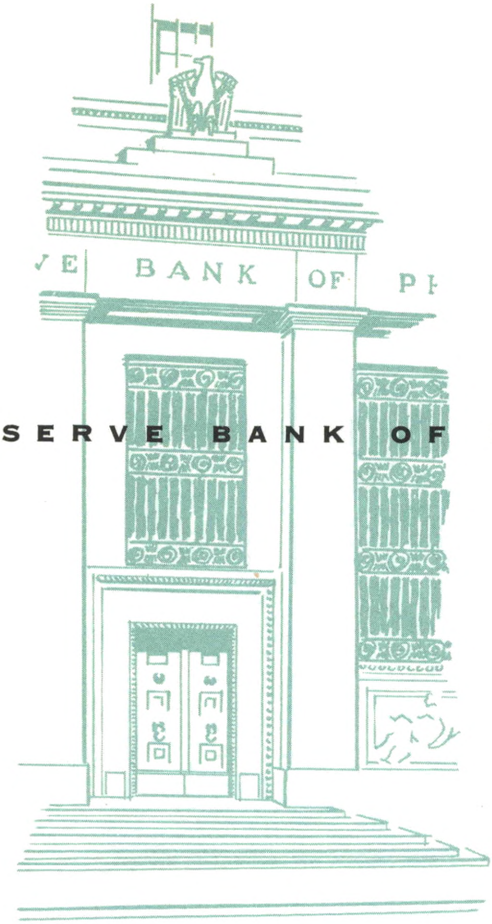

FEDERAL RESERVE BANK OF PHILADELPHIA

MARCH

1958

a flexible monetary policy

pennsylvania's billion dollar babies

business review

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A FLEXIBLE MONETARY POLICY

By Karl R. Bopp, President*

I would like at the very outset to express my sincere appreciation for the good wishes that so many of you have expressed. I can hope for no more than that you will feel as kindly toward me when my turn comes to retire as you feel now when I am about to assume the challenging responsibilities that lie ahead.

I seize this first opportunity since the announcement of the retirement of Alfred H. Williams as President of the Federal Reserve Bank of Philadelphia and W. Jonathan Davis as First Vice President to pay tribute to these two great public servants. All of you know Al and John very well; nevertheless, I venture the judgment that none of you knows them as well as Bob Hilkert and I who succeed them on March 1. Al Williams is incomparable, unique. There is no second Al Williams and there never will be—and there never will be a second John Davis either.

Fortunately, Bob and I have lived and worked intimately with them for more than fifteen years. They have done their best to develop in us the qualities that our jobs demand: An open mind that bases its decisions on the relevant evidence, awareness of personal fallibility even when motives are pure, courage to do what is in the public interest even though it may occasionally be unpleasant. They never lost sight of the dignity and importance of every individual. We are ambitious to maintain in the Bank an environment in which each of the thousand individuals on the staff will derive zest from making his or her maximum contribution to the important work of the Bank.

The title of these remarks, a flexible monetary policy, indicates that we intend to continue the efforts inaugurated by President Williams to explain the role of the Federal Reserve System in our dynamic economy. It is in the national interest

*An address before Group 2, Pennsylvania Bankers Association, Philadelphia, Pa., Saturday, February 8, 1958 that the role of the System be understood without exaggeration or minimization. This is a substantial undertaking that cannot be completed at one session. I shall, therefore, discuss today a few aspects of the problems that are of current and continuing importance.

Indication of future actions

One feature that needs to be understood is that a central banker cannot indicate possible future actions. This necessity arises from the very nature of the problem and not from any desire on the part of the central banker to be mysterious or reticent. Since some of you may have come with the expectation of hearing a discussion of future policy, I shall begin by demonstrating why I cannot satisfy that expectation either today or at any time in the future. One reason is that such a statement injects a new force into the situation. An act that may have been appropriate before the statement was made may not be appropriate after it is made. The options then confronting the central banker who has talked of the future is either to act as he said he would—even though it is no longer appropriate—or not to act in that way and thus falsify his own predictions. I am sure you will agree that a central banker should not place himself in this dilemma.

Perhaps I can make this point more vivid by reference to other fields. You all remember Pat's reply to Mike who wondered why Pat wanted to know where he was going to die: "Because then I wouldn't go there." No one should be put in the position of telling Pat where he is going to die.

Here is another illustration. Suppose that I had developed a formula by which I could predict with precision the daily movement of the price of a particular stock for a week in advance. Suppose, also, that I had done this for the past five years and that I had delivered each prediction under seal to a notary. Suppose next that I had brought the notary to this meeting to open the predictions and compare them with the actual behavior of the price of the stock and that the predictions had been perfect. And now suppose, finally, that I make the dramatic announcement: "On the basis of my formula the price of the stock will rise $x a share to $y on Thursday, February 13, 1958." Do you think it would? I have a hunch that Monday, not Thursday, would be the big day on the Exchange in that stock. The important point, however, for our purposes is that what might have been appropriate before the announcement might not be appropriate after it.

This principle is important in central banking. A central bank exerts its influence primarily through the money market. Its operations affect the supply and availability of money relative to the demand and thereby the cost. Injections of funds tend to ease the market and withdrawals tend to tighten it. *But* the tone of the market is also influenced by the expectations of those who deal in it. If they expect the market to ease, lenders will try to lend funds before the easing results in a decline in rates and borrowers will try to postpone their borrowing until rates have declined. In other words, the expectations of ease will increase the current supply of funds and will reduce the current demand and thus will themselves produce the conditions that are anticipated. An easing in the market brought about in this way may not continue, however, if there is no actual increase in funds. But the timing of such release as well as the rate and terms needed to produce and maintain a given tone in the market will be influenced by the change in expectations.

I have neither the time nor, frankly, the competence to analyze all of the ramifications of this problem. I hope I have said enough to indicate that a central banker cannot say what he will do next.

Flexibility vs. commitments

A flexible monetary policy means that the responsible officials act in accordance with their view of the current situation, not in accord with any prior commitment.

I appreciate, of course, that there have been dramatic occasions in the past—such as the outbreak of war—when it has been in the public interest for a central bank to commit itself. We all hope that no such occasion arises again, but if it does, you can be sure that the Federal Reserve System will deliver on any commitment it makes.

Another important facet of this problem is that a central banker is a public servant. He cannot do his job and profit personally or permit others to profit, even inadvertently, from any prior knowledge that he may possess.

Public information

Within the limits that I have indicated, the System keeps the public informed of its activities. I happen to have studied central banking in a number of European countries before the Second World War. One of the most frustrating aspects of those studies was the difficulty of securing information. In contrast, the Federal Reserve System informs the public of its operations. There is first of all the Annual Report of the Board of Governors which contains a record of all policy actions of the Federal Open Market Committee as well as of the Board itself. Included are all directives issued by the Committee to the Federal Reserve Bank of New York with respect to operations in the open market. For the reasons I have already indicated, these directives are not made public prior to issuance of the Annual Report. The Annual Report also contains a complete list of the holdings of Government securities by the Federal Reserve Banks at the end of the year. Each week the System publishes the statement of condition of the Federal Reserve Banks, including a breakdown of Government security holdings by type and maturity. The information is available to anyone who wishes to have it.

I need not tell you as bankers that the meaning of the statement and of changes in the magnitudes is not obvious to a casual observer. I need not tell you either that it is worth a good deal of effort to become skilled in the analysis of the statement.

With a desire to be helpful in developing such skill, I would like to point out a few pitfalls in analysis that I have observed in recent years.

The first arises from the unexpressed assumptions that the Reserve System is the only institution that puts money into the market or takes money out and that it does so exclusively through open market operations. These mistaken assumptions lead to the false conclusion that one can determine the direction of Federal Reserve policy simply by following the System's portfolio of Government securities. Persons who make those assumptions become confused when the System buys securities in a period of tight money or sells securities in a period of ease.

The confusion disappears as soon as one changes his assumptions to reflect the realities of the money market. Actually there are many operations besides purchases and sales of Government securities by the Federal Reserve System that put money into the market or take it out.

For example, the American public gradually withdraws currency from the banks toward the end of the year and returns it to the banks in January. The amount involved is about a billion dollars. It should not confuse an observer to notice that the Federal Reserve System has purchased Government securities toward the end of the year as currency was withdrawn even though it is pursuing a policy of restraint. Nor should it cause confusion to see the System sell securities in January even though it is pursuing a policy of ease. A strategic feature to keep in mind when analyzing the money market is that all other operations that put funds into the market or withdraw funds from the market have an impact on the reserves of the member banks. It is the reserve position of the member banks that deserves the focus of attention. One measure of the tone of the money market is the net reserve position of the member banks. If banks are able to maintain their required reserves only by borrowing from the Federal Reserve Banks, they will be under pressure to limit their loans and investments. If, on the other hand, they have excess reserves beyond their requirements, they will be under inducement to expand their loans and investments.

At any moment of time, of course, some banks are borrowing to maintain their required reserves, some have excess reserves, and some, interestingly enough, are borrowing even though they have excess reserves. The net position of the banking system is measured by subtracting the amount of borrowing from the amount of excess reserves. The tone of the money market is greatly influenced by the net position: a net borrowing position being reflected in a tighter market and a net free reserve position being reflected in an easier market. The tone of the market is also influenced, of course, by the distribution of the borrowings and the excess reserves among the member banks as well as expectations, as I mentioned previously.

The System publishes information on borrowing and on excess reserves in its weekly release. When you consider the magnitude and complexity of the forces in the money market and the impossibility of predicting their behavior accurately even a day or two in advance, you will appreciate, of course, that not every change in the net reserve position of the banking system reflects a change in Federal Reserve policy. But the general level over time is important.

Another measure of conditions in the money market is the cost of money. One of the tools that the System uses is the rate at which the Reserve Banks discount the notes of their members. Each Reserve Bank establishes such a rate subject to review and determination by the Board of Governors.

Reasons for policy actions

A change in the rate, of course, is news. It is understandable that question will be raised as to why the change was made. Unfortunately, it is not possible to give a brief and accurate description of why the specific decision was made.

Occasional misunderstanding on this score arises because we are tempted to apply different standards in judging others than we apply in judging ourselves. W. Somerset Maugham had something to say about this problem in his reminiscences published as "The Summing Up."

We all have shared the experience of trying to determine why a relative, a friend, a customer or a public official behaved as he did. We become impatient with elaborate explanations and are tempted to believe they are designed to cover a few simple—and perhaps base or embarrassing motives. We are tempted to say, "Get to the point! Why—in two or three sentences—did you do it?"

How different it all seems when we are on the receiving end of such questions! Again, we become impatient; not now with elaborate explanations, but rather with the demand for brevity!

How, then, can one explain why a given decision was reached? The answer must be based on all the surrounding circumstances. Rarely will one or two factors be decisive.

Each month the Board of Governors publishes the *Federal Reserve Bulletin* with more than 60 pages of statistical tables and a *Chart Book on Financial and Business Statistics* with about 60 pages of charts of economic magnitudes that are relevant in reaching a decision on monetary policy. Each Federal Reserve Bank, in turn, has data on developments in its own district. In addition, many non-systematic and qualitative factors are relevant.

I am not so naive as to say that the full implication of all relevant forces is taken into account—or even known—in reaching a decision. We are not yet living in the millennium! But I do think that mere mention of these areas of information should make it apparent that decisions on policy are based on judgments as to the net effect of a wide variety of forces that are operating in our dynamic economy.

Formation of such a judgment is hard work. I can appreciate that many would find it dull and unexciting. For myself, I find it so enormously important and stimulating that no effort is too great if it results in even a single improvement in judgment. Since, as John Donne said: "No man is an island unto himself," I am happy to have the active support of my thousand colleagues at all levels at the Federal Reserve Bank of Philadelphia.

PENNSYLVANIA'S BILLION DOLLAR BABIES

The Story of Our Mushrooming Municipal Authorities

Authorities are curious organizations. They are not quite governments and they are not private businesses. They lie in a hazy, quasi area in between. Like centaurs, authorities are neither one thing nor the other. They are a breed of their own.

The life story of authorities is paradoxical. Although born of government, they are not directly controlled by the electorate. Nourished by business methods, they are non-profit, have no stockholders, and are immune from anti-trust laws. They build public projects using private money. They often operate public utilities, yet they are normally not regulated by public utility commissions. Authorities are different.

And they are controversial. People feel strongly about authorities—perhaps because of these diverse characteristics. Some believe authorities mix the best features of government and business. Others say they combine the drawbacks of both.

Whether you're for or against, one thing is certain—authorities are a force to be reckoned with in civic life today. They have grown tremendously in the past two decades. They now flourish in many states and are found on all three levels of government—Federal, state, and local. Nowhere, however, has the development of authorities been more spectacular than in Pennsylvania's municipalities. Most of these authorities have been established in the past ten years, but their roots lie deep in history. Let's "flash back."

DEBT: "AN ENORMOUS EVIL"

Governmental borrowing rolled in waves during the nineteenth century. Exuberance and speculation drove debt to dizzy heights. Then, before long, optimism would dissolve into panic and borrowings would tumble. Debt structures contracted in a spate of repudiations, restrictions, and resolve that "it must never happen again." But it did, in time.

Pennsylvania governments twice rode this seesaw course. State borrowing boomed in the early 1830's. That was a prosperous time, trade was expanding, and many new roads and canals were needed—or so it seemed. Private companies did most of the actual building but the state treasury backed them up. The state, with its superior credit standing, either borrowed money and re-lent it to the builders, or guaranteed the builders' own obligations.

Though there was indeed a solid demand, the building "binge" got out of hand. Some projects were overly ambitious, others poorly engineered, a few downright fraudulent. Then the panic of 1837 struck and the construction fever turned to chill. Only prime projects were completed. Half-cleared roads, half-dug canals soon returned to dust and mud. Only the debts remained.

With a string of failures on its hands, the state had difficulty meeting its obligations. By 1843, it was almost $3 million in arrears on interest payments.

Public reaction was strong. Defaults were considered a disgrace, and indignation welled up all over the Commonwealth. There were calls to "stop the legislature in its mad career," but the damage had been done. Wise men of the day believed borrowing to be an almost irresistible folly and sought to place future legislatures out of the way of temptation.

In 1857, a law was passed to limit state debt to a mere $750,000—only 2 per cent of what it had been 15 years earlier. The ceiling was effective. It held state borrowing to a minimum and kept the state pretty much out of the construction business. But the country was growing and somebody had to provide new facilities, so much of the building burden passed by default to the municipalities.

After the Civil War, municipalities—with this pressure behind them—went on a borrowing-spending spree of their own. It was the same old story. Basic demand began it and optimism plus speculation puffed it out of hand. A newspaper of the day, describing the situation in Pittsburgh said, "Contractors, middlemen, real-estate speculators, impecunious councilmen, rogues and fools combined to push ahead with all sorts of improvements."

By coincidence, the panic of 1873 occurred about the same time Pennsylvania was holding a convention to draft a new constitution. The towering, by now tottering, municipal debt caused considerable concern. The majority feeling was summed up, "There is no reason why a town should be permitted to commit [financial] suicide even if it has a disposition to do so."

The Constitution of 1873 included a provision restricting municipal borrowing to 7 per cent of the assessed value of taxable property—"to check the enormous evil of municipal debt," the Governor said. The new constitution also permanently limited state debt to a million dollars, and governmental finance in Pennsylvania functioned more smoothly for many years thereafter.

ENTER AUTHORITIES

After the turn of the century, however, debt limits

PENNSYLVANIA'S MUNICIPAL AUTHORITY ACT

A Brief Sketch

CREATORS	Municipal authorities may be incorporated by cities, towns, townships, boroughs, counties and school districts. Two or more units may combine to create a joint authority.
POWERS	Authorities may buy, build and operate projects, borrow money, issue revenue bonds, enter contracts, condemn property, and accept grants from the federal government.
PURPOSES	Very numerous. A partial list: Construct and own schools, build and operate bridges, tunnels, parking lots, airports, water and sewer works, swimming pools, playgrounds, hospitals, transit systems, etc. Electric utilities NOT permitted.
FINANCE	Debt maturities limited to 40 years. Bonds based on revenue, not "full faith and credit" of any municipal government.
MANAGEMENT	By a board of five or more members appointed by the creating government.
LIFE	50 years with extension possible.

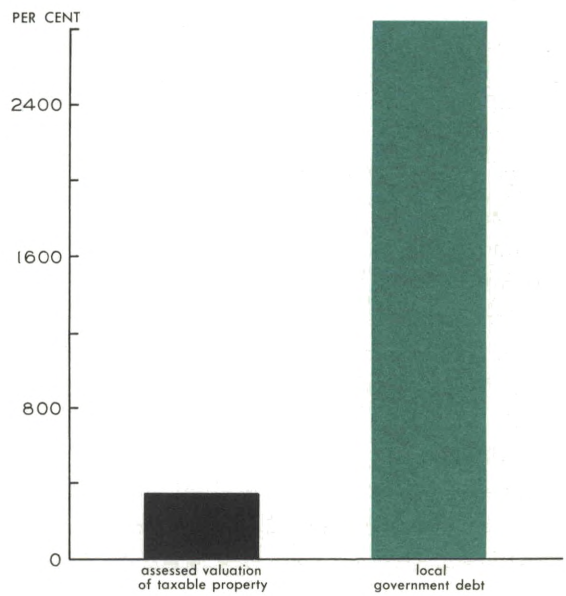
began to chafe. Something new had been added to the demand for government's services—the automobile. Hard-top roads had to be laced all over the state and huge sums were required to build them. Assessed values, and therefore debt limits, did not rise as fast as the need for extra funds, and some governments bumped their borrowing ceilings. The limits held fast, though, and Pennsylvania communities managed to get by on their debt rations.

The depression of the 1930's wrought economic havoc on the nation. Recovery medicine called for heavy government expenditures on all levels. Washington set up its own alphabetical agencies and cajoled the states to borrow and spend more.

To spur spending, Pennsylvania combined two relatively new techniques—authorities and revenue bonds. Both were conceived at about the same time but at different ends of the country. The nation's first authority was set up in Maine in 1899, and revenue bonds were introduced in Spokane,

DEBT HAS OUTRACED ASSESSED VALUES

Pennsylvania—Percentage Increase 1890-1955.



Washington, in 1897. The two first met in New York in 1921 and they proved to be a natural team.

An authority is a tailor-made public corporation that functions outside the regular governmental structure. Because of this status and because authorities were unknown when the constitution was framed, they are not subject to normal debt restrictions. Legally, they may borrow huge sums. But how? Against what security? Their offshoot character usually makes it impossible for them to collect taxes.

Here is where revenue bonds come in. Authorities are given a specific job to do—building and operating turnpikes, water works, sewage plants, etc. Users generally pay for these services and this income goes to the authority.

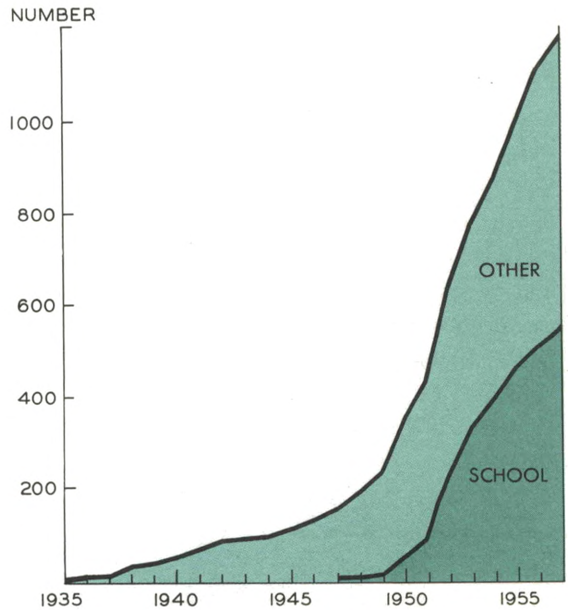
This revenue, or the prospect of it, forms a substantial borrowing base. The authority may issue securities, appropriately called revenue bonds, against its anticipated income. Facilities which will generate income to pay off the debt can be built with the proceeds of the issue. It may sound like fancy financial "footwork," but the same principle underlies many corporate bonds—borrow to build to increase income to provide the means to repay.

This is only an illustration of an authority's operation. Under Pennsylvania law there can be many mutations and variations such as our school authorities. (See box, page 18)

Authorities don't just happen. They don't spring spontaneously from governments. First, the state must enact legislation which permits its municipalities to set up authorities and to issue revenue bonds. Then, acting under the enabling law, the unit desiring to create an authority applies for a charter. If the state approves, the authority comes to life and may commence operations.

The first Pennsylvania municipal authority act was passed in 1933 and was amended in 1935, but early authority activity occurred primarily on the state level. State debt was restricted severely, even more so than the debt of municipalities. The state's million-dollar ceiling still applied (as it does today). Of course, constitutional amendments have stretched this limit for specific purposes but they require voter approval which often is hard to get.

THE BEANSTALK GROWTH
OF OUR MUNICIPAL AUTHORITIES



It was not until the end of World War II that local authorities really began to multiply. The year 1945 brought a liberal new law for municipalities, giving Pennsylvania far and away the broadest authority legislation in the nation.

The flood gates were open. At first municipal authorities came in dribbles but soon the trickle turned to a torrent. Before 1950, about 200 authorities were in existence, and now there are close to 1,200. The peak year was 1952 when 209 authorities were incorporated.

FOR BETTER OR FOR WORSE?

Pennsylvania is the leading exponent in the municipal authority field. Our record of 1,200 authorities with a total of a billion dollars of borrowing is unchallenged by any other state. We have an average of one authority for every four governments in the state.

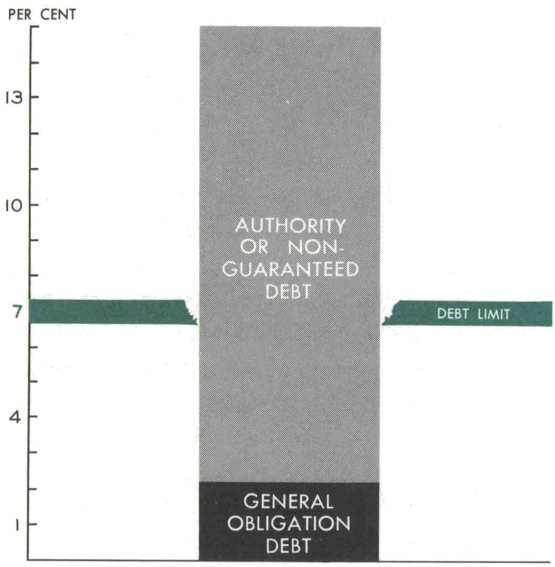
The importance of our authorities is an established fact; so is their rapid growth. But what caused them to catch on so well? Certainly, we have a broad law, but this just makes authorities possible. It doesn't give their creation real impetus. Authorities must have important advantages as a governmental technique.

Strong points

As already indicated, circumvention of debt limits was initially the prime force behind the authority movement. It provided the *raison d'etre* in the 1930's and 1940's. Debt limits are largely responsible for the surge in the 1950's too. Our expanding population, ever demanding more and better services, has put strong pressure on local governments to borrow, and authorities are such an effective way to do it.*

HOW CITIES CAN USE AUTHORITIES TO BREAK THE BORROWING BARRIER

Debt as a percentage of assessed property valuation —1956 figures for ten selected medium-sized cities.



Governments don't always wait until their general obligation debt (the type that counts against their limit) nudges the 7 per cent ceiling. Many swing to authorities long before this happens to conserve their regular borrowing power. Notice the preceding chart which represents the most intensive authority users among our larger cities. Total borrowing is more than twice the limit, yet much of it is non-guaranteed or authority debt. General obligation debt could be almost tripled and still stay within bounds.

The desire to conserve also helps explain the next chart showing average general obligation borrowing as a percentage of legal ability for four important types of governments. Plenty of borrowing power remains, as you can see; yet, on the whole, these units have used authorities extensively.

The idea behind conservation is even more practical than saving for a rainy day. Revenue-supported authorities mean lower general obligation debt and lower taxes to pay the debt. Lower taxes lighten the burden on real property, thereby boosting its value.

In explaining the why of Pennsylvania's municipal authorities, some experts might stop right here, with debt limits. Others believe that debt limits, though important, can be over-emphasized. They say it takes a number of reasons to explain fully something so striking as our authority movement.

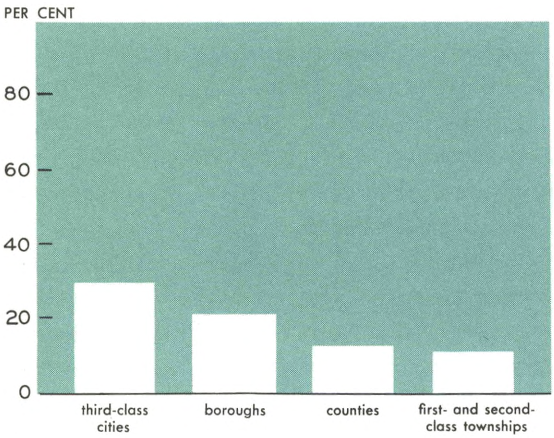
In addition to avoiding debt limits, authorities are alleged to offer a number of advantages as

*See the December 1957 issue of the **Business Review.**

ROOM TO SPARE

Selected types of local government—

Net general obligation debt as a percentage of legal borrowing capacity—1955.



a means of doing business. They can skip across governmental boundaries and provide service to natural economic, rather than political, units. Authorities, in other words, are a way to share services and the responsibility for providing them.

It is among school districts that the urge to get together is strongest. Some districts have merged completely, while many others—retaining their identities—have cooperated to form a "joint" authority. About one-third of all school authorities have been created by two or more districts to build a common school. While it may mean a little more traveling for some of the students, it also may mean a tax saving for their parents. Much of this joining has taken place on the high-school level where students are better able to travel and expensive facilities, such as gyms and auditoriums, are more desirable.

Non-school authorities operate on the popular principle, "the user pays." Service facilities are built by borrowing against revenue which, in turn, comes from the people who receive and benefit from the service. Under the authority system, you buy what you need. If you don't benefit, you don't pay.

Carrying this user-pays principle one step further reveals another potential advantage. Non-school authorities should be a paying proposition and their revenue potential—thus indirectly the need for their specific service—must be shown clearly before construction can be started. Tax-supported ventures generally lack such a concise measure of their desirability, being based on a good-of-the-community principle. Therefore, authority projects, some boosters maintain, often are more carefully conceived and more closely fitted to public needs.

Ask any authority man and he will mention many more attributes. Authorities are better managed, he might say. They can attract experienced businessmen to serve on their boards and commissions on a part-time basis. Serving is considered an honor and this talent usually comes "for free."

Authorities are more flexible. Not bound by governmental red tape and rules, they can be organized in the manner most suited to their task. Their accounting systems also can be adapted. In short, authorities use business methods which supposedly give them an edge in efficiency.

Quite apart from apparent advantages, some of the fabulous growth of authorities in the fifties may be due to momentum or "me-too-ism." Some governments seem to have started them simply because everybody else was doing it. Authorities are easy to come by under our laws and some may have been incorporated before their creators actually had decided on their function. The evidence: the latest roster of authorities shows 121 in the category "purpose not known as yet." This listing also indicates that 453 authorities have no debt outstanding and seemingly are not yet functioning. And many of these have been chartered for five years or more.

Drawbacks

The advantages are impressive but authorities are still controversial. Some people believe they are dangerous or at least unnecessary. We now give the opposition "equal time."

Certainly authorities are effective in circumventing debt limits, critics argue, but *should* these limits be breached? Their purpose was and is to protect the taxpayer from unwise or unscrupulous public officials. With authorities there is no concrete limit to the borrowing-spending cycle. Communities still can sink over their heads as they did in the last century. The passage of a hundred years does not always bring one hundred years worth of wisdom.

Just imagine what a wave of defaults would do to our communities today, how it would ruin their future borrowing ability. Service would have to be curtailed and taxes raised. The public would be the real loser.

The ease with which authorities can be created and the borrowing freedom they enjoy could breed over-development and extravagance, some feel. Lavish projects might be pushed with an "oh, well, let's have the authority do it" attitude. On the other hand, there is perhaps no better way to insure that only the most practical facilities are built than to have planners "staring down the barrel" of a debt limit.

The authority concept is contrary to the principles of democratic control, it is said. The public has, at best, only an indirect influence. Though a regular government creates the authority and appoints its top management, its policies and practices are never directly subjected to approval by the voters.

Yes, authorities are flexible, the "cons" maintain—too flexible!

Relief from debt limit tension is also available in other ways, the opposition claims. For example, Pennsylvania now has PL 481, which has been called the "tax-anything" law. This Act gives local government the right to levy on anything not already taxed by the state. Just raise taxes, the argument goes, increase current revenue, and reduce the need to borrow.

City planners often are frustrated by authorities. To them, an authority is just one extra unit, single-purpose at that, piled on top of the overpopulated, overlapping tangle that is local government. Many communities already come under the jurisdiction of county, city or township, school district, and still other units. In Pennsylvania, not even counting authorities, there is about one government for every 2,000 people. Planners, striving to promote coordination and consolidation, wring their hands when they hear of a new authority.

Getting down to pocketbooks—some experts point out that revenue bond financing is more costly. From this extra expense to authorities naturally follows a higher charge for services and increased rent payments from school districts.

The cost of revenue bonds

Revenue bonds usually carry higher interest rates. The reason is simple, if not completely justified. Revenue bonds are not backed by the "full faith and credit and taxing power" of an established government. The market believes they are riskier, hence investors demand more interest to compensate for the supposedly greater danger.

The idea of extra risk really has not been proven, one way or the other, by the default record. In fact, some revenue bonds can be every bit as safe as general obligations. The market doesn't think so, however, and that's what counts.

It is easy to show that a rate difference exists between the two types of bonds. The chart on the next page makes this clear. Measuring the difference is another matter because adequate information just isn't available. Many revenue bond issues are small and privately sold. Then, too, there is limited trading in revenue bonds, save for the very large issues. One case exists where the same town issued both revenue bonds and general obligations on the same day. A quarter of a point more interest was paid on the revenue bonds. One instance, though, doesn't measure the statewide average.

Experts consulted on this matter say, "It depends." The spread between general obligations and revenue bonds seems to range from one-eighth of a point to a full point, depending on the size and standing of the issuer and whether market rates are rising or falling. The spread is narrower between highly rated issues and on a rising market.

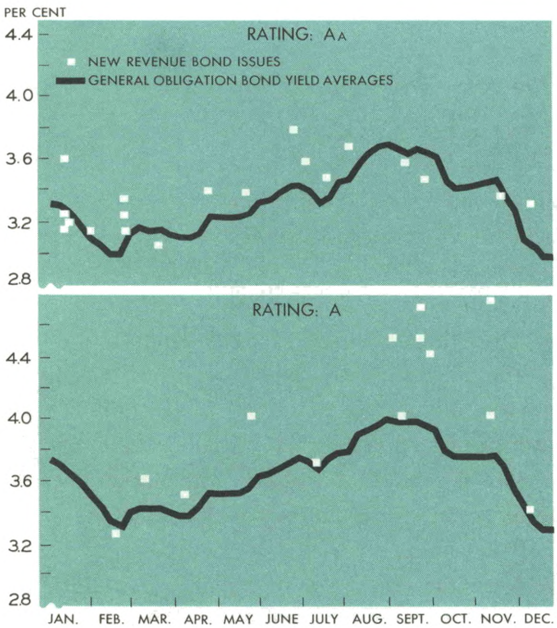
We did some rough figuring of our own, based on our experts' estimates. It appears that the use of revenue bonds versus general obligations cost Pennsylvania local governments between $5 million and $10 million in extra interest during 1957. A staggering figure? Not necessarily, when one considers that authorities have borrowed almost a billion dollars.

Nor would our communities have been able to save all this $5 million to $10 million in interest costs had they issued only general obligation bonds. The quantity of G.O.'s on the market would have been increased and the volume of revenue bonds proportionately reduced. Natural forces of supply and demand would have narrowed the spread between the two.

As you can see, there is convincing reasoning on both sides of the fence. But, by necessity, the debate has been pretty much of a "'tis-'tain't" affair. There is little real proof because authorities are so new. They're not time-tested because there hasn't been enough time. Whether our authorities are for better or worse remains for the future to decide. For the present let's inspect the anatomy of the authority movement in more detail.

THE HIGHER COST OF REVENUE BONDS

New revenue bond issue prices compared to the average yield for general obligation bonds—issues over $1 million of roughly the same quality and maturity —1957.



PRESENT PATTERNS

The growth of our municipal authorities has been a pervasive thing, reaching into every corner of the Commonwealth. Only one county is barren of authorities. Nevertheless, the movement has been more intense in some instances than others. The development pattern of authorities varies by county, by governmental unit, by type of municipal management and by purpose.

By county

We made two yardsticks to measure the relative concentration of authorities by county. The first was the ratio of the number of authorities in each county to the total number of regular governments. The second was the ratio of authority debt to the assessed value of all real estate in the county.

The two measures jibe poorly. The counties that show strong concentration on the debt scale didn't rank high in relative number of authorities and vice versa. Notice the following maps. Counties where authorities are most numerous compared to governments lie largely in the southeastern part of the state, with a few in the western section. On the other hand, counties where debt is highest in relation to assessments are clustered near the middle of the state.

The top ten counties on each scale were examined closely. Counties where authority concentration was high by number typically were densely populated and had a high degree of manufacturing activity. They often were part of metropolitan areas. In contrast, the counties that ranked high in debt-real estate ratios were sparsely settled and farming was important. They were the poorer counties as measured by their need for state aid to education.

We dug deeper for county characteristics other than the pressure of debt limits that might have steered the growth of authorities. We compared our two concentration yardsticks to a quantity of county data. This time all 67 counties were included, not just the top ten. In the language of statistics, we ran correlations.

The results were disappointing. There was little or no correlation between the concentration of authorities and the factors we supposed might have influenced it. Even the characteristics that distinguished our top ten counties (relative wealth, land uses, etc.) lost much of their significance when applied to the whole state. Population density gave the only positive relationship and even this was not really solid.

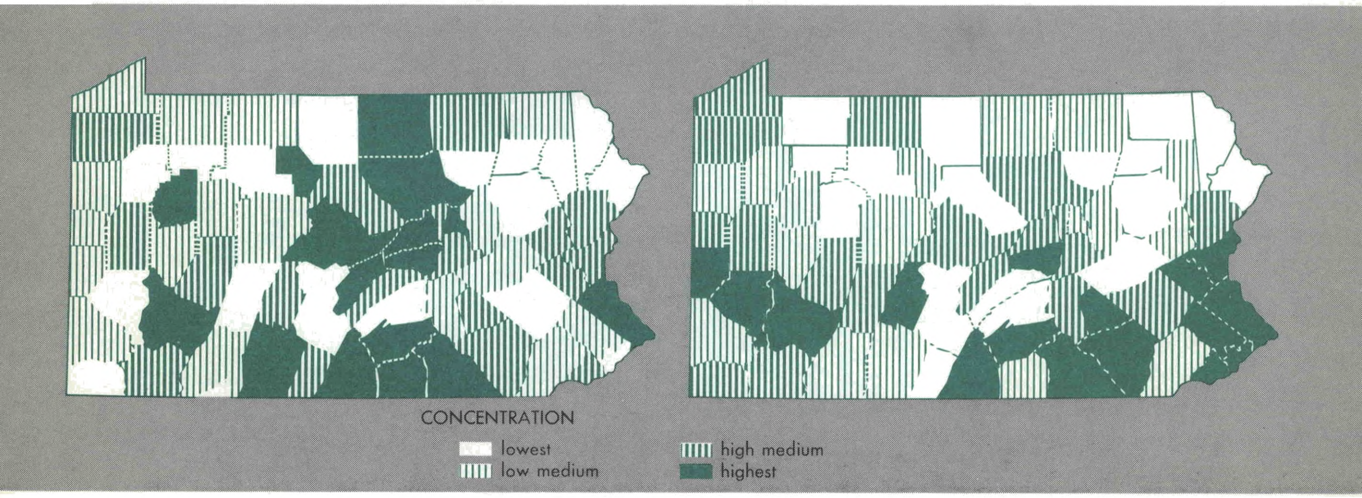
It was especially surprising to learn that authority concentration by either measure was apparently not related to rate of population growth. It would have seemed otherwise—that fast-growing counties would have had greater reason to resort to authorities.

COUNTY CONCENTRATION BY DEBT

Concentration of authorities as measured by the ratio of authority debt to assessed value of real estate.

COUNTY CONCENTRATION BY NUMBER

Concentration of authorities as measured by the ratio of authorities to total governmental units.

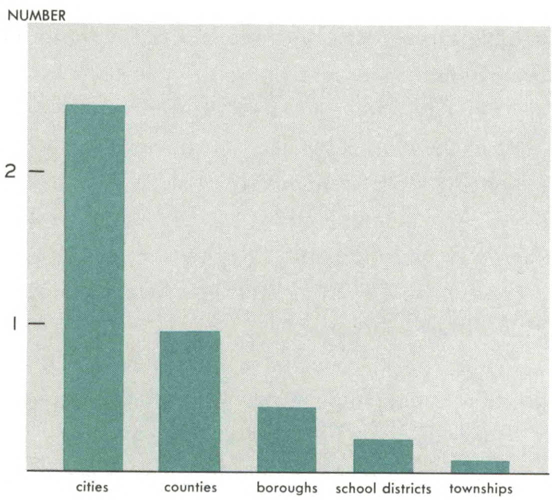


By governmental unit

Relatively speaking, authorities are used most intensively by cities. Each city on the average, has about 2½ authorities. Counties rank next with almost one for one. Then come boroughs and school districts, while townships trail.

WHO USES AUTHORITIES

On the average, each government has set up this many authorities.

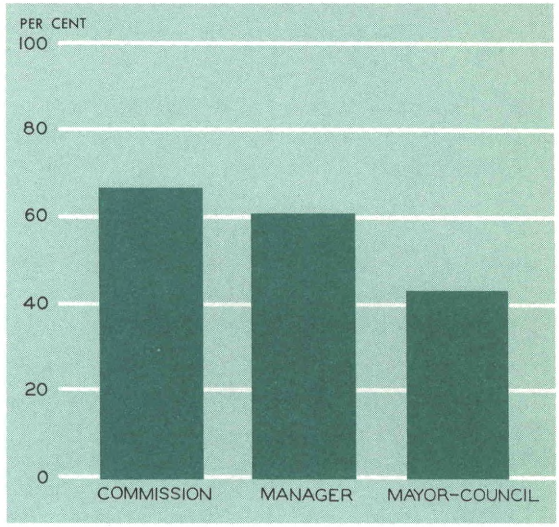


By municipal management

The method of municipal management seems to have some bearing on the use of authorities. Taking data for all "incorporated places" with over 5,000 population we found that commission-type governments are most likely to have authorities. Two-thirds of the cities, towns, and boroughs with this form of management have authorities. The increasingly popular city-manager form is a close second in usage. When a mayor and council are running things, however, authorities are harder to find. About 40 per cent of these cases have them.

MANAGEMENT METHOD MAKES A DIFFERENCE

Percentage of governmental units having authorities, shown by type of management. Data are for Pennsylvania incorporated places with population over 5000.



By purpose

Our authorities aren't ambidextrous. They usually have just one job to do, but how these jobs vary! Airports, schools, parking lots, incinerators, gymnasiums or war memorials—authorities have accomplished all these projects and many more.

JOBS OUR AUTHORITIES DO
February 1957

	Number of Authorities	Bond Issues $ Thousands
School	526	$494,527
Water	162	165,104
Purpose not yet known	121	—
Sewer	113	142,008
Housing	76	70,028
Parking	57	26,504
Dual purpose	43	40,409
Miscellaneous purpose	24	2,213
Airports	18	200
Total	1,140	$940,993

Note: Seventy more authorities were started in 1957. A breakdown by purpose is not yet available.

THE INGENIOUS SCHOOL AUTHORITIES

Pennsylania school authorities are in a class by themselves. They differ from our other municipal authorities and there's nothing else quite like them in the field of education. Here's how they work.

Let's say a school district—a local government with its own debt limits—needs a new building. The district decides to charter an authority. The authority begins to draw up plans for a school building and the district agrees to rent it upon completion. A long-term lease is signed providing for regular rental payments from the district to the authority.

With the lease as security, the authority issues revenue bonds to raise funds for construction. When the building is finished the district moves its teachers and pupils in and uses its taxing power to pay the rent.

CONCLUSION

The record of authorities has been impressive. Most of them are well managed and they have accomplished much good. They have built a billion dollars worth of schools, water works and other projects at a time when such services were sorely needed.

Authorities have enabled Pennsylvania to get things done and prompt action has often meant a saving in construction costs. Wages and material prices have been rising steadily in the past few years and many of our facilities have been built at lower costs than prevail today.

Yet authorities could be potentially dangerous. Unfettered by debt restrictions, they may borrow too much. Nobody really knows what happens when an authority fails—there have been so few examples. But it is highly unlikely that debts would be repudiated. Something would have to be done and the taxpayer probably would end up footing the bill.

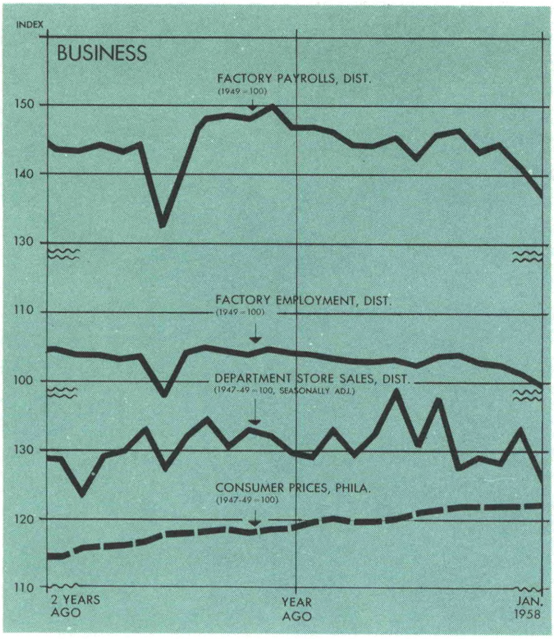
The trouble spots—if trouble ever comes—could be in poorer, rural counties where debt is already high. In one county authority borrowings now stand at over 70 per cent of the assessed value of taxable property. In three others the figure is over 40 per cent.

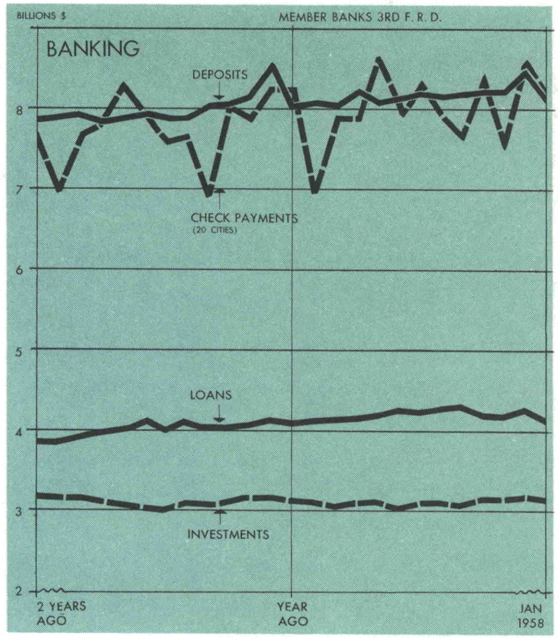
Authority debt is limited theoretically by the "test of the market." Their statements are closely analyzed by professionals. If existing debt seems too high or the undertaking too risky, lenders will shy away and the authority won't be able to sell its securities. The market can be wrong, though. It has been in the past.

Trouble is not inevitable, however. It can be prevented, and public attention and understanding will help do the trick. Voters can't say who runs an authority but public opinion can strongly influence its operation. Authorities are most dangerous when they operate behind a curtain of apathy. On the other hand, they are not likely to borrow excessively in an informed, watchful community.

Authorities are established to serve the public interest. It's up to the public to show an interest in authorities.

FOR THE RECORD...





SUMMARY	Third Federal Reserve District		United States	
	Per cent change		Per cent change	
	January 1958 from		January 1958 from	
	mo. ago	year ago	mo. ago	year ago
OUTPUT				
Manufacturing production	−3	− 9	−1	− 9
Construction contracts*	+6	−13	+4	−10
Coal Mining	+1	−27	−1	−15
EMPLOYMENT AND INCOME				
Factory employment (Total)	−2	− 4	−3	−6
Factory wage income	−3	− 7	...	...
TRADE**				
Department store sales	−5	− 3	−5	− 1
Department store stocks	0	+ 3	−3	− 3
BANKING (All member banks)				
Deposits	−4	+ 1	−3	+ 3
Loans	−3	+ 1	−3	+ 3
Investments	−1	+ 1	0	+ 2
U.S. Govt. securities	−2	− 2	0	0
Other	+3	+ 8	+1	+10
Check payments	−4†	0†	−3	+ 4
PRICES				
Wholesale	...	...	0	+ 2
Consumer	0‡	+ 3‡	−1	+ 3

*Based on 3-month moving averages.
**Adjusted for seasonal variation.
†20 Cities
‡Philadelphia

LOCAL CHANGES	Factory*				Department Store				Check Payments	
	Employment		Payrolls		Sales		Stocks			
	Per cent change January 1958 from		Per cent change January 1958 from		Per cent change January 1958 from		Per cent change January 1958 from		Per cent change January 1958 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Lehigh Valley	−2	− 1	−4	−10	...	...	...	...	− 3	+ 4
Harrisburg	−4	−10	−2	−13	...	...	...	...	− 5	− 2
Lancaster	0	− 2	−2	0	−58	−3	−7	+ 3	0	+ 5
Philadelphia	−1	− 4	−2	− 3	−58	−3	−2	+ 6	− 5	− 2
Reading	−3	− 7	−2	− 9	−59	−2	−5	+ 3	− 4	+ 2
Scranton	−2	− 8	−2	− 9	−65	+1	−7	− 3	− 7	+ 2
Trenton	−4	− 8	+1	− 5	−59	−1	+7	+11	+24	+33
Wilkes-Barre	−1	− 4	0	− 8	−64	−3	−5	− 3	− 7	+ 5
Wilmington	−1	+ 1	−6	+ 1	−62	+1	−6	+ 5	−16	− 6
York	−3	− 8	−4	− 7	−61	−1	+4	+ 1	− 2	+ 4

*Not restricted to corporate limits of cities but covers areas of one or more counties.