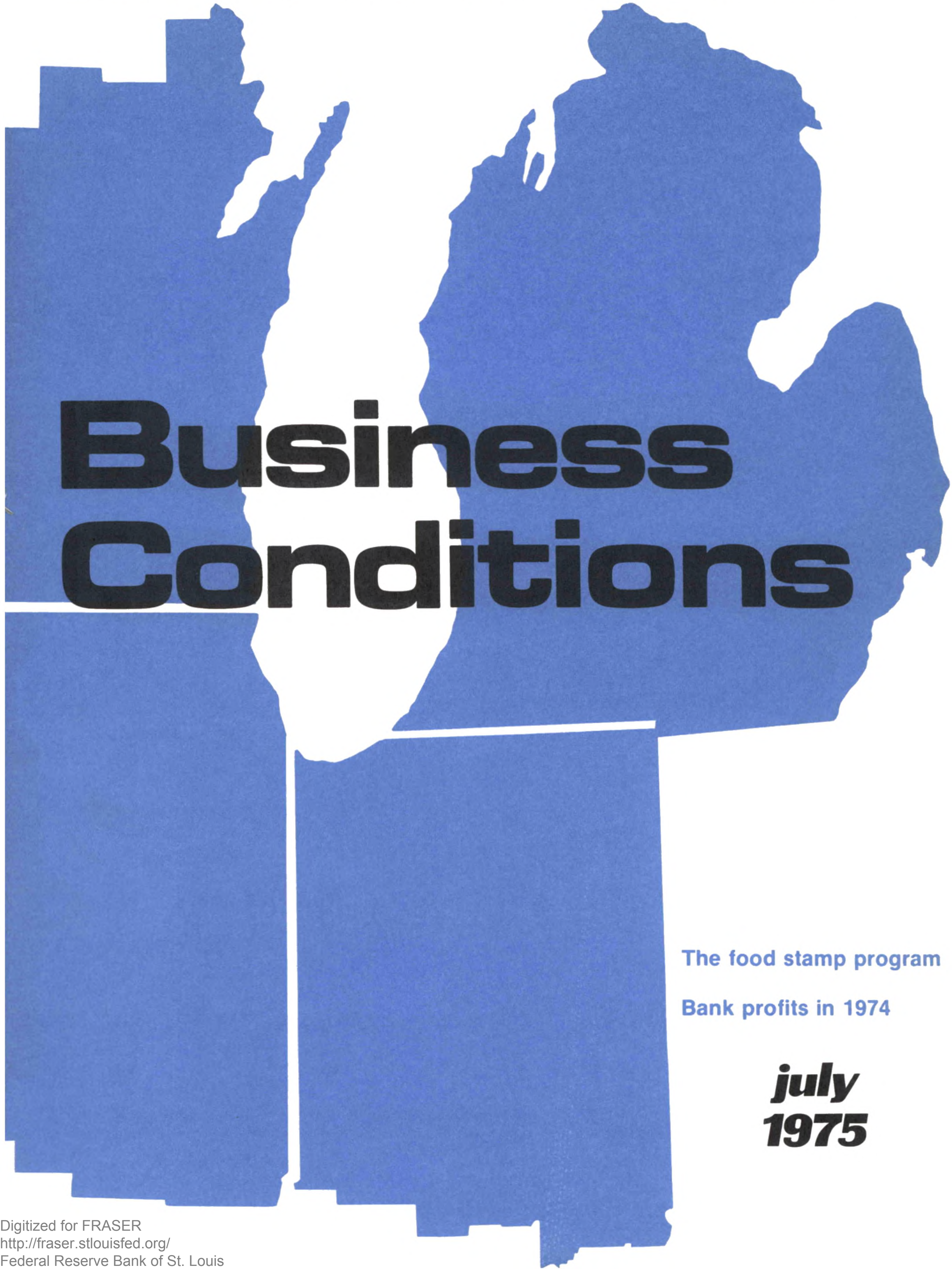
an economic review by the Federal Reserve Bank of Chicago



Business Conditions

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The food stamp program

The food stamp program has been greatly expanded in recent years. The number of areas—political subdivisions—covered by the program has more than doubled since 1969 and now virtually blankets the entire United States and extends to Guam, Puerto Rico, and the Virgin Islands. Participation in the program has risen sixfold since the end of fiscal 1969 and presently encompasses some 20 million individuals. Federal government outlays to support the program have soared 19-fold during the same period, reaching an estimated $4.8 billion in fiscal 1975.

The rapid expansion might indicate to some observers that the United States has turned the corner in feeding its hungry, a plight featured in several documentaries in the 1960s and a major factor supporting the legislative changes that have contributed to the growth in the program. Nevertheless, criticisms of program shortcomings and proposals for revision from several differing viewpoints suggest the food stamp program has fallen short of complete success. Some observers argue the program needs further liberalization to achieve its goals. Others contend the program is in need of major revisions to curtail costs and needless excesses. Still others argue the program, as presently constituted, is not capable of achieving its objectives and that more efficient alternatives should be considered.

These opposing viewpoints have become particularly apparent in recent months and will continue to generate wide-ranging debate in federal policy-making circles in the months ahead. This article, in attempting to provide a common base for evaluating the various proposals, describes the characteristics of the existing food stamp program as well as the policy actions that have contributed to the program's growth over the past few years. Also, concerns and proposals that will weigh heavily in the future direction of the food stamp program are discussed.

Organization of the program

The food stamp program is administered by the U.S. Department of Agriculture. The operation of the program—including certification of applicants, issuance of coupons, and promotional efforts—is conducted through the local county offices of cooperating state agencies.[1] State agencies must operate the program according to regulations established by the U.S. Department of Agriculture. The flexibilities in the regulations, however, often result in slight differences in program operation between counties. Eligibility standards and benefits are uniform throughout the contiguous states. Slightly different benefits are applicable in Alaska, Hawaii, and U.S. territories.

The food stamp program provides eligible households with a monthly allotment of coupons that are redeemable for food. The value of the monthly coupon allotment varies by household size and is based on the USDA's "economy food plan," a quantity of food designed to provide the recommended daily allowance of all major nutrients. The value of the monthly coupon allotment is adjusted upward semiannually to match increases in food prices, provided the higher food prices have boosted the cost of the economy food plan by at least $2 per month.

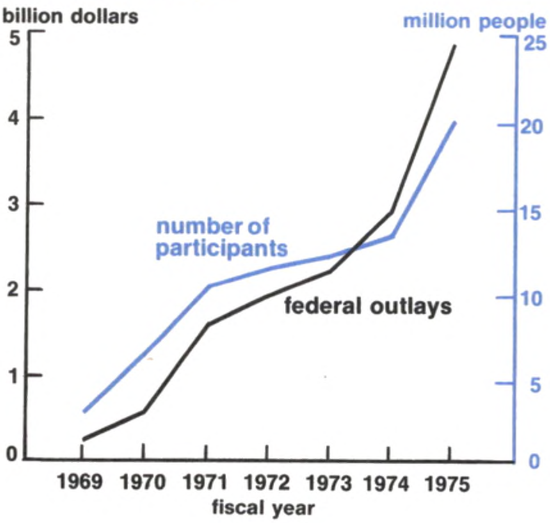
[1]One-half of all operating expenses incurred by the state agencies in conducting the program are reimbursed by the federal government.

Participating households with little or no income receive their entire coupon allotment free, while households qualifying at the upper range of the income eligibility standards pay the equivalent of 75 to 85 percent of the value of coupons received. The difference between the value of the coupons issued to a household and the amount the household pays for the coupons represents the value of "bonus" stamps or, alternatively, the government subsidy extended to participants. In fiscal 1974 bonus stamps accounted for nearly 58 percent of all the coupons issued to participating households.

Food stamp coupons are issued through several sources, but banks, post offices, and local offices of the cooperating state agency are the predominate issuing points. The coupons are issued at least semimonthly, although some counties offer a more frequent issuance schedule. Participating households have the option of purchasing all, three-quarters, one-half, or one-quarter of their coupon allotment.

The coupons are issued in booklet form in denominations of $1, $5, and $10. The participating household can use the coupons only in authorized[2] food stores to purchase food—excluding pet food, tobacco, and alcoholic beverages—and plants and seeds that can be used to grow food in gardens. However, elderly persons unable to prepare their own meals may use the coupons to purchase meals prepared by authorized communal dining facilities or prepared and delivered by authorized nonprofit meal delivery services. Moreover, alcholics and drug addicts participating in regular treatment or rehabilitation programs can use the coupons to purchase food prepared as a part of treatment. In addition, eligible households living in remote areas of Alaska may use coupons to purchase hunting and fishing equipment, excluding firearms, ammunition, and other explosives.

Expanded participation in the food stamp program boosts federal outlays



Food stamp coupons received by stores or food service organizations can be used by the firm to purchase food from wholesalers or can be deposited for cash or credit at a bank. The first bank to receive the coupons is responsible for marking them "paid" or "canceled" and affixing its routing symbol on the coupon. The coupons are then routed to the regional Federal Reserve Bank, which credits the account of the bank that sent the coupons, charges the U.S. Treasury for the face value of the coupons received, and destroys the coupons. In 1974 the value of food stamp coupons processed by the Federal Reserve Bank of Chicago totaled nearly $668 million.

Eligibility standards and procedures

The state agency is required to certify all applicants for the food stamp program. For households in which *all* members are included in a federally aided public assistance program—old-age assistance, aid to families with dependent children,

[2]The U.S. Department of Agriculture is responsible for authorizing firms that trade in food stamps.

aid to the blind and the disabled—certification is based solely on the applicant's signed affidavit and the assistance case file. Public-assistance households typically account for about three-fifths of all those participating in the program. For all other households the state agency bases its certification on the household's completed application form, an interview, and a verification of the household's reported income, assets, and expenses.

The certification process must be completed within 30 days. Households declared eligible for participation are assigned a certification period—the length of time the household can participate in the food stamp program before going through another certification process if it is to continue in the program. The certification period most commonly authorized is three months, but may range from as short as one month to as long as 12 months.

Nonassistance households must meet three standards to be certified as eligible for the food stamp program; the income standard, the resource standard, and the work registration standard.[3] There are no local residency requirements, but participants must be U.S. citizens or aliens lawfully admitted to the United States for permanent residence.

The income standard is based on a *net* income concept that permits liberal deductions from a household's gross income. Earnings and compensation received by all household members from virtually all sources—including wages, government payments, scholarships, pensions, strike benefits, etc.—are combined in determining a household's gross income. However, earnings of a student under 18 years old and many lump sum payments—such as insurance settlements, cash prizes, inheritances, tax refunds, etc.—are not included as household income. In most cases the standard applies to income that will be received by the household during the certification period.

[3]Public assistance households also must meet the work registration standard.

In deriving *net* monthly income, the following items are deducted from gross income:

- 10 percent of wages and salary, up to a maximum of $30 per month.
- Mandatory withholdings from earned income—such as income taxes, social security taxes, union dues.
- All medical expenses if in excess of $10 per month per household.
- Payments for the care of children or other persons when necessary for a household member to work or seek work.
- Expenses resulting from disaster or casualty losses.
- Tuition and mandatory fees assessed by educational institutions.
- Court-ordered support and alimony payments.
- Shelter costs—including utilities, rent or mortgage payments, and taxes—that exceed 30 percent of the household's income less all of the above deductions.

A household qualifies under the income standard if its *net* monthly income is equal to, or less than, the amount obtained by multiplying the monthly coupon allotment for its size of household by three and one-third. For example, the current $162 monthly coupon allotment for a four-person household would permit a family of four with a *net* monthly income of $540 or less to qualify for the program. On an annual basis such an amount would be equivalent to a *net* income of $6,480 and perhaps as much as $8,000 to $10,000, or more, in gross income.

If a household qualifies for the food stamp program, its *net* monthly income also determines its purchase requirement, the amount the household must pay for its monthly coupon allotment. As suggested by the table, a family of four with a *net* monthly income of $350 would only have to pay $95 to receive the $162 monthly coupon

Food stamp allotments and purchase requirements*

Monthly net income	Number of persons in household** 1	2	3	4	5	6	7	8
	Monthly coupon allotment (dollars) 48	90	128	162	192	222	250	278
	Monthly purchase requirement (dollars)							
0 - 19.99	0	0	0	0	0	0	0	0
20 - 29.99	1	1	0	0	0	0	0	0
30 - 39.99	4	4	4	4	5	5	5	5
40 - 49.99	6	7	7	7	8	8	8	8
50 - 59.99	8	10	10	10	11	11	12	12
60 - 69.99	10	12	13	13	14	14	15	16
70 - 79.99	12	15	16	16	17	17	18	19
80 - 89.99	14	18	19	19	20	21	21	22
90 - 99.99	16	21	21	22	23	24	25	26
100 - 109.99	18	23	24	25	26	27	28	29
110 - 119.99	21	26	27	28	29	31	32	33
120 - 129.99	24	29	30	31	33	34	35	36
130 - 139.99	27	32	33	34	36	37	38	39
140 - 149.99	30	35	36	37	39	40	41	42
150 - 169.99	33	38	40	41	42	43	44	45
170 - 189.99	36	44	46	47	48	49	50	51
190 - 209.99	36	50	52	53	54	55	56	57
210 - 229.99	38	56	58	59	60	61	62	63
230 - 249.99		62	64	65	66	67	68	69
250 - 269.99		68	70	71	72	73	74	75
270 - 289.99		70	76	77	78	79	80	81
290 - 309.99		70	82	83	84	85	86	87
310 - 329.99			88	89	90	91	92	93
330 - 359.99			94	95	96	97	98	99
360 - 389.99			100	104	105	106	107	108
390 - 419.99			109	113	114	115	116	117
420 - 449.99			110	122	123	124	125	126
450 - 479.99				131	132	133	134	135
480 - 509.99				138	141	142	143	144
510 - 539.99				138	150	151	152	153
540 - 569.99				138	159	160	161	162
570 - 599.99					164	169	170	171
600 - 629.99					164	178	179	180
630 - 659.99					164	187	188	189
660 - 689.99						190	197	198
690 - 719.99						190	206	207
720 - 749.99						190	214	216
750 - 779.99							214	225
780 - 809.99							214	234
810 - 839.99							214	238
840 - 869.99								238
870 - 899.99								238
900 - 929.99								238

*Effective July 1, 1975 for participants in the 48 contiguous states.

**For each additional household member over 8, add $22 to the 8-person allotment.

allotment. The difference of $67 would represent the value of bonus stamps.

The resource standard restricts food stamp program eligibility to those households that have $1,500 or less in assets ($3,000 for households having two or more persons with at least one aged 60 years or more). However, assets specifically exempt from the resource standard are numerous, including a home and lot, one licensed vehicle—two if needed for purposes of employment—household goods, the cash value of life insurance policies and pension funds, personal effects, income-producing property, tools and machinery deemed essential to the employment of a household member, and resources with cash values not accessible to the household—such as irrevocable trusts.

The work registration standard requires each able-bodied household member between the ages of 18 and 65—except those caring for children, students in school at least half time, and those working at least 30 hours per week—to register for employment with the local state or federal employment office. Registration must take place at the time of applying for the food stamp program and every six months thereafter while participating in the program. Such individuals are required to accept bona fide offers of suitable employment as a condition of continued participation in the food stamp program.

Factors contributing to growth

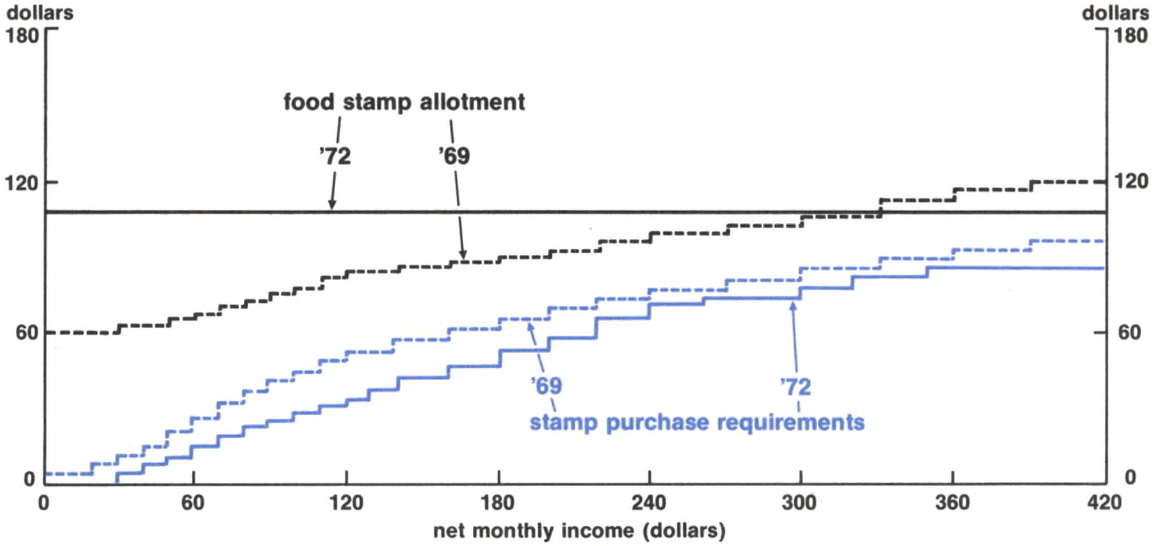
The growth in the food stamp program since its modern day inception[4] in 1961 largely reflects legislative changes that have expanded program coverage, liberalized eligibility standards, and altered the emphasis of the program. The Food Stamp Act of 1964 expanded program coverage from the few counties established by Presidential directives during the preceding three years to all areas requesting coverage. Throughout the Sixties, the emphasis of the program was to "supplement" the ability of low income households to "more nearly" attain a nutritionally adequate diet. Consequently, purchase requirements were established at levels that corresponded to normal food expenditures, while coupon allotments were established at levels that were closer to the cost of a nutritionally adequate diet. Implementation of this concept was achieved by linking both the purchase requirement and the coupon allotment to a household's income, reflecting the tendency of food expenditures to rise with income. Hence, households with higher incomes were eligible for a larger coupon allotment than were households of the same size but with lower incomes. Lower-income households, however, paid proportionately less for the stamps received than did higher-income households.

Legislation in 1971 contributed to the growth of the food stamp program by expanding program coverage—to Guam, Puerto Rico, and the Virgin Islands—and by replacing state-determined eligibility standards with a uniform and more liberal set of national standards. But the most important growth element that emerged in this legislation was the concept that all households should have the opportunity to consume a nutritionally adequate diet.

As suggested by the chart, this change in program emphasis substantially altered coupon allotment schedules. In contrast to the former stepwise allotment schedules, the revision instituted a uniform monthly coupon allotment for all households of a given size, regardless of income. For most

[4]The original food stamp program, inaugurated in 1939, permitted families on relief to purchase—in the amount equivalent to normal food expenditures—orange colored stamps that were redeemable for the purchase of any foods. In addition, participants were provided free blue stamps—equal in value to one-half of the orange stamps—that could be used to purchase surplus-declared foods. Participation in this original program peaked at 4 million people in the early-Forties, then declined until the program ended in 1943 as the unfolding of World War II reduced unemployment and the availability of surplus foods.

Comparison of 1969 and 1972 food stamp issuance schedules for four-person households



households the revised allotment substantially exceeded the allotment provided under the old standard, particularly among lower-income households. The 1971 legislation also severed the tie between purchase requirements and normal food expenditures.[5] The combined effect of the resulting lower purchase requirement and the rise in coupon allotments led to a 30 to 80 percent boost in the value of bonus stamps issued to most participants.

In 1973 growth in the program was stimulated further by a congressional mandate that required all areas of the United States to adopt a food stamp program by June 30, 1974.[6] Prior to this change state agencies had to request coverage. The 1973 legislation also replaced the annual cost-of-food adjustment in coupon allotments with the semiannual adjustment. The more frequent adjustments contribute to program growth in two ways. First, the adjustments raise the value of bonus stamps since purchase requirements remain unchanged as a function of income. Second, cost-of-food adjustments permit higher-income households to qualify for the program because the upper limit of the income eligibility standard is related to the monthly coupon allotment.

The number of individuals participating in the food stamp program soared from 14.4 million in September 1974 to 18 million at the start of 1975. This increase, which is as rapid as any experienced in the history of the program, reflects the deteriorating conditions in the labor market and, to a lesser extent, the conversion from the food distribution program to the food stamp program in Puerto Rico.

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[5]The severance of purchase requirements from normal food expenditures effectively added an income supplement to the food stamp program. The supplement, which is equal to the difference between the amount a household would normally spend for food while not participating in the program and the amount paid for stamps as a participant, can be used to purchase food or nonfood items.

[6]While this resulted in a substantial increase in the number of participants in the program, the bulk of the increase represented the conversion of households from the "food distribution program"—a plan that provides government-acquired foods to low income families—to the food stamp program. The Food Stamp Act prohibits, with only minor exceptions, the simultaneous operation of both programs in a county.

Emerging issues

A number of observers have criticized the food stamp program and offered suggestions for refinement. Their criticisms and proposals, however, cover a broad range of differing viewpoints and differing priorities. Some observers are primarily interested in curbing program abuses and eliminating unwarranted costs. Others argue that the regulations and operations of the food stamp program are too restrictive and that further liberalization is needed. Still others contend that the program is a highly inefficient means of achieving its goals and that other alternatives should be considered. These varying viewpoints are certain to generate a wide-ranging policy debate in the months ahead.

There have been repeated efforts, with only limited success, to close apparent loopholes in the eligibility standards. Recently, such efforts succeeded in tightening the eligibility prospects for individuals who are employed under an annual contract but do not receive regular compensation throughout the entire year.[7] But many observers contend there are other eligibility loopholes that should be closed. Examples most frequently cited include those that permit the eligibility of college students—particularly those who have parents with incomes and resources that exceed eligibility levels—and households that qualify solely on the grounds that a member is not working because of a strike.

Proposals to cut the surging costs of the food stamp program have been most evident in recent Administration actions. One proposal would limit "cost-of-food" increases to 5 percent through July 1, 1976. Another proposal attempted to raise the purchase requirement, for all households—except those with little or no income—to 30 percent of net income, the legal maximum provided under existing legislation.[8] Although Congress has not accommodated either of these proposals, the issues are likely to persist in the future.

The Senate Committee report

Arguments of observers who are concerned with program shortcomings and needed program improvements are summarized in a recent report by the Senate Select Committee on Nutrition and Human Needs. The report cites evidence that the participation ratio in the program—the number of people actually participating in the program relatve to the total number eligible to participate—has declined from over 50 percent in 1972 to around 40 percent in 1974.[9] The report concluded there were a number of factors contributing to the apparent decline in the participation ratio including insufficient promotional efforts, certification bottlenecks, and problems in issuing stamps.

The rules and regulations of the food stamp program require each state agency to take ". . . effective action . . . to inform low income households . . . of the availability and benefits of the program and encourage the participation of eligible households." Aside from the fact that one might be hard pressed to recall any food stamp promotional campaigns through

[7]This tightening—designed primarily to prevent teachers and professional athletes from being eligible during summer vacations or during off seasons—was accomplished by requiring that the monthly incomes of such individuals be averaged over an annual period rather than over the months in which no salary was received.

[8]Under current regulations the purchase requirement, as a percent of net household income, varies from 5 percent upward to the legal maximum of 30 percent. A recent study concluded that for the average household participating in the food stamp program, the purchase requirement was equivalent to 23 percent of its net monthly income.

[9]Three separate studies conducted in 1974 suggested that the number of people eligible to participate in the food stamp program ranged from 36 to 38 million people. Although most observers concur that the number of people eligible to participate substantially exceeds the number of actual participants, the paucity of data for estimating the total number of eligible people renders such estimates suspect.

established media channels, the report cites evidence that suggests a number of states expended no money for promotional efforts in fiscal 1974. Consequently, it is conceivable that many people may not be aware of the food stamp program, or more likely, do not understand the eligibility requirements sufficiently to know if they qualify for participation. And based on the results from the few concentrated promotional campaigns, it would appear that sizable increases in participation would result from expanded promotional efforts. To strengthen promotional efforts, the committee recommends that the U.S. Department of Agriculture develop a model promotional campaign and monitor all state agencies for compliance.

The committee report also attributed the low participation ratio to "certification bottlenecks." The report indicated that lengthy application forms, inflexibilities in acquiring trained certification workers, and inadequate facilities to handle peak work loads were preventing completion of the certification process within the 30-day maximum established by regulations. It also noted that in some areas extremely short certification periods were commonly issued to participants. In such cases the process of recertification is doubly taxing on the strained state agency facilities during periods when participation rises rapidly. To counter these problems, the report suggests that the certification process be simplified by standardized application forms and replacement of the verification requirement by a monitoring program similar to that used by the Internal Revenue Service in checking for tax fraud. Moreover, the report recommends the adoption of an optional standard deduction that could be used in lieu of itemizing actual deductions.

The select committee report also enumerated problems in issuing stamps that have contributed to the low participation ratios. The report suggested that semimonthly coupon issuance schedules result in undue hardship on participants, particularly since most people purchase food weekly. Other problems include a shortage of issuing facilities in some areas, a limited number of issuance days, such as three days per week, and restrictive hours of issuance, such as fours hours per day. To ease the problems of coupon issuance, the committee proposed that the postal service be required by law to offer stamps for sale in every post office during all hours of business.

In addition to the above proposals, the select committee also recommended the following actions which, if implemented, would have an obvious impact on program participation and costs:

- Boosting the federal government's share of state operating costs from the present 50 percent to 65 percent.
- Changing to quarterly adjustments in coupon allotments to maintain closer parallels with food costs.
- Reducing the maximum purchase requirement from the current 30 percent of net income to 25 percent.
- Raising the resource eligibility standard from the current $1,500 to $2,000 for a two-member household, up to a maximum of $3,000 for a household of six. Old age limits would be raised to $4,500.

The AEI report

A standing criticism of the food stamp program is that it is inefficient in meeting its expressed objectives and that other alternatives should be considered. These conclusions, expressed many times in the past, were most recently summarized in a study published by the American Enterprise Institute (AEI).

Since its inception in 1964, the objectives of the food stamp program have been:

- To strengthen the agricultural economy by providing a more beneficial distribution of agricultural surpluses.

- To alleviate hunger and malnutrition by making it possible for low-income households to purchase a nutritionally adequate diet through normal channels.

The AEI study concludes that the benefits of the food stamp program to the agricultural economy are, at best, minimal, particularly in regard to surplus commodities. The impact of the program on the distribution of surplus commodities is entirely contingent upon the types of foods participants purchase with coupons that would not be purchased if no program was available. Although some studies indicate that a dollar's worth of bonus stamps might increase food expenditures by 50 to 65 cents, other studies indicate most of the increased expenditures are used to purchase convenience foods and/or preference foods rather than a larger quan-

Profile of participants

A study of 2,191 households that were eligible for the food stamp program in November 1973 found that one- and two-member households accounted for nearly one-half of those surveyed. Three- and four-member households accounted for one-fourth, and households with seven or more members accounted for just over one-tenth.

Individuals 18 to 34 years old headed well over one-fourth of the eligible households as did those 66 years of age or over. Household heads aged 45 to 54 accounted for only one-eighth of those surveyed. A predominance of female household heads was evident in all age categories, especially among those of 18 to 34 years of age. Overall, women headed nearly two-thirds of the households surveyed.

Roughly 18 percent of the households resided in rural areas and about 58 percent were located in the city portions of Standard Metropolitan Statistical Areas. The remaining 24 percent of the households were located in urban areas (nonmetropolitian areas containing 25,000 or more inhabitants). By race, blacks accounted for 38 percent of the households, and whites represented 55 percent. Spanish-Americans accounted for 8 percent of the households in the study.

About seven out of ten household heads were not in the civilian labor force. Of these, five were unemployed and not seeking work, while two were retired. Thirteen percent of household heads were employed full time (30 hours or more per week), 10 percent were employed part time, and 8 percent were unemployed but seeking work. The employment status of public assistance households and nonpublic assistance households, however, varied widely. Over three-fourths of the households not on public assistance were in the labor force—either working or seeking work—as opposed to only 15 percent of the public assistance households.

Net after tax incomes of participating households averaged $364 per month in November of 1973. One-fifth of this amount represented cash income from private sources, while 45 percent was cash income from public sources—such as social security payments, unemployment compensation, and other types of governmental transfers payments. The remainder represented "in-kind" income, i.e., the cash equivalent of benefits received from such programs as medicaid, public housing, food stamp, etc.

tity of foods. Consequently, processors and producers of preference-type commodities—such as fresh fruit or meat—tend to reap the bulk of the increased food expenditures rather than producers of surplus commodities.[10]

The AEI study expands the same argument as evidence that the food stamp program falls short of meeting its objective to eliminate hunger and malnutrition. The tendency of participants to use coupons to purchase convenience and/or preference foods does not guarantee the consumption of a more adequate diet. Indeed, the additional processing associated with the preparation of convenience foods can lower the nutritional content of food.

The AEI study demonstrates the difficulties of improving nutritional levels of low-income families above what the families themselves, rightly or wrongly, perceive to be adequate. While many low-income households lack adequate diets, they apparently have a preference for expanded purchases of nonfood items as opposed to increasing their food consumption levels. Many participants value the stamps at well under the actual dollar value of the stamps issued. The AEI study estimates that in the eyes of the average household participating in the program, a dollar of bonus stamps is valued at 82 cents. In other words, the average household would just as soon have an 82 cent cash transfer as a dollar's worth of bonus stamps.[11]

The AEI study recommends the divorce of the dual objectives embodied in the Food Stamp Act. Proposed considerations for improving nutrition among low-income households include expanded consumer education, direct transfer payments to increase consumer incomes, and the nutritional fortification of food products as a way to lower nutrition costs.

Summary

The above discussion represents some of the more divergent views regarding needed revisions to the food stamp program. In all likelihood, the changes that emerge from the ongoing policy-making process will reflect a compromise of these views. It is true that loopholes exist in the food stamp program and that some participants obtain benefits out of proportion to actual need. But it is also true that in some areas a variety of problems in certification, stamp issuance, and promotional efforts add needless encumberances to legitimate participants. But in the same vein, due consideration must be given to the costs and benefits of the food stamp program and possibilities for more efficient alternatives.

Gary L. Benjamin

[10]One could also add that the objective to strengthen the agricultural economy is somewhat redundant since the Food Stamp Act virtually prohibits the simultaneous operation of the food stamp program and the food distribution program, a program designed to expand the distribution of surplus commodities.

[11]The AEI study suggests that this preference is related to two important side issues. First, reports of a large black market in which stamps are traded at less than 50 cents per coupon dollar tend to support the view that participants would prefer to increase their nonfood expenditures before boosting food consumption levels. The second related issue is that participation in the food stamp program is more responsive to the households' valuation of bonus stamps than the actual dollar value of bonus stamps. Hence, large increases in the value of bonus stamps, in the absence of a black market, would not neccessarily lead to significant increases in program participation.

Bank profits in 1974

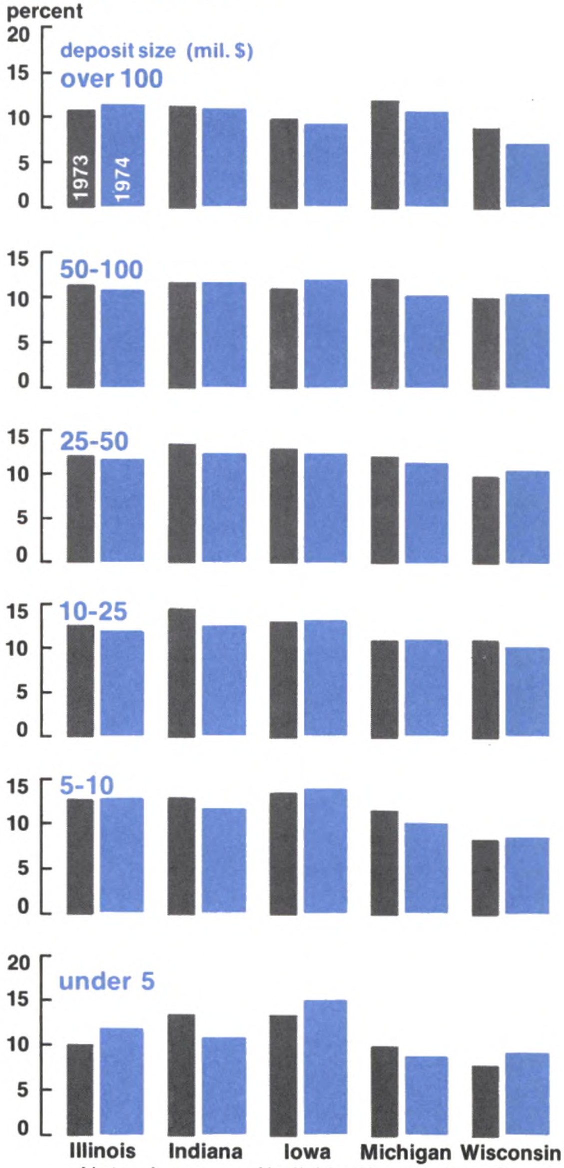
The effects of increased expenses and higher losses on securities and loans in 1974 than in 1973 were largely offset by higher incomes at Seventh District member banks last year. Profitability of member banks, as measured by the ratio of net income to equity capital including reserves, averaged 11.6 percent, just about matching the recent high of 11.7 percent in 1973. For banks in a number of deposit-size groups in the various states, average profitability ratios were actually higher than in 1973. While the average bank in most deposit-size groups recorded a profitability ratio above 10 percent, it was the banks with less than $50 million in deposits that showed the highest returns.

High interest rates affected both earnings and expenses. The net effect of high interest rates on profits of individual banks depended largely upon the composition and the maturity of assets and liabilities. Loans—especially federal funds—yielded the highest returns, while reliance on short-term sources of funds was relatively costly.

The return on loans (the ratio of interest and fees to the average of total loans outstanding on three call report dates) was 9.52 percent for the average district bank, up 77 basis points from 1973. The return on loans excluding sales of federal funds averaged 8.46 percent, up 66 basis points. Increases in average returns on securities were somewhat smaller. Although net loan losses over recoveries rose last year, they averaged only ¼ of 1 percent of outstandings.

Interest paid on deposits averaged 5.78 percent of time and savings deposits, an increase of 66 basis points—the largest ab-

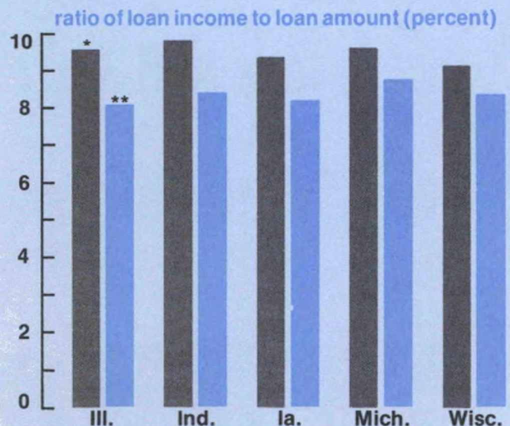
Profitability ratios of member banks, 1973-1974



Note: Averages of individual bank ratios of net income to equity capital plus reserves.

Average operating ratios for district banks are heavily weighted by banks in the $10-25 million deposit-size group, which includes almost one-third of the membership. At these banks:

Gross revenue from sales of fed funds and securities purchased under resale agreements increased the return on loans significantly. . .



*Includes federal funds and security RPs.
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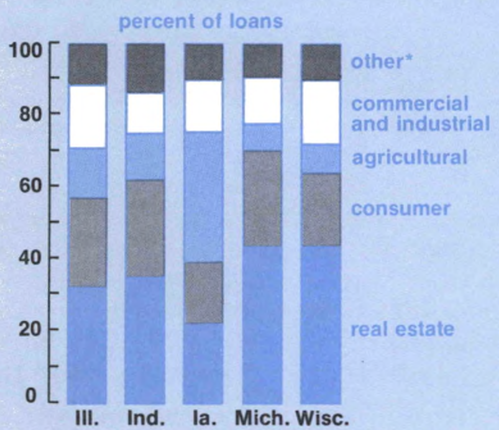
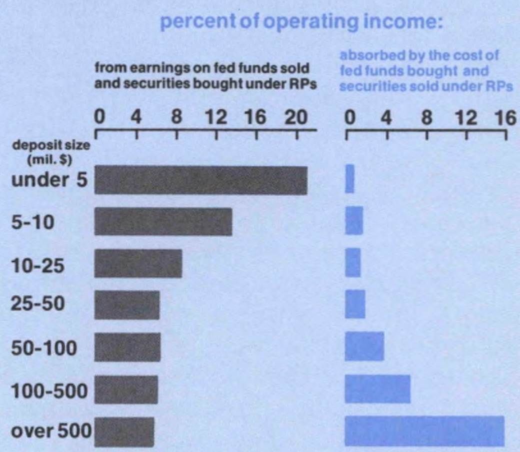
. . . while the composition of total loans was in line with each state's usual pattern.



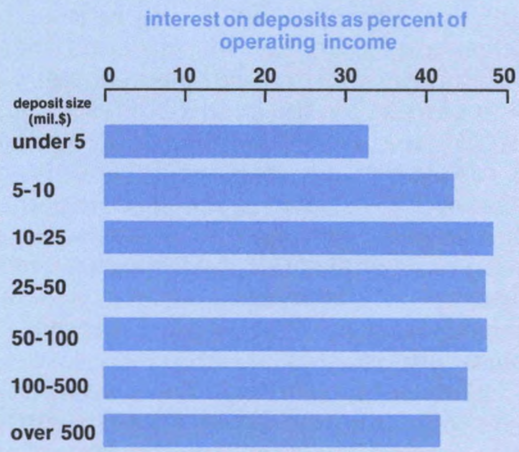
*Includes federal funds sold.

Record high rates paid on federal funds (overnight loans to other banks) boosted earnings of the smaller banks but were an important cost to the largest banks that are the major purchasers.



Note: Ratios are based on gross revenues and gross expenses and exclude banks not reporting amounts for these items.

Interest on deposits was the largest expense item for the average bank in each size group—even for the smallest banks, some of which were in business little more than a year.



Income and expenses involved in earning $1 of profit in 1974

	Deposit-size groups of district member banks *(million dollars)*							
	Under 5	5-10	10-25	25-50	50-100	100-500	Over 500	All members
Income from:								
Loans[1]	$3.90	4.52	5.10	5.51	6.05	6.13	9.06	5.26
U.S. Treasury sec.	1.28	.98	.90	.78	.66	.52	.44	.85
U.S. agency sec.	.39	.44	.51	.47	.55	.39	.23	.47
State & local sec.	.25	.44	.65	.71	.76	.77	.70	.62
Other sec.	.05	.07	.09	.10	.16	.13	.14	.09
Other sources[2]	.31	.30	.38	.51	.65	.72	1.14	.46
Total	$6.18	6.75	7.63	8.08	8.83	8.66	11.71	7.75
Minus expenses:								
Interest on deposits	$2.03	2.92	3.69	3.83	4.20	3.91	4.88	3.57
Interest on borrowings	.01	.04	.04	.10	.27	.54	1.98	.15
Salaries & benefits	1.40	1.24	1.31	1.43	1.57	1.48	1.78	1.39
Bank premises	.20	.16	.19	.23	.27	.27	.33	.21
Loan loss provision	.09	.13	.14	.16	.18	.18	.27	.15
Taxes[3]	.49	.42	.34	.28	.23	.23	.28	.32
Other subtractions[4]	.96	.84	.92	1.05	1.11	1.05	1.19	.96
Total	$5.18	5.75	6.63	7.08	7.83	7.66	10.71	6.75
Income minus expenses	$1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

[1]Includes income from sales of federal funds and securities purchased under agreements to resell.
[2]Includes service charges, trust department income, and net remittable income from foreign branches.
[3]Estimate of taxes applicable to 1974 income.
[4]Largely other operating expenses but includes net securities losses and all other additions and subtractions, net.

solute increase on record and the largest relative increase since 1963. A substantial portion of last year's increased interest expense stemmed from upward adjustments in rates paid following the raising of legal ceilings in mid-1973. The full effect of these adjustments on bank costs was not felt until 1974. At the largest district banks, moreover, a very important interest expense factor was the record high rates paid on large time certificates of deposit that are not subject to any rate ceiling. These rates exceeded 12 percent for several weeks in the summer of 1974. At banks with deposits over $500 million the ratio of total interest paid to total time and savings deposits averaged 7.36 percent, an increase of 144 basis points over the previous year. Since there are relatively few banks in the group, this increase had little effect on the average cost of funds district-wide.

A number of the factors determining income appear to be related to bank size. The importance of loans in asset portfolios, the average return on loans (excluding the effects of federal funds sold), and consequently, the proportion of operating income provided by loan income all were higher at larger banks. Higher average interest rates paid on time deposits and greater reliance on nondeposit sources of funds combined to absorb an increasing proportion of income as bank size increased. These differences are reflected in the amounts of revenue and expense involved in earning an average dollar of profit. As the table shows, both income and expense per dollar of profit were about twice as high at the average bank in the largest size group as at the average bank in the smallest size group.

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