufactured housing and property used by an institution in the conduct of its business. The institution must not fall below such percentage on an average basis in three out of every four quarters and two of every three years.

³For example, in 1985 Borod & Huggins conducted a seminar entitled "The Thrift Charter—Should You Convert Your Commercial Bank to a Thrift with a Unitary S&L Holding Company?"

⁴William J. Brown, *The Dual Banking System in the United States* (New York: American Bankers Association Department of Economics and Research, 1968), pp. 64-65.

⁵State-chartered institutions are regulated by agencies of the state government. Rules of operation are dependent upon the state of residency. They are subject to federal supervision only if they insure with the FDIC, or FSLIC, or NCUSIF, or affiliate with the Home Loan Bank System. Federally chartered S&Ls are regulated by the FHLBB and FSLIC. State and federal chartered institutions possess similar powers, which allows the institutions the opportunity to select the form that best fits its structure. At times the federal savings bank form is specified because it allows an institution to use "bank" in its title.

⁶For a fuller discussion of the new powers granted to savings institutions, both state and federal chartered, see Robert E. Goudreau, "S&L Use of New Powers: A Comparative Study of State- and Federal-Chartered Associations," *Economic Review*, Federal Reserve Bank of Atlanta, vol. 69 (October 1984), pp. 18-33.

⁷Some savings institutions appear willing to use this technique. For example, see comments of Theodore W. Barnes, chairman of Old State Bank in Alan Wade, "A National Financial Services Company," *United States Banker*, vol. 96 (March 1985), p. 31.

⁸It has been contended that a customer can maintain the demand deposit account even after the loan has been paid when the nature of the customer's business reasonably suggests a need for further loans. However, section 312 of Garn-St Germain is silent on this matter. See Thomas P. Vartanian and John D. Hawke Jr., "It Sounds Like a Banker's Fantasy, But It Isn't," *American Banker*, April 13, 1983. Also see Title III, Section 312 of the Garn-St Germain Depository Institutions Act of 1982.

⁹Although savings institutions can accept demand deposits and make commercial loans, they are not considered commercial banks. The Bank Holding Company Act defines a bank as an institution that both receives demand deposits and makes commercial loans, and so a savings institution might be classified as a commercial bank for some purposes. However, because section 333 of the Garn-St Germain Act excludes from the previous act's definition any institution that is either chartered by the FHLBB or insured by the FSLIC, savings institutions retain their distinction from commercial banks. Similarly, they are not treated as full competitors of commercial banks in most merger and acquisition analyses.

¹⁰For detailed discussions of interstate banking issues see "New Directions in Interstate Banking—Special Issue," *Economic Review*, Federal Reserve Bank of Atlanta, vol. 70 (January 1985) and "Interstate Banking Laws: Time to Remodel?—Special Issue," *Economic Review*, Federal Reserve Bank of Atlanta, vol. 70 (March 1985).

¹¹See the FHLBB's policy on remote service units (RSUs) in FHLBB, *Annotated Manual of Statutes and Regulations*, Paragraph 931, subsection 545.141, 5th edition.

¹²A national bank is prohibited from owning or renting an ATM across state lines because such an action would be in violation of the McFadden Act. According to the comptroller's ruling in 1976, an ATM that is neither owned nor rented by a national bank is not deemed a branch of that national bank merely because that bank's customers may use the ATM in exchange for the payment by that bank of a transaction fee to the ATM-owner. Thus a national bank may participate in a shared electronic network. The Court of Appeals ruling on the Marine Midland case affirmed the comptroller's position.

¹³The federal banking regulatory agencies define primary capital as comprising common and perpetual preferred stock, surplus and undivided profits, contingency and other capital reserves, mandatory convertible instruments, 100 percent of funds set aside as reserve for possible loan

losses, and minority interest in consolidated subsidiaries. Subtracted from the above categories are equity commitment notes and intangible assets. The FDIC and OCC subtract all intangible assets except for purchased mortgage servicing rights. The Federal Reserve subtracts only the goodwill portion of intangible assets. For a description of the above categories and information regarding new bank capital standards see R. Alton Gilbert, Courtenay C. Stone, and Michael E. Trebing, "The New Bank Capital Adequacy Standards," *Review*, Federal Reserve Bank of St. Louis, vol. 67 (May 1985), pp. 12-20.

¹⁴See, for example, "FHLBB Tightens Net Worth Rules Despite Opposition," *Savings Institutions*, vol. 106 (January 1985), pp. 6-8.

¹⁵Net worth is defined as the amount by which a savings institution's assets exceed its liabilities. It acts as a cushion to protect savers against any losses on loans and other investments, and consists of federal insurance and general reserves, paid-in surplus, undivided profits, subordinated debentures, appraised equity capital, net worth certificates, and mutual capital certificates for a mutual institution or permanent stock for a stock association.

¹⁶Although a number of savings associations have converted from mutual to stock ownership, many thrifts remain mutual institutions. For example, in its 1983 annual report the FHLBB notes that the number of FSLIC-insured institutions with stock form of organization increased from 755 at the end of 1982 to 780 at the end of 1983 as a result of conversions and new charters; over the same period, the number of FSLIC-insured mutual institutions declined from 2,594 to 2,403 because of conversions and mergers. See FHLBB, "Revitalizing America's Savings Institutions," 1983 *Federal Home Loan Bank Board Annual Report* (Washington, 1984), p. 40.

¹⁷See Ira L. Tannenbaum, "Memorandum, re: Comparability in Thrift and Bank Regulation," *Golembe Reports*, no. 2 (March 5, 1984).

¹⁸"Why Some Banks Think It's Better to Be a Thrift," *Business Week*, November 19, 1984, p. 151.

¹⁹12 U.S.C. 770(a)(19)(c).

²⁰See Herbert Baer, "Tax Barriers to Diversification by Savings and Loan Associations," in Federal Reserve Bank of Chicago, *Bank Structure and Competition*, Proceedings of a Conference held at Chicago, Illinois, May 1983, Conference Series, vol. 19 (May 1983), pp. 151-70.

²¹See Charles D. Salley, "1970 Bank Holding Company Amendments: What Is Closely Related to Banking?" *Monthly Review*, Federal Reserve Bank of Atlanta, vol. 56 (June 1971), p. 100.

²²A federally chartered S&L or federal savings bank can invest in real estate via a service corporation without a holding company structure. See FHLBB, *Annotated Manual of Statutes and Regulations*, paragraphs 1452-1452c, fifth edition.

²³The FHLBB defines a qualified institution as an insured institution, the business of which consists principally of acquiring the savings of the public and investing in loans. In addition, at least 60 percent of the institution's total assets at the close of its taxable year must consist of certain assets among which are cash, government obligations, loans secured by deposits, loans secured by residential real property, property acquired through liquidation of defaulted eligible loans, and property used by the institution in the conduct of its business. The subsection lists 10 categories of assets. For a complete listing see, FHLBB *Annotated Manual of Statutes and Regulations*, Paragraph 1452b, subsection 584.2-2, 5th edition.

²⁴Converting state-chartered savings institutions may remain insured by the FDIC for a transition period.

²⁵See Jeffrey C. Gerrish, "The Thrift Charter: Should You Convert Your Commercial Bank to a Thrift with a Unitary S&L Holding Company?" (Presented to the Sigma Foresight Meeting, Albuquerque, New Mexico, February 24-26, 1985), p. 28.

²⁶In addition to the states mentioned in note 1, the *Federal Register* reports that the Idaho and Illinois statutes are silent on the matter and may permit such conversion. Michigan would allow commercial banks to convert to state-chartered thrifts if such a conversion is permissible under federal regulation. See *Federal Register*, April 24, 1985, p. 16071.

²⁷*Ibid.*, p. 16072.

²⁸Investment in a service corporation is one of the most liberal powers that state agencies grant state-chartered thrifts. The three states with the highest limits on such investment are Florida, Texas, and California. State-chartered institutions in Florida may invest up to 10 percent of assets or net worth, whichever is less; in Texas the limit is 10 percent, and in California 100 percent. The additional investment privilege may enable a thrift to invest in more risky ventures.

²⁹See, for example, Thomas P. Vartanian and John D. Hawke Jr., "Conversions May Spur Thrift Industry Rebirth," *American Banker*, April 14, 1983, and Carter Golembe, "Is There Really a Thrift Industry?" *Bottomline National Council of Savings Institutions*, no. 2 (February 1985), pp. 39-46.

³⁰Gerrish (1985) and Tannenbaum (1984) seem to suggest this.

³¹As an indication, the 1983 Federal Home Loan Bank Board annual report states that the board approved 138 mergers in 1983, eliminating 159 institutions, whereas it had approved a record 425 mergers (involving 483

disappearing institutions) in 1982. Of the mergers approved in 1983, 23 were FSLIC-assisted, down from 44 in 1982; 31 were of a supervisory nature but without assistance, down from 166 in 1982; and 84 were voluntary, down from 215 in 1982.

³²See "Bank Board Sets S&L Assessment," *American Banker*, February 25, 1985, and "Ohio S&L Crisis May Spur Industry," *Wall Street Journal*, April 8, 1985.

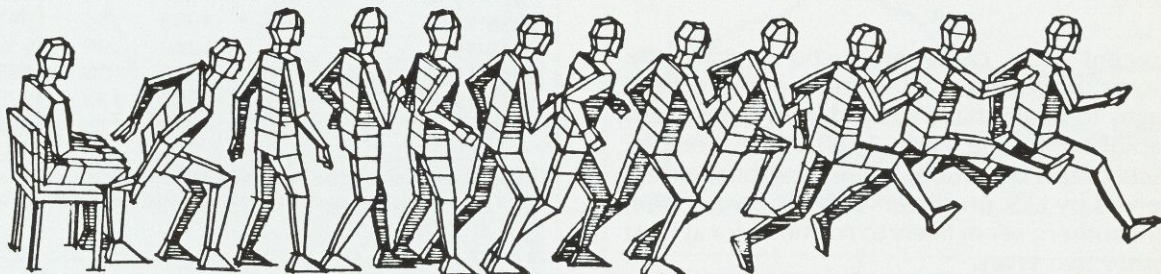
³³Eight privately insured state-chartered savings institutions in Georgia have decided to convert to state-chartered banks covered by FDIC insurance. See Peter Mantius, "Privately Insured Georgia S&Ls Are Switching to FDIC," *Atlanta Constitution*, May 15, 1985. In addition, state savings and loan regulators in Ohio report that, since the recent crisis involving privately insured S&Ls, seven associations have converted to

commercial banks. For comments on marketing considerations see "New Law Simplifies and Shortens Process for Converting State Banks to S&Ls and Thrifts to Banks," *American Banker*, June 25, 1985.

³⁴In some expanding areas, Florida and Texas for example, the rate of growth of new state chartered thrifts during the first six months of 1984 has outpaced that of state chartered commercial banks. During that period the rate of state thrift openings has remained stable while that for federal charters has risen, but the rate of national bank openings has dropped. This could suggest that where growing real estate and consumer business exists, in addition to the increased denial rate of the OCC, thrift charters are attractive. See Mark Basch, "Rate of State Thrift Openings Stable, But Commercial Bank Start-Ups Fall," *American Banker*, August 22, 1985.

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The Cattle Cycle: A Pattern Gone Awry

Charles Lokey, Jr. and Gene Wilson

In recent years cattle production cycles, the periodic undulations in cattle numbers from troughs to peaks, have strayed from the pattern established in the early 1900s. The irregular effects of this deviation, influencing both prices received by U.S. producers and the cost of beef to consumers, seem likely to continue for at least another two years.

Over the period from 1928 to 1979, five production cycles were completed in this country. They averaged ten years in length, with individual cycles ranging from nine to twelve years (see Table 1). In each of these cycles, cattle inventory numbers generally trended upward, meaning that each successive cycle started at a higher inventory level than the preceding one. Although cycles have displayed considerable similarity, the amplitude and length of each cycle have varied. The length of the upward phase is constrained biologically by the time required to produce additional calves and raise female stock to breeding age. The length of the downward or liquidation phase, on the other hand, is determined by the relative advantages to selling rather than maintaining stock, namely, the relationship between production costs and cattle prices.

Historically, cycles have peaked in approximately the middle of each decade; the last four complete cycles peaked in 1945, 1955, 1965, and 1975. The most recent cycle, however, deviates from the past century's persistent general pattern. Starting from a production trough at the beginning of 1979, the expansion trend in cattle numbers should have peaked in 1985 or 1986. Instead, the national beef cattle inventory apparently reached its summit early in 1982. Evidently, cattle producers recently have altered

Table 1. Cattle and Calves on Farm at Peak and Trough

Cycle	(Million Head)			
	Trough	Year	Peak	Year
1928-1938	57	1928	74	1934
1938-1949	65	1938	86	1945
1949-1958	77	1949	96	1955
1958-1967	91	1958	109	1965
1967-1979	109	1967	132	1975
1979-	111	1979	115	1982

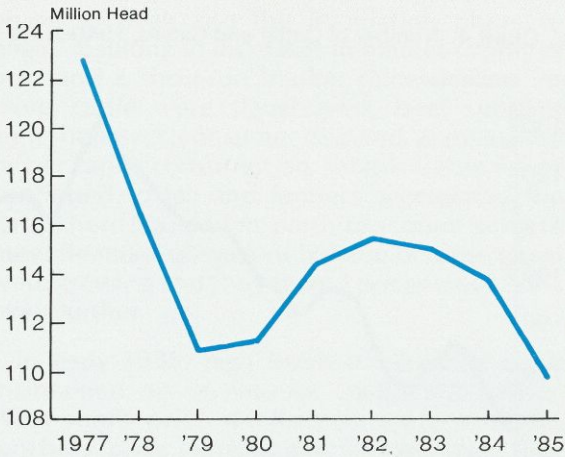
Source: Derived from USDA, *Agricultural Statistics*, various issues, and *Livestock and Poultry Outlook and Situation Report*, various issues.

their decisions in such a way that inventories no longer follow the typical cycle.

The 1979 production cycle began typically, with inventory levels of 110.9 million head rising to 115.6 million by the beginning of 1982 (see Chart 1). With improved forage supplies and grazing conditions, cattlemen were expected to expand their herds further in 1983 in order to use the greater carrying capacity of pastures and ranges. However, a decline in cattle prices and a run-up in feed costs combined with a weak economy and continued uncertainty about economic recovery made ranchers reluctant to boost inventories. As a result, the expansion phase of the cycle halted, cattle numbers declined, and the liquidation phase began prematurely. After a very slight decline in 1982, cattle inventories decreased by one percent, while the number of heifers (immature females) held for herd expansion dropped four percent. In 1984 inventories declined an additional three percent and total cattle liquidation reached a high level.

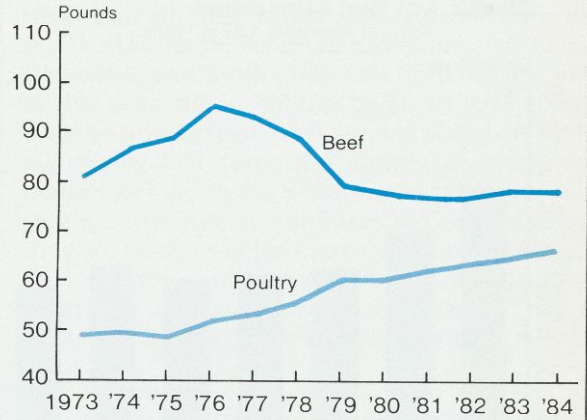
An additional reason for the shortened cattle cycle appears to be changing consumer tastes. Per capita consumption of beef fell in the late seventies, breaking a long upward trend, while consumption of poultry continued its growth

Chart 1. Cattle on Farms, January 1, 1977-1985



Source: USDA, *Livestock and Poultry, Outlook and Situation*, various issues from 1984 and 1985.

Chart 2. U.S. Per Capita Consumption of Beef and Poultry, 1973-1984



Source: USDA, *Agricultural Statistics 1984*

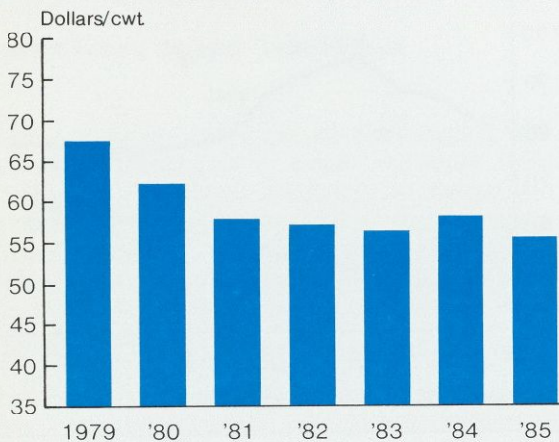
straight through the early years of this decade (Chart 2). American consumers' willingness to replace beef with poultry suggests that cattle inventories may not need to expand as much as in past cycles.

Financial difficulties caused by low returns and high feed costs in the 1983-1984 period, plus drought in some areas, led to unusually high levels of beef cow slaughter.¹ This suggests that the U.S. cattle inventory will drop even lower in 1985. On July 1 the total inventory was 4 percent less than a year ago and at its lowest point since 1968. Reflecting cattlemen's unwillingness to retain heifers for breeding, beef replacement heifers were down 11 percent from year-earlier levels. As a result of this trend, the percentage of calves to cows has declined throughout the eighties and contributed to continuing inventory liquidation. Prospects for a larger calf crop and therefore another period of inventory expansion depend heavily on a rise in the calving rate. However, poor financial incentives and producers' need to generate additional cash flow

have led them to sell a substantial number of heifers.² This low retention rate indicates that less than 70 percent of the cows slaughtered during 1985 will be replaced. In fact, the estimated calf crop for 1985 is 3 percent less than last year's. Because fewer heifers will calve and enter the cow herd this year, prospects for rebuilding cattle inventories in the near future are dimmed further.

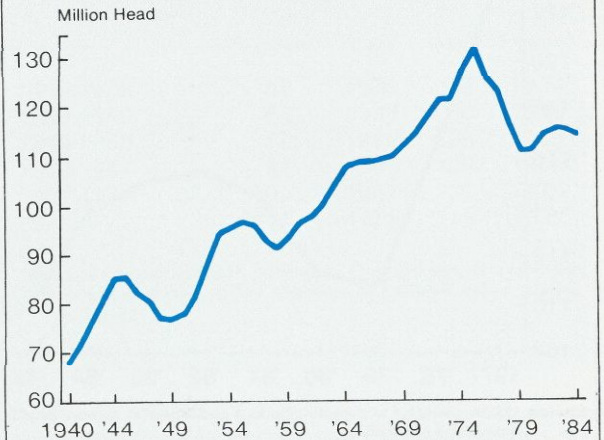
In the present cycle, cattle liquidation differs significantly among regions of the United States. The largest drop (7 percent) in beef cow numbers from year-ago levels occurred in the Great Plains region; inventories fell 5 percent and 3 percent in the North Central and Southern regions, respectively. Since the cow herd is a highly liquid source of capital, operators who need cash for crop planting expenses apparently continued to liquidate their herds through the spring. Beef cow slaughter remained high during the first half of 1985 in the North Central and Northern Plains regions where the farm sector's economic distress has been most severe.

Chart 3. U.S. Beef Cattle Prices
Annual Average, 1979-1985



Source: USDA, *Agricultural Prices*, 1984 Summary and June 1985 issue.

Chart 4. Number of Cattle and Calves, 1940-1984



Source: USDA, *Agricultural Statistics*, various years.

Returns to beef producers have fallen in each of the major regions since 1980. From 1980 to 1983, net returns per cow fell in the Great Plains, North Central, and Western regions. Producers in the South have lost money on their herds since 1981.³

Cattle are simultaneously a form of investment and a source of immediate income. For this reason, we can view ranchers' expectations about future prices from two perspectives. As an investment cattle give the producer a source of future income with asset values rising along with herd size. But herd expansion may be halted at any time and the cattle sold to slaughter for immediate income.

When cattle are regarded in this manner, beef price changes may influence ranchers in one of two ways. A rise in the price of beef may cause ranchers to expect higher prices in the future, inducing them to increase the size of their breeding herds to take advantage of these prices. On the other hand, an increase may encourage

producers to sell cattle immediately to profit from the current high price. The market price of cattle serves to equilibrate the demand for and the supply of beef and to channel resources into and out of beef production. Consequently, price trends usually lead production cycles and tend to reflect the net effect of demand and supply forces at work (see Charts 3 and 4).

In the present cycle, these price factors come into play. From 1975 to 1980, the price per head increased each year, peaking in 1980 at an average of \$502. Presumably because their price expectations are heavily influenced by recent experience, ranchers increased inventories nearly 3 percent by 1981. The stepped-up production from the expanded herd also permitted slaughter to increase nearly 4 percent in the same period. In these years, the expectation of future price increases swelled inventories through early 1982, when prices declined to \$414 per head. These price downturns, along with higher costs and greater cash flow needs, caused the expansion

phase to peak and the liquidation phase to begin, resulting in increases in market supply of beef and a short-run market price decline. As more cattle were slaughtered, beef supplies grew; however, consumer demand, as measured by per capita consumption, shrank. Cattle prices continued to fall and farmers accelerated the rate of herd liquidation, partly to acquire funds to meet financial obligations but also because losses were growing and they feared prices would sink even further.

In early 1985, high levels of slaughter were maintained, so inventories contracted further. With sharp price declines in early summer, ranchers' price expectations for the future may remain depressed. By late July, cash prices at Midwest markets were reported to be the lowest since 1978. Cattle futures prices continued in a slump that originated in the fourth quarter of 1984, apparently as a result of enlarged beef supplies from further herd liquidation combined with heavier weights of animals marketed from feed lots.⁴ Even if production slackens substantially, it might not increase prices significantly considering the ample non-beef meat supplies. The decreasing calf crop and reduced heifer retention indicate that ranchers expect no immediate upturn.

For consumers, increased herd liquidation since 1982 most likely has produced lower retail prices than would otherwise have been the case. Retail beef prices, as measured by the Consumer Price Index, certainly have fallen consistently the first half of this year. But the beef-loving consumer should find the tables turned during the next few years. With small inventories, when cattlemen become more optimistic and retain more livestock for breeding purposes, beef prices may rise substantially. The degree to which substitute products can satisfy the consumer palate will be a major factor, as will the level of beef imports, in determining how much beef prices can increase.

The timing of a turnaround is uncertain, but the latter part of 1985 might see cattle inventories reach their nadir. As retail movement picks up seasonally and production falls from the first half of the year, prices should begin to strengthen. With an upward price movement, slaughter rates eventually will slow, the supply of cattle for market will shrink even more, and cattlemen will regain a measure of confidence. Consequently, they are likely to begin increasing their herd size, thus starting a new cycle. Will the cycle then revert to a more traditional pattern? That is largely up to the American consumer.

Lokey is a research intern, Wilson a senior economic analyst on the Research Department's regional economics team.

NOTES

¹U.S. Department of Agriculture, Economic Research Service, *Livestock and Poultry Outlook and Situation* (February 1983), p. 5.

²USDA ERS, *Agricultural Outlook* (September 1985), p. 29.

³USDA ERS, *Agricultural Outlook* (April 1985), p. 5.

⁴Animal weights tend to increase when feed lot operators postpone sales of fat cattle following an unexpected price decline. Their unwillingness to accept immediate losses often aggravates the over-supply problem and contributes to additional losses. Infrequently, slaughter weights may also rise when a drop in feed costs makes it profitable to feed heavy animals past the point of optimum condition.

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FINANCE

	AUG 1985	JUL 1985	AUG 1984	ANN. % CHG.		AUG 1985	JUL 1985	AUG 1984	ANN. % CHG.
\$ millions									
UNITED STATES									
Commercial Bank Deposits	1,529,412	1,517,476	1,388,132	+11	Savings & Loans**				
Demand	327,086	331,838	305,958	+ 7	Total Deposits	740,862	628,086	682,453	+ 9
NOW	107,248	103,140	90,674	+18	NOW	25,666	19,941	20,582	+25
Savings	426,497	419,675	355,986	+20	Savings	176,076	148,708	166,929	+ 5
Time	706,491	707,177	670,766	+ 5	Time	540,949	461,454	497,490	+ 9
Credit Union Deposits	65,349	64,267	53,366	+22	JUN		MAY	JUN	
Share Drafts	7,705	6,457	5,762	+34	Mortgages Outstanding	623,275	617,574	563,375	+11
Savings & Time	57,695	56,985	47,445	+22	Mortgage Commitments	39,956	40,705	47,754	-16
SOUTHEAST									
Commercial Bank Deposits	177,055	175,964	158,738	+12	Savings & Loans**				
Demand	37,766	37,957	35,892	+ 5	Total Deposits	98,049	95,723	N.A.	
NOW	14,062	13,437	11,624	+21	NOW	3,976	3,679	N.A.	
Savings	47,540	46,655	40,855	+16	Savings	22,018	21,143	N.A.	
Time	82,112	82,588	74,127	+11	Time	72,346	72,596	N.A.	
Credit Union Deposits	7,461	7,321	6,203	+20	JUN		MAY	JUN	
Share Drafts	711	674	559	+27	Mortgages Outstanding	79,181	78,571	70,986	+12
Savings & Time	6,569	6,475	5,507	+19	Mortgage Commitments	4,872	4,791	5,424	-10
ALABAMA									
Commercial Bank Deposits	17,950	18,336	16,507	+ 9	Savings & Loans**				
Demand	3,984	3,878	3,759	+ 6	Total Deposits	6,454	6,369	5,517	+17
NOW	1,409	1,312	1,035	+36	NOW	232	219	169	+37
Savings	3,716	3,685	3,297	+13	Savings	1,097	1,062	880	+25
Time	9,409	9,942	8,939	+ 5	Time	5,131	5,132	4,506	+14
Credit Union Deposits	1,140	1,124	971	+17	JUN		MAY	JUN	
Share Drafts	129	121	99	+30	Mortgages Outstanding	4,484	4,411	4,165	+ 8
Savings & Time	947	937	851	+11	Mortgage Commitments	333	349	222	+ 5
FLORIDA									
Commercial Bank Deposits	64,091	63,286	55,909	+15	Savings & Loans**				
Demand	13,528	13,618	12,610	+ 7	Total Deposits	63,234	61,063	57,948	+ 9
NOW	5,876	5,642	4,794	+23	NOW	2,668	2,460	2,283	+17
Savings	22,026	21,678	19,210	+15	Savings	15,079	14,318	14,460	+ 4
Time	24,169	24,000	20,511	+18	Time	45,401	44,285	41,282	+10
Credit Union Deposits	3,360	3,302	2,729	+23	JUN		MAY	JUN	
Share Drafts	354	341	279	+27	Mortgages Outstanding	47,453	46,959	41,759	+14
Savings & Time	2,857	2,822	2,307	+24	Mortgage Commitments	3,276	3,206	3,386	- 3
GEORGIA									
Commercial Bank Deposits	28,110	27,744	24,372	+15	Savings & Loans**				
Demand	7,786	7,878	7,190	+ 8	Total Deposits	8,425	8,387	8,064	+ 4
NOW	1,886	1,792	1,537	+23	NOW	429	384	283	+52
Savings	7,435	7,222	5,653	+32	Savings	1,890	1,874	1,794	+ 5
Time	12,432	12,400	11,080	+12	Time	6,260	6,272	6,117	+ 2
Credit Union Deposits	1,523	1,504	1,305	+17	JUN		MAY	JUN	
Share Drafts	117	109	88	+33	Mortgages Outstanding	9,419	9,426	8,798	+ 7
Savings & Time	1,420	1,405	1,217	+17	Mortgage Commitments	416	410	489	-15
LOUISIANA									
Commercial Bank Deposits	28,202	28,175	26,134	+ 8	Savings & Loans**				
Demand	5,450	5,520	5,633	- 3	Total Deposits	10,962	10,966	9,605	+14
NOW	1,724	1,682	1,527	+13	NOW	328	313	244	+34
Savings	6,568	6,362	5,511	+19	Savings	2,348	2,306	2,218	+ 6
Time	14,970	15,132	13,946	+ 7	Time	8,424	8,499	7,273	+16
Credit Union Deposits	191	189	213	-10	JUN		MAY	JUN	
Share Drafts	18	17	24	-25	Mortgages Outstanding	9,457	9,368	8,766	+ 8
Savings & Time	177	184	209	-15	Mortgage Commitments	354	337	724	-51
MISSISSIPPI									
Commercial Bank Deposits	13,169	13,063	12,195	+ 8	Savings & Loans**				
Demand	2,546	2,469	2,361	+ 8	Total Deposits	1,913	1,907	N.A.	
NOW	958	914	849	+13	NOW	62	62	N.A.	
Savings	2,592	2,532	2,355	+10	Savings	321	310	N.A.	
Time	7,439	7,457	6,947	+ 7	Time	1,589	1,591	N.A.	
Credit Union Deposits	*	*	*		JUN		MAY	JUN	
Share Drafts	*	*	*		Mortgages Outstanding	2,156	2,149	2,059	+ 5
Savings & Time	*	*	*		Mortgage Commitments	285	263	223	+28
TENNESSEE									
Commercial Bank Deposits	25,533	25,360	23,621	+ 8	Savings & Loans**				
Demand	4,472	4,594	4,339	+ 3	Total Deposits	7,061	7,031	6,996	+ 1
NOW	2,209	2,095	1,882	+17	NOW	257	241	197	+30
Savings	5,203	5,176	4,829	+ 8	Savings	1,283	1,273	1,282	+ 0
Time	13,693	13,657	12,704	+ 8	Time	5,541	6,817	5,549	- 1
Credit Union Deposits	1,247	1,202	985	+27	JUN		MAY	JUN	
Share Drafts	93	86	69	+35	Mortgages Outstanding	6,212	6,258	5,439	+14
Savings & Time	1,168	1,127	923	+27	Mortgage Commitments	208	226	380	-45

Notes: All deposit data are extracted from the Federal Reserve Report of Transaction Accounts, other Deposits and Vault Cash (FR2900), and are reported for the average of the week ending the 1st Monday of the month. This data, reported by institutions with over \$15 million in deposits and \$2.2 million of reserve requirements as of June 1984, represents 95% of deposits in the six state area. The annual rate of change is based on most recent data over December 31, 1980 base, annualized. The major differences between this report and the "call report" are size, the treatment of interbank deposits, and the treatment of float. The data generated from the Report of Transaction Accounts is for banks over \$15 million in deposits as of December 31, 1979. The total deposit data generated from the Report of Transaction Accounts eliminates interbank deposits by reporting the net of deposits "due to" and "due from" other depository institutions. The Report of Transaction Accounts subtracts cash in process of collection from demand deposits, while the call report does not. Savings and loan mortgage data are from the Federal Home Loan Bank Board Selected Balance Sheet Data. The Southeast data represent the total of the six states. Subcategories were chosen on a selective basis and do not add to total.

* = fewer than four institutions reporting.
 ** = S&L deposits subject to revisions due to reporting changes.
 N.A. = not available at this time.



CONSTRUCTION

	JUL 1985	JUN 1985	JUL 1984	ANN. % CHG.		JUL 1985	JUN 1985	JUL 1984	ANN. % CHG.
UNITED STATES									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	65,966	64,639	58,587	+13	Value - \$ Mil.	76,609	75,280	74,834	+ 2
Industrial Bldgs.	8,630	8,566	7,730	+12	Residential Permits - Thous.				
Offices	16,712	16,485	14,014	+19	Single-family units	910.2	897.0	940.3	- 3
Stores	10,210	10,027	8,883	+15	Multifamily units	728.9	727.7	770.8	- 5
Hospitals	2,115	2,025	1,865	+13	Total Building Permits				
Schools	1,124	1,127	891	+26	Value - \$ Mil.	142,575	139,919	133,421	+ 7
SOUTHEAST									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	10,878	10,065	8,972	+21	Value - \$ Mil.	13,397	13,636	14,195	- 6
Industrial Bldgs.	1,075	1,040	897	+20	Residential Permits - Thous.				
Offices	2,504	2,438	2,015	+24	Single-family units	189.9	187.4	193.2	- 2
Stores	2,073	2,018	1,741	+19	Multifamily units	157.7	159.1	183.8	-14
Hospitals	415	372	474	-12	Total Building Permits				
Schools	140	115	116	+21	Value - \$ Mil.	24,274	23,700	23,166	+ 5
ALABAMA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	651	646	736	-12	Value - \$ Mil.	476	477	478	- 0
Industrial Bldgs.	68	68	184	-63	Residential Permits - Thous.				
Offices	125	122	80	+56	Single-family units	9.4	9.1	8.3	+13
Stores	150	139	111	+35	Multifamily units	6.6	6.4	8.5	-22
Hospitals	52	51	13	+300	Total Building Permits				
Schools	13	9	6	+117	Value - \$ Mil.	1,127	1,123	1,214	- 7
FLORIDA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	5,746	5,111	4,362	+32	Value - \$ Mil.	7,545	7,746	8,300	- 9
Industrial Bldgs.	572	559	428	+34	Residential Permits - Thous.				
Offices	1,131	1,102	933	+21	Single-family units	100.9	100.0	105.9	- 5
Stores	1,165	1,156	995	+17	Multifamily units	95.3	96.2	102.1	- 7
Hospitals	211	183	218	- 3	Total Building Permits				
Schools	49	40	45	+ 9	Value - \$ Mil.	13,290	12,857	12,662	+ 5
GEORGIA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	1,883	1,821	1,608	+17	Value - \$ Mil.	2,850	2,843	2,733	+ 4
Industrial Bldgs.	279	272	168	+66	Residential Permits - Thous.				
Offices	502	493	517	- 3	Single-family units	45.1	44.3	43.1	+ 5
Stores	303	290	236	+28	Multifamily units	23.1	23.1	27.9	-17
Hospitals	26	29	62	-58	Total Building Permits				
Schools	19	16	17	+12	Value - \$ Mil.	4,733	4,664	4,341	+ 9
LOUISIANA									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	1,334	1,310	1,184	+13	Value - \$ Mil.	832	848	1,170	-29
Industrial Bldgs.	47	46	29	+62	Residential Permits - Thous.				
Offices	401	390	307	+31	Single-family units	12.4	12.4	16.3	-24
Stores	241	239	204	+18	Multifamily units	8.6	8.9	17.5	-51
Hospitals	68	64	148	-54	Total Building Permits				
Schools	43	37	41	+ 5	Value - \$ Mil.	2,167	2,158	2,353	- 8
MISSISSIPPI									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	273	242	246	+11	Value - \$ Mil.	341	353	383	-11
Industrial Bldgs.	18	14	14	+29	Residential Permits - Thous.				
Offices	50	45	27	+85	Single-family units	6.2	6.2	5.8	+ 7
Stores	56	48	51	+10	Multifamily units	3.1	3.5	6.3	-51
Hospitals	17	6	13	+31	Total Building Permits				
Schools	8	5	1	+700	Value - \$ Mil.	613	594	629	- 3
TENNESSEE									
Nonresidential Building Permits - \$ Mil.					Residential Building Permits				
Total Nonresidential	991	935	836	+19	Value - \$ Mil.	1,353	1,369	1,131	+20
Industrial Bldgs.	91	81	74	+23	Residential Permits - Thous.				
Offices	295	286	151	+95	Single-family units	15.9	15.4	13.8	+15
Stores	158	146	144	+10	Multifamily units	21.0	21.0	21.5	- 2
Hospitals	41	39	20	+105	Total Building Permits				
Schools	8	8	6	+33	Value - \$ Mil.	2,344	2,304	1,967	+19

NOTES: Data supplied by the U. S. Bureau of the Census, Housing Units Authorized By Building Permits and Public Contracts, C-40. Nonresidential data excludes the cost of construction for publicly owned buildings. The southeast data represent the total of the six states. The annual percent change calculation is based on the most recent month over prior year. Publication of F. W. Dodge construction contracts has been discontinued.



GENERAL

	LATEST DATA	CURR. PERIOD	PREV. PERIOD	YEAR AGO	ANN. % CHG.		AUG 1985	JUL 1985	AUG 1984	ANN. % CHG.
UNITED STATES										
Personal Income (\$bil. - SAAR)	1Q	3,129.1	3,082.9	2,906.5	+ 8	Agriculture				
Taxable Sales - \$bil.		N.A.	N.A.	N.A.		Prices Rec'd by Farmers Index (1977=100)	122	126	143	-15
Plane Pass. Arr. (000's)						Broiler Placements (thous.)	86,679	86,858	84,353	+ 3
Petroleum Prod. (thous.)	AUG	8,926.0	8,957.5	8,785.0	+ 2	Calf Prices (\$ per cwt.)	60.20	60.00	59.10	+ 2
Consumer Price Index 1967=100	AUG	323.5	322.8	313.0	+ 3	Broiler Prices (\$ per lb.)	28.70	30.60	30.60	- 6
Kilowatt Hours - mils.	JUN	189.2	177.6	189.1	+ 0	Soybean Prices (\$ per bu.)	5.05	5.42	6.50	-22
						Broiler Feed Cost (\$ per ton)	192	196	225	-15
SOUTHEAST										
Personal Income (\$bil. - SAAR)	1Q	381.7	375.9	351.5	+ 9	Agriculture				
Taxable Sales - \$bil.		N.A.	N.A.	N.A.		Prices Rec'd by Farmers Index (1977=100)	114	119	143	-20
Plane Pass. Arr. (000's)	JUN	4,811.1	5,037.1	4,669.4	+ 3	Broiler Placements (thous.)	33,620	33,358	31,059	+ 8
Petroleum Prod. (thous.)	AUG	1,527.0	1,539.0	1,502.0	+ 2	Calf Prices (\$ per cwt.)	56.69	56.15	56.10	+ 1
Consumer Price Index 1967=100		N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	27.72	29.89	28.90	- 4
Kilowatt Hours - mils.	JUN	32.9	28.5	31.1	+ 6	Soybean Prices (\$ per bu.)	5.25	5.49	6.59	-20
						Broiler Feed Cost (\$ per ton)	189	190	224	-16
ALABAMA										
Personal Income (\$bil. - SAAR)	1Q	41.1	40.7	38.6	+ 6	Agriculture				
Taxable Sales - \$bil.		N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: AUG, AUG)	N.A.	-	1,218	
Plane Pass. Arr. (000's)	JUN	147.1	147.8	122.8	+20	Broiler Placements (thous.)	11,317	11,244	10,720	+ 6
Petroleum Prod. (thous.)	AUG	58.0	58.0	54.0	+ 7	Calf Prices (\$ per cwt.)	54.60	54.70	55.00	- 1
Consumer Price Index 1967=100		N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	27.50	29.00	28.00	- 2
Kilowatt Hours - mils.	JUN	4.3	3.7	4.1	+ 5	Soybean Prices (\$ per bu.)	5.44	5.55	6.53	-17
						Broiler Feed Cost (\$ per ton)	191	191	220	-13
FLORIDA										
Personal Income (\$bil. - SAAR)	1Q	145.4	142.9	131.7	+10	Agriculture				
Taxable Sales - \$bil.	AUG	89.8	88.9	80.7	+11	Farm Cash Receipts - \$ mil. (Dates: AUG, AUG)	N.A.	-	3,213	
Plane Pass. Arr. (000's)	JUN	2,113.6	2,258.7	2,198.7	- 4	Broiler Placements (thous.)	2,063	2,065	1,852	+11
Petroleum Prod. (thous.)	AUG	34.0	34.0	35.0	- 3	Calf Prices (\$ per cwt.)	58.90	59.90	59.60	- 1
Consumer Price Index 1967=100		JUL	JUL	JUL		Broiler Prices (\$ per lb.)	27.00	30.00	29.00	- 7
Kilowatt Hours - mils.	JUN	9.9	8.1	8.6	+15	Soybean Prices (\$ per bu.)	5.44	5.55	6.53	-17
						Broiler Feed Cost (\$ per ton)	220	230	245	-10
GEORGIA										
Personal Income (\$bil. - SAAR)	1Q	70.6	69.4	64.2	+10	Agriculture				
Taxable Sales - \$bil.		N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: AUG, AUG)	N.A.	-	1,890	
Plane Pass. Arr. (000's)	JUN	2,016.8	2,104.8	1,788.9	+13	Broiler Placements (thous.)	13,699	13,634	13,130	+ 4
Petroleum Prod. (thous.)		N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	56.60	53.70	51.50	+10
Consumer Price Index 1967=100		AUG	JUN	AUG		Broiler Prices (\$ per lb.)	27.00	29.50	28.00	- 4
Kilowatt Hours - mils.	JUN	5.5	4.8	5.2	+ 6	Soybean Prices (\$ per bu.)	5.21	5.70	6.55	-20
						Broiler Feed Cost (\$ per ton)	193	195	245	-21
LOUISIANA										
Personal Income (\$bil. - SAAR)	1Q	49.6	49.1	46.9	+ 6	Agriculture				
Taxable Sales - \$bil.		N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: AUG, AUG)	N.A.	-	649	
Plane Pass. Arr. (000's)	JUN	300.9	290.7	345.5	-13	Broiler Placements (thous.)	N.A.	N.A.	N.A.	
Petroleum Prod. (thous.)	AUG	1,350.0	1,362.0	1,322.0	+ 2	Calf Prices (\$ per cwt.)	61.00	58.40	56.30	+ 8
Consumer Price Index 1967=100		N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	29.50	31.00	31.00	- 5
Kilowatt Hours - mils.	JUN	5.4	4.8	5.2	+ 4	Soybean Prices (\$ per bu.)	5.26	5.38	6.79	-23
						Broiler Feed Cost (\$ per ton)	250	250	265	- 0
MISSISSIPPI										
Personal Income (\$bil. - SAAR)	1Q	23.9	23.4	22.6	+ 6	Agriculture				
Taxable Sales - \$bil.		N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: AUG, AUG)	N.A.	-	990	
Plane Pass. Arr. (000's)	JUN	38.4	38.5	37.3	+ 3	Broiler Placements (thous.)	6,541	6,414	6,358	+ 3
Petroleum Prod. (thous.)	AUG	85.0	85.0	91.0	- 7	Calf Prices (\$ per cwt.)	53.90	56.80	57.30	- 6
Consumer Price Index 1967=100		N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	29.50	32.00	31.50	- 6
Kilowatt Hours - mils.	JUN	2.3	2.0	2.2	+ 5	Soybean Prices (\$ per bu.)	5.18	5.43	6.47	-20
						Broiler Feed Cost (\$ per ton)	154	154	178	-13
TENNESSEE										
Personal Income (\$bil. - SAAR)	1Q	51.1	50.4	47.4	+ 8	Agriculture				
Taxable Sales - \$bil.		N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: AUG, AUG)	N.A.	-	1,004	
Plane Pass. Arr. (000's)	JUN	194.3	196.6	176.2	+10	Broiler Placements (thous.)	N.A.	N.A.	N.A.	
Petroleum Prod. (thous.)		N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	56.40	53.60	55.30	+ 2
Consumer Price Index 1967=100		N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	26.00	28.50	29.50	-12
Kilowatt Hours - mils.	JUN	5.5	5.2	5.8	- 5	Soybean Prices (\$ per bu.)	5.22	5.53	6.59	-21
						Broiler Feed Cost (\$ per ton)	172	173	200	-14

NOTES: Personal Income data supplied by U. S. Department of Commerce. Taxable Sales are reported as a 12-month cumulative total. Plane Passenger Arrivals are collected from 26 airports. Petroleum Production data supplied by U. S. Bureau of Mines. Consumer Price Index data supplied by Bureau of Labor Statistics. Agriculture data supplied by U. S. Department of Agriculture. Farm Cash Receipts data are reported as cumulative for the calendar year through the month shown. Broiler placements are an average weekly rate. The Southeast data represent the total of the six states. N. A. = not available. R = revised.



EMPLOYMENT

	JUL 1985	JUN 1985	JUL 1984	ANN. % CHG		JUL 1985	JUN 1985	JUL 1984	ANN. % CHG
UNITED STATES									
Civilian Labor Force - thous.	117,536	116,572	116,198	+ 1	Nonfarm Employment - thous.	97,636	98,353	94,510	+ 3
Total Employed - thous.	108,854	107,819	107,484	+ 1	Manufacturing	19,356	19,538	19,465	- 1
Total Unemployed - thous.	8,682	8,753	8,714	- 0	Construction	4,951	4,834	4,627	+ 7
Unemployment Rate - % SA	7.3	7.3	7.5		Trade	23,416	23,355	22,293	+ 5
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	15,474	16,297	15,223	+ 2
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	22,121	22,031	20,946	+ 6
Mfg. Avg. Wkly. Hours	40.1	40.6	40.3	- 0	Fin., Ins. & Real. Est.	6,014	5,971	5,771	+ 4
Mfg. Avg. Wkly. Earn. - \$	382	386	370	+ 3	Trans. Com. & Pub. Util.	5,319	5,342	5,192	+ 2
SOUTHEAST									
Civilian Labor Force - thous.	15,351	15,280	15,064	+ 2	Nonfarm Employment - thous.	12,660	12,727	12,244	+ 3
Total Employed - thous.	14,055	14,024	13,806	+ 2	Manufacturing	2,284	2,307	2,310	- 1
Total Unemployed - thous.	1,296	1,257	1,258	+ 3	Construction	791	783	778	+ 2
Unemployment Rate - % SA	8.3	8.0	8.3		Trade	3,155	3,148	2,992	+ 5
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	2,165	2,229	2,096	+ 3
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	2,672	2,671	2,518	+ 6
Mfg. Avg. Wkly. Hours	40.5	41.1	40.7	- 0	Fin., Ins. & Real. Est.	730	727	701	+ 4
Mfg. Avg. Wkly. Earn. - \$	338	341	326	+ 4	Trans. Com. & Pub. Util.	733	735	720	+ 2
ALABAMA									
Civilian Labor Force - thous.	1,803	1,800	1,815	- 1	Nonfarm Employment - thous.	1,404	1,398	1,392	+ 1
Total Employed - thous.	1,636	1,634	1,603	+ 2	Manufacturing	350	354	359	- 3
Total Unemployed - thous.	167	166	212	-21	Construction	69	67	67	+ 3
Unemployment Rate - % SA	8.9	8.4	11.3		Trade	295	295	292	+ 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	302	295	294	+ 3
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	234	233	229	+ 2
Mfg. Avg. Wkly. Hours	40.8	40.9	40.7	+ 0	Fin., Ins. & Real. Est.	66	66	64	+ 3
Mfg. Avg. Wkly. Earn. - \$	348	347	327	+ 6	Trans. Com. & Pub. Util.	73	74	73	0
FLORIDA									
Civilian Labor Force - thous.	5,268	5,239	5,179	+ 2	Nonfarm Employment - thous.	4,378	4,423	4,156	+ 5
Total Employed - thous.	4,900	4,877	4,827	+ 2	Manufacturing	513	516	499	+ 3
Total Unemployed - thous.	368	362	352	+ 5	Construction	334	332	326	+ 2
Unemployment Rate - % SA	7.0	6.9	6.9		Trade	1,165	1,167	1,107	+ 5
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	645	687	609	+ 6
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	1,143	1,145	1,062	+ 8
Mfg. Avg. Wkly. Hours	41.0	41.2	41.2	- 0	Fin., Ins. & Real. Est.	316	315	300	+ 5
Mfg. Avg. Wkly. Earn. - \$	321	323	312	+ 3	Trans. Com. & Pub. Util.	251	251	243	+ 3
GEORGIA									
Civilian Labor Force - thous.	2,876	2,881	2,777	+ 4	Nonfarm Employment - thous.	2,601	2,609	2,459	+ 6
Total Employed - thous.	2,665	2,677	2,597	+ 3	Manufacturing	540	544	547	- 1
Total Unemployed - thous.	210	204	180	+17	Construction	156	152	138	+13
Unemployment Rate - % SA	7.1	7.0	6.3		Trade	675	671	610	+11
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	435	451	424	+ 3
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	487	485	446	+ 9
Mfg. Avg. Wkly. Hours	40.7	41.1	40.7	0	Fin., Ins. & Real. Est.	137	136	131	+ 5
Mfg. Avg. Wkly. Earn. - \$	325	323	307	+ 6	Trans. Com. & Pub. Util.	163	162	156	+ 4
LOUISIANA									
Civilian Labor Force - thous.	1,981	1,981	1,959	+ 1	Nonfarm Employment - thous.	1,575	1,593	1,602	- 2
Total Employed - thous.	1,752	1,752	1,764	- 1	Manufacturing	178	181	183	- 3
Total Unemployed - thous.	229	230	195	+17	Construction	110	112	124	-11
Unemployment Rate - % SA	11.3	11.1	9.6		Trade	381	382	385	- 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	314	322	314	0
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	314	317	312	+ 1
Mfg. Avg. Wkly. Hours	40.6	41.5	41.3	- 2	Fin., Ins. & Real. Est.	84	84	84	0
Mfg. Avg. Wkly. Earn. - \$	421	425	418	+ 1	Trans. Com. & Pub. Util.	115	116	119	- 3
MISSISSIPPI									
Civilian Labor Force - thous.	1,134	1,114	1,083	+ 5	Nonfarm Employment - thous.	837	841	817	+ 2
Total Employed - thous.	1,011	1,001	961	+ 5	Manufacturing	218	221	220	- 1
Total Unemployed - thous.	124	114	122	+ 2	Construction	42	41	40	+ 5
Unemployment Rate - % SA	10.5	9.5	10.8		Trade	186	186	177	+ 5
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	181	182	175	+ 3
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	127	127	123	+ 3
Mfg. Avg. Wkly. Hours	39.4	40.6	39.9	- 1	Fin., Ins. & Real. Est.	35	35	34	+ 3
Mfg. Avg. Wkly. Earn. - \$	281	292	274	+ 3	Trans. Com. & Pub. Util.	40	40	39	+ 3
TENNESSEE									
Civilian Labor Force - thous.	2,289	2,265	2,251	+ 2	Nonfarm Employment - thous.	1,865	1,863	1,818	+ 3
Total Employed - thous.	2,091	2,083	2,054	+ 2	Manufacturing	485	491	502	- 3
Total Unemployed - thous.	198	181	197	+ 1	Construction	80	79	83	- 4
Unemployment Rate - % SA	8.4	7.9	8.5		Trade	453	447	421	+ 8
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	288	292	280	+ 3
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	367	364	346	+ 6
Mfg. Avg. Wkly. Hours	40.3	41.4	40.4	- 0	Fin., Ins. & Real. Est.	92	91	88	+ 5
Mfg. Avg. Wkly. Earn. - \$	331	337	318	+ 4	Trans. Com. & Pub. Util.	91	92	90	+ 1

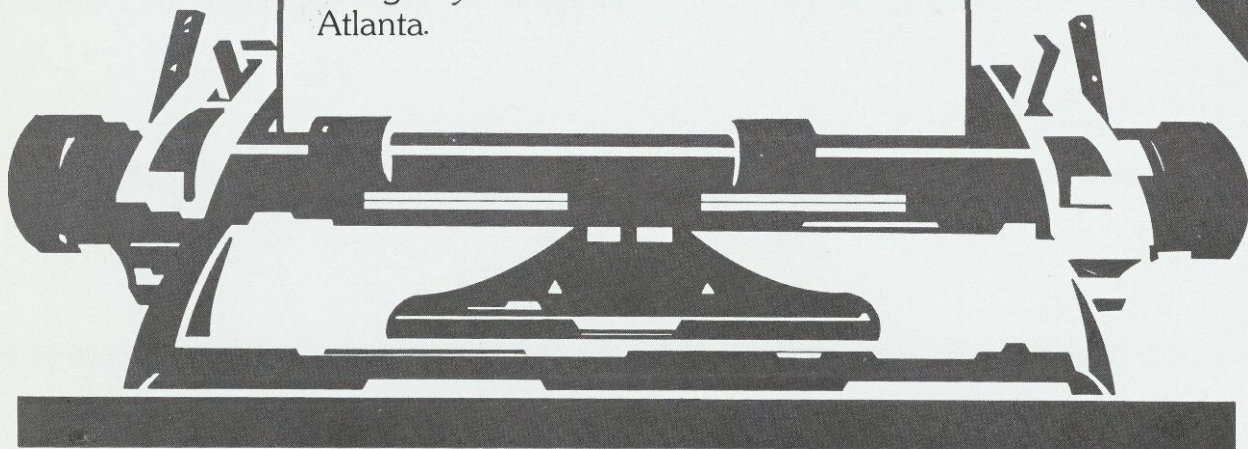
NOTES: All labor force data are from Bureau of Labor Statistics reports supplied by state agencies. Only the unemployment rate data are seasonally adjusted. The Southeast data represent the total of the six states. The annual percent change calculation is based on the most recent data over prior year.

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