

BUSINESS REVIEW



November 1969

FEDERAL RESERVE BANK OF PHILADELPHIA

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A commercial bank will make a loan to an individual without security even though the bank knows relatively little about the borrower. A Federal Reserve bank cannot legally make a loan to a member bank without security even though the Fed knows a great deal about the borrower. Why this double standard? The reason is that law sometimes responds very slowly to changing conditions and views.

Why Collateral Requirements?

by Ira Kaminow

Law books are haunted by ghosts from the past, by laws that were adopted in response to the real or imagined needs of yesterday, but that serve no apparent function in the contemporary environment. Discussion of these laws can be fascinating and fruitful. It can be fascinating because the laws are often living fossils of once-powerful social forces. It can be fruitful because legislative inertia often works against repeal of these laws despite their current irrelevance and not infrequent propensity for harm. Continued discussion of outdated laws keeps the spotlight on potential dangers in our legislative structure and encourages useful changes.

One legal anachronism that merits discussion on both these counts concerns an aspect of the nation's financial system. When commercial banks borrow from the Federal Reserve, they are required to place on deposit with the Fed some kind of collateral. This requirement can be costly for both the borrowing bank and the Fed because the relevant laws are quite complex. Compliance can require a good deal of work at both professional and clerical levels. Even ignoring the costs of legal interpretations and form-filling, the physical effort of as mundane an activity as locating, transporting, and storing collateral can be great.

Once, collateral requirements were thought to be integral parts of the operation of the Federal Reserve System. Today, the environment that precipitated this belief is gone. Like the human appendix, the requirements outlived their original context, and are redundant at best, downright harmful at worst.

BUSINESS REVIEW is produced in the Department of Research. Evan B. Alderfer is Editorial Consultant; Ronald B. Williams is Art Director. The authors will be glad to receive comments on their articles.

Requests for additional copies should be addressed to Public Information, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

Why isn't something done about the situation? Since 1963, the Federal Reserve System, with the support of leading experts has been trying to get one relatively minor liberalization built into the law. Although the reform has been passed by the Senate on several occasions, it has never gotten out of committee in the House. It seems likely, therefore, that a complete overhaul of the law will require a good deal of work.

HISTORICAL BACKGROUND

Laws almost always stem from compromise and, so, rarely reflect the views of any particular group. Moreover, even when compromise is unnecessary or minimal, support may come from many diverse groups, each of which favors the legislation for quite different reasons. Because of space limitations, we will try to capture only the "main currents of thought" that prevailed. We will ignore all the subtle (and some not so subtle) points of disagreement about both content and emphasis.

Panic, Currency Elasticity, and Eligibility Requirements. The post-Civil War National Banking Act had provided the Nation with a highly restrictive monetary system and a currency supply that was unresponsive to the demands of the public. To most observers of the day, the periodic financial crises following the Civil War stemmed from this monetary system. Sharp increases in the demand for currency led to deposit withdrawals. Banks, finding their fixed currency reserves depleted, suspended withdrawal privileges, and the panic was on. Each suspension resulted in a further decline in confidence until credit dried up and the economy succumbed.

In the winter of 1907, the Nation was facing its fourth severe panic since the end of the Civil War. The situation bordered on national dis-

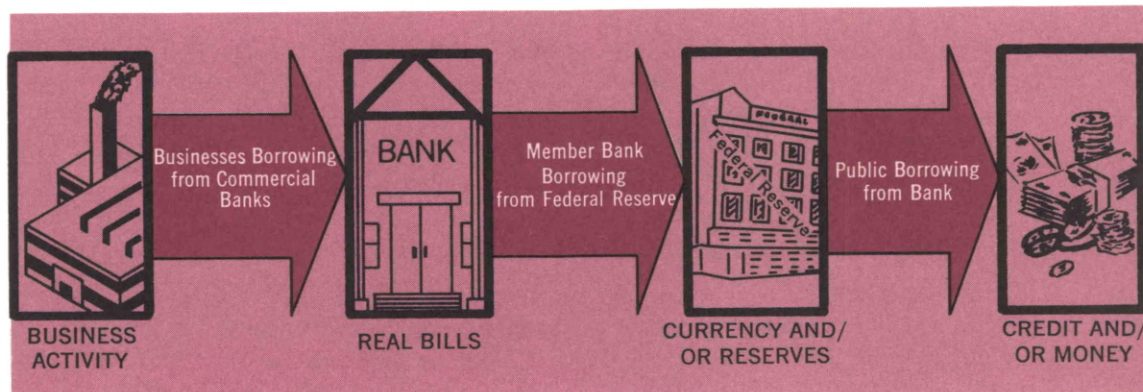
aster, "and it seemed likely that, unless the hysterical rush for liquidity could be stopped, economic transactions would return to the barter state."¹ The public was getting fed up; the cry for an elastic currency supply, responsive to demand, grew louder. From 1907 to 1912, a major economic reform was planned. It culminated in the Federal Reserve Act—"An Act . . . to furnish an elastic currency. . . ."²

The elastic currency was to be provided by allowing banks to sell promissory notes they held against loans to the Federal Reserve Banks. (The sale was made at a discount from the face value; hence, the process was called discounting.) When banks needed currency to meet increased withdrawals, they could go to the Fed to swap notes for currency.

The Federal Reserve Act, however, attempted to do more than provide an elastic currency supply. An elastic currency required only that banks have an opportunity to convert their non-currency assets into currency; it really didn't matter what assets were sold to the Fed. With an eye toward influencing banks' portfolios and contributing to economic and financial stability, however, the framers of the Act limited assets eligible for discount to so-called real bills—in the words of the Act, to short-term "bills of exchange issued or drawn for agricultural, industrial, or commercial purposes." By limiting the class of eligible assets, legislators made the eligible assets more attractive to banks. Banks were encouraged to hold real bills for two reasons. First, because real bills mature quickly,

¹ Paul Studenski and Herman Kroos, *Financial History of the United States*, (New York: McGraw-Hill Book Company, Inc., 1963), p. 253.

² This quotation comes from the title of the Act. The full title reads "An Act to provide for the establishment of Federal reserve banks to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."



banks that hold them experience a rapid turnover. Every day some loans are maturing and providing the bank with an inflow of funds. This rapid turnover was considered a highly desirable property in bank-held assets because the majority of bank liabilities were payable on demand; unexpectedly large withdrawals could be met by the inflow of funds from a constant stream of maturing real bills. Second, real bills were created to finance “productive” activities. The Act, consequently, was believed to encourage “productive” loans at the expense of “non-productive” loans, particularly loans to finance speculative activities.³

Eligibility requirements were supposed to do more than merely encourage prudent banking practices and contribute to a socially desirable allocation of credit. In 1913, there was considerable sympathy for the view that eligibility requirements would contribute to economic stability. It was believed that sharp economic fluctuations could be avoided if bank holdings of eligible paper grew and shrank with business activity and that the volume of real bills in bank portfolios would fluctuate in the desired fashion.

³ It is not clear whether speculative loans were to be discouraged because speculative activities were to be discouraged, or because the issuance of credit and/or money to finance speculation and other “non-productive” activities would lead to an over-supply of money and/or credit.

There is currently less than complete agreement on why linking bank ownership of eligible paper to business activity was considered stabilizing. Most of the earlier arguments, however, seemed to consider this relationship as the first link in a rather round-about connection between business activity and the volume of currency, or reserves, or money, or credit (depending on the version of the theory—these four magnitudes were not always clearly distinguished). The proposed linkage went something like this (see the accompanying diagram): The level of business activity would control the quantity of real bills in bank portfolios, the quantity of real bills in bank portfolios would control the volume of discounting, the volume of discounting would determine the quantity of currency and/or reserves in the system, and finally the quantity of currency and reserves would control the volume of credit and/or money. Through this complicated mechanism, eligibility requirements were supposed to serve a crucial role in fostering a semi-automatic connection between business activity and currency, reserves, credit, or money.

The Fed and the War. Clearly, much was expected of eligibility requirements. They turned out to be incapable of handling the burden they

were designed to bear. Renunciation of eligibility requirements as a bulwark of financial stability was hastened by the onset of World War I.

The war broke out only months before the Federal Reserve Banks opened their doors. In 1915 and 1916, it was becoming increasingly evident that the United States would not remain neutral. And by late 1916, wartime preparations were under way. To facilitate financing the anticipated rise in Government borrowing, Congress amended the Federal Reserve Act to allow banks to borrow money from Reserve Banks on pledge of Government securities. This change was designed to increase the desirability of Government bonds. At this time, member banks were also given the option of borrowing from the Fed on the security of eligible paper instead of discounting that paper. Member-bank borrowing became another vehicle for obtaining currency in time of emergencies. Limiting the kinds of assets eligible as collateral was no more related to currency elasticity than similar requirements on assets eligible for discount. Indeed, nothing in the concept of currency elasticity suggests the need for collateral at all. Collateral requirements, like the requirements on discounting, were designed to influence bank portfolios and to link the level of discounting-borrowing to the level of business activity. This latter link was severely weakened,⁴ of course, when Government securities were made acceptable as collateral.

Real Bills and Real Disaster. During and after the war, the Fed followed a liberal discount-loan policy and kept interest rates low on member-bank borrowing and discounting. The

enormous bank borrowing that followed contributed to the inflation that lasted until 1920.

It was this experience with large-scale bank borrowing that prompted both the Fed's attitude of discouraging member-bank borrowing except on a temporary basis, and a reluctance on the part of banks to borrow. By 1929, the tradition against member-bank borrowing had hardened considerably, and when the crash came, the discounting mechanism was rusty and unprepared.

There is general agreement today that the depression of the thirties would have been milder if the Fed was more willing to lend and commercial banks more willing and able to borrow. Some banks may have been unable to borrow because they lacked enough eligible paper.

In an effort to override the restrictive lending policies of some Reserve Bank officials, to bring more banks to the discount windows, and to make more assets acceptable as collateral, Congress passed the Glass-Steagall Act in 1932 which liberalized collateral requirements.⁵

The Act permitted banks to use any collateral acceptable to the Fed. The use of "ineligible" collateral, however, was seen as an emergency measure only, and carried a one per cent per annum penalty. In the Banking Act of 1935, the emergency nature of the change was lifted, and the penalty was reduced to the current one-

⁴ The link probably was not very strong to begin with.

⁵ Milton Friedman and Anna J. Schwartz, in *A Monetary History of the United States*, Princeton University Press, Princeton, 1963, argue that Congress passed the Act mainly to encourage more member bank visits to the Fed discount window and that there was no lack of eligible paper in the System. In the hearings relating to the Banking Act of 1935, however, Governor Marriner Eccles, of the Federal Board argued that the Glass-Steagall Act was passed "after a great many banks had gone to the wall at least partly because of lack of eligible paper. . . ."

half of one per cent. Roughly, this is where the law stands today.

ELIGIBILITY AND COLLATERAL REQUIREMENTS IN 1969

Nineteen-sixty-nine is not 1913. Our economic environment is different today from what it was in 1913, not only because the world has changed, but also because our perception of it is no longer the same. Because of the way the world has changed, even the original proponents of eligibility requirements would probably reject them in the context of current banking institutions. Because of the change in our perception of the world, modern economists would reject the requirements in almost any context.

In 1913, experts felt that the main source of instability in the System was an inelastic currency supply. Today, modern central banking techniques make currency famines impossible. In 1913, bank reserves were to be determined mainly by member-bank discounting. Today, the main source of variation in member-bank reserves is open market operations. In 1913, member-bank portfolios were concentrated heavily in eligible commercial paper. Today, this paper probably accounts for less than 15 per cent of member-bank loans and investments. In 1913, it was anticipated that banks would make extensive use of their borrowing privileges. Today, bank borrowing is trivial when compared with total bank liabilities. In 1913, banking authorities considered an increase in bank holdings of real bills desirable. Today, these authorities recognize that many other assets appropriately belong in bank portfolios.

Collateral Requirements and Economic Stability in 1969. Are there any reasons to maintain collateral requirements in the current system? To answer this question, one must first recog-

nize that the driving force of the Fed is to protect the economy, not its own investments. The Fed's collateral requirements cannot, therefore, be judged on the same grounds as a private bank's collateral requirements. The Fed's actions can only be judged by their contribution to the nation's economy. On these grounds, almost all economists and bankers would agree that collateral requirements serve no useful purpose.

The original attempts to tie discounting to business activity through real bills were based on two misconceptions. First of all, there is nothing desirable about varying currency, reserves, money, or bank credit with the level of business activity. Increasing any of these quantities during a boom frequently will fuel smoldering inflationary fires. Cutting back on any of them during a slowdown frequently will add to the downward pressure. Second, even if it were desirable to relate the level of discounting to the volume of business activity, it is by no means clear that the real bills mechanism is an adequate conduit. Banks need not increase discounting simply because they hold more real bills and businesses need not borrow from banks simply because production increases—they may go to other suppliers of credit.

Collateral Requirements and Bank Portfolios in 1969. There is general agreement today that collateral and eligibility requirements cannot be defended on grounds of their contribution to economic stability. What about their influence on bank portfolios? The answer to this question is most properly, "What influence?" The conditions that would permit eligibility requirements to exert substantial influence on bank portfolios do not exist in 1969. In the post-World War II period, member-bank borrowing has rarely accounted for more than one-half of

one per cent of liabilities of member banks. Moreover, since 1932, any asset acceptable to the Fed may be used as collateral. There is, therefore, a very real, and probably low, limit on the extent to which banks are willing to alter portfolios just to beef up balances of eligible paper. Why should bank portfolios be very different with or without eligibility requirements?

Not only do collateral and eligibility have just a marginal impact on member-bank portfolios, it is far from obvious that their impact is in the right direction. Eligibility requirements were written in 1913. What seemed appropriate in 1913 may not be appropriate in 1969. To whatever extent eligibility requirements influence portfolios, they can be expected to do so by enticing banks to hold more eligible paper than otherwise. This enticement would be translated into more Government securities in bank portfolios; more short-term loans; fewer personal loans, because these loans are ineligible; and less open-end consumer credit, like credit cards, because these loans, too, are ineligible. Each of these tendencies runs counter to current trends in bank portfolio practices.

On Changing the Law. The main effect of requiring banks to put up security is to increase the costs of running the banking system. Member banks which want to borrow must find appropriate collateral and bring it to the Fed. The Reserve Banks must judge the eligibility and soundness of the collateral, interpret the law, and write the necessary regulations. The law has been particularly irksome in recent years when the volume of bank borrowing has been rising and more hard-to-process non-Gov-

ernment collateral has been presented.⁶

Not all the costs of complex collateral requirements can be easily measured in terms of dollars and cents. Unnecessary obstacles to member-bank borrowing may hurt relations between the Fed and member banks. Small banks especially may be intimidated by the apparent complexity of the collateral requirements.

Clearly, for all these reasons, operations of the Fed's lending mechanism could be significantly improved if collateral requirements were removed from the law. In 1963, the Federal Reserve System took a first step toward this end by proposing legislation that would eliminate the distinction between eligible and ineligible collateral.⁷ The bill has received the support of leading experts, and its adoption has been urged by the American Bankers Association, Federal Deposit Insurance Corporation, Treasury Department, Independent Bankers Association of America, and others. To date, the bill has not been passed, but it is hoped that the Congress will soon pass it and thus start on the road toward complete elimination of collateral requirements.

⁶ It is much easier for all concerned when banks present Government securities as collateral, because this collateral obviates the need for complex credit-checking procedures as well as the need to check for eligibility. Unfortunately, banks don't own as many Governments as they once did, and this has resulted in fewer Government securities available as collateral.

⁷ The date 1963 is chosen because it represents the start of the most recent attempt to get the law changed. Actually, a similar proposal was made in 1935 by Governor Marriner Eccles of the Board of Governors of the Federal Reserve System. In the version of the original Federal Reserve Act passed by the Senate, the Fed was authorized to make advances on any "satisfactory securities" in an emergency. This authorization was not in the House version, and it was subsequently dropped from the final Act.

Appalachia: Back from the Brink? by Shirley A. Goetz*

In the early part of the decade, the hopeless poverty of 18 million Americans captured national attention. Magazines and newspapers featured stories and photographs of bleak towns, lonely "hollers," underdeveloped economies, and wasted lives that made up the 13-state region known as Appalachia.

National attention became national concern, and the country sought a way to help the people of Appalachia. The question was (and is) whether Appalachia could achieve, with help, a self-sustaining economy capable of providing its population with jobs, incomes, and standards of living similar to those in the rest of the United States. Or would money be better spent in providing Appalachians with the means and the skills to try their luck in other parts of the U.S.? In 1965, Congress made its decision: the Appalachian Regional Development Act. Since that time, three-quarters of a billion dollars has been appropriated to revitalize the Appalachian economy.

It is, of course, too soon to estimate the impact of the Act itself on the economy of Appalachia. It is worthwhile, however, to look at what has happened to the region during the sixties to see how well Appalachia stacks up against the nation.

Over the decade, the region has progressed. Unemployment declined much more rapidly in Appalachia than in the nation. In the Pennsylvania portion of Appalachia, the jobless rate fell almost twice as much as it did for the country as a whole.

Nevertheless, severe problems remain. In the Pennsylvania counties of Appalachia, for in-

* The author expresses appreciation to the Appalachian Regional Commission and to the Pennsylvania Bureau of State and Federal Economic Aid for information upon which much of this article is based.

stance, employment grew at only half the national rate during the sixties. The labor force increased by only 1 per cent compared with a 13 per cent gain in the U.S. Consequently, the sharp drop in the local unemployment rate stemmed not only from expanded job opportunities, but also from a large out-migration of the working-age population. Furthermore, the differential between local and national rates of employment growth has not improved since the passage of the Appalachian Act. These facts raise some questions as to how adequate the progress of the sixties has been.

To put this progress into perspective, we first need to understand the roots of the economic problems of Appalachia. Why was this region singled out by the Federal Government for special assistance? What kind of special assistance is Appalachia receiving? What is behind the upswing in the area's economy since the start of this decade? Where does Appalachia go from here?

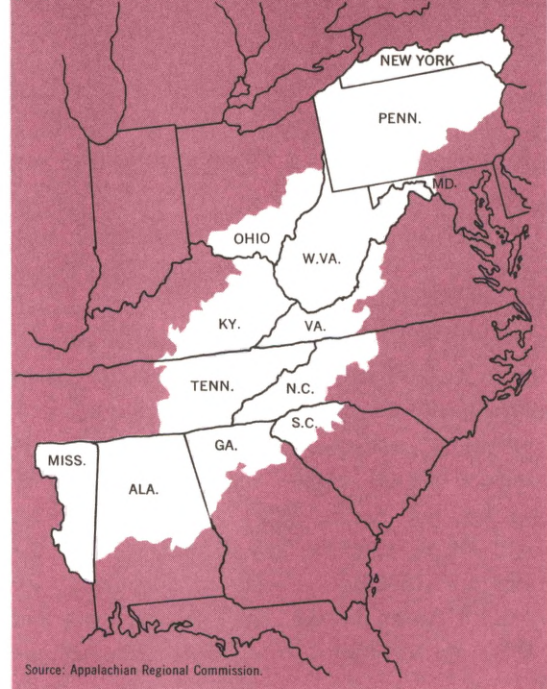
CAUSES OF THE PROBLEM

Geographic isolation. Appalachia is strategically located between the industrialized East Coast and Midwest, with prosperous Atlanta to the South (see map). However, mountainous terrain has isolated the region geographically and restricted Appalachians from realizing the potential of their location.

Economic isolation. Appalachia has been called a "region apart"—apart not only geographically, but economically. Cut off from the mainstream of American growth and prosperity, the area has known poverty for decades. Conditions, however, worsened in the 1950's. Statistics on health, housing, and income in some areas of Appalachia resembled those of an underdevel-

APPALACHIA—WHERE IS IT?

Appalachia cuts diagonally through 13 states from southern New York to northern Alabama and Mississippi. Located between the East Coast and Midwest, the region includes 52 of Pennsylvania's 67 counties (all except the southeastern corner), and one-half of the state's population. Overall, Appalachia is home for 18 million people, or one out of every 11 Americans.



oped country rather than a part of the United States. In 1960, for instance, average annual income per person in Wolfe County, Kentucky, was \$435—about the same as in Jamaica.

Much of the poverty has been related to Appalachia's natural resources. These resources include almost all of the nation's anthracite coal, two-thirds of all bituminous coal mined in the United States, large forests, scenic mountains, and abundant rainfall.

Dependent on its natural resources, the Appalachian economy climbed and crashed with their development. When steam locomotives gave way to diesels, and when long-distance natural gas and oil pipelines were installed, demand for Appalachian coal suffered significantly. Replace-

ment of labor with both underground and strip mining machinery further reduced the number of people employed in mining.

Appalachian timber had been used for railroad ties, mine-supports, furniture, and construction. But over the years, the demand from railroads and mines has been exhausted, and Appalachian hardwood has had to compete with labor-saving substitutes in the furniture and home-building industries.

Land also has caused economic problems. First and foremost, the mountains make transportation expensive and difficult, and second, topography severely limits agricultural productivity. Rugged Appalachian land usually makes mechanization impractical. Yet, without mechanization, farmers often find it impossible to compete in food markets. Furthermore, Appalachia has few natural lakes to catch mountain runoff. Consequently, runoff pours from the mountains causing soil erosion and floods. In addition, years of soil neglect and improper cultivating techniques have taken their toll on fertility.

Another source of trouble stems from Appalachia's reliance on the railroad. Like mining, forestry, and agriculture, the railroad industry was an economic mainstay in parts of Appalachia, such as Altoona, Pennsylvania. But in the decade of the fifties, rail employment plummeted as, once again, technology and competition erased many jobs.

Although employment in manufacturing, trade, and service industries increased in the 1950's, gains in these sectors were below the national performance. In manufacturing, for instance, employment grew at only two-thirds the rate of the rest of the country. Service jobs expanded at only one-half the rate of the rest of the nation. Consequently, these employment in-

creases did not counteract losses in mining, agriculture, and rails. The impact of this net loss of employment hit home in the Pennsylvania portion of Appalachia, and the unemployment rate in some Pennsylvania counties neared 25 per cent in the late 1950's.

Lack of job opportunities was only one of Appalachia's problems. In 1960, Appalachia lagged behind the nation in virtually every indicator of economic and social well-being—employment, income, education, health, and housing. Almost one out of three Appalachian families had an income less than \$3,000 a year. Only one out of five in the rest of the United States had an income that small. Many people were moving out, especially those of prime working age and their dependents. Not only was there an erosion of human resources, but physical resources deteriorated, and communities were unable to provide needed services. Under these conditions, the people left behind in Appalachia could not strengthen their own economy and break out of the circle of poverty. Only the Federal Government had the financial muscle and the authority to cope with the poverty of this multi-state region.

UNCLE SAM TO THE RESCUE

In 1965, Congress passed the Appalachian Regional Development Act. The Act embodies a six-year program designed “. . . to assist the region in meeting its special problems, to promote its economic development, and to establish a framework for joint Federal and state efforts toward providing the basic facilities essential to its growth. . . .”¹ Major sections of the Act provide Federal assistance for transportation and for improvement and develop-

¹ Appalachian Regional Development Act of 1965, Public Law 89-4, 79 Stat. 5, Sec. 2.

ment of natural and human resources. Programs include an expressway system, mine reclamation, land stabilization, educational facilities, low-cost housing, and health centers.

To implement these programs, the Act pioneered a new approach to Federal, state, and local cooperation. Traditional approaches to coordination would not suffice because of the diversity of problems facing Appalachia. For example, Appalachia is predominantly rural, but the Pennsylvania portion is almost two-thirds urban, and contains the nation's ninth largest metropolitan area—Pittsburgh. Even within states, problems and potentials differ. Many Pennsylvania cities seek to fill the void left by the decline in coal, steel, or rails. Pittsburgh, for example, is concentrating on industrial research, while people in the anthracite area around Wilkes-Barre, Hazleton, and Scranton are exploiting their proximity to major markets by developing manufacturing and distribution facilities. In some parts of the state, such as the sparsely-settled highlands, tourism and recreation offer the most promise.

Because of vast differences throughout sub-regions of Appalachia, the Federal Government guards against superimposing solutions from Washington. Individual states and local areas are given a large role in planning, implementing, and administering projects. Usually after consultation with officials of local areas, state authorities submit goals and projects to the Appalachian Regional Commission. That Commission, which is composed of a representative from each Appalachian state and a Federal appointee of the President, must approve projects before the Federal Government releases any funds.

To increase the effectiveness of Appalachian aid, top priority usually is given those geo-

graphic areas which have the greatest potential for development. To determine developmental potential and the most beneficial project for local areas, each state has set up multi-county units called local development districts. Counties within each district have common economic and social ties and similar growth possibilities. LDD's, as they are called, are the basic planning units for Appalachian programs.

Pennsylvania has seven of these districts. Each of the seven has its own board made up of regional planners, tourist promoters, and industrial and local government leaders. These boards engage in several regional programs under the direction of the state. For instance, the Economic Development Council of Northeastern Pennsylvania, which combines the resort area of the Poconos and the coal country of Wilkes-Barre, Hazleton, and Scranton, is working on water resources, the highway system, tourist development, local education, and the problem of auto junkyards.

The highway approach. In spite of emphasis on local initiative for development measures, Congress did dictate the major thrust of the overall program. It is transportation. Under the Appalachian Act, \$1.015 billion was authorized for highways over a six-year period and \$335 million for non-highway programs through 1969. While a total of only \$765 million was actually appropriated through fiscal 1969, over 60 per cent was for roads, as shown in Table 1.

In Pennsylvania, 48 per cent, or about \$53 million, has been allocated to highway development through fiscal 1969. An additional \$25 million has been committed to the highway program in Pennsylvania for fiscal 1970 and 1971, bringing highway grants under the Appalachian Act to \$78 million.

TABLE 1

**How Funds Provided by the Appalachian Act Were Used
(Fiscal 1965-1969)**

Project	Appalachia	Pennsylvania
Highways	61.5%	48.2%
Natural Resources	7.0	22.3
Mine reclamation	3.2%	19.2%
Land stabilization	2.1	1.0
Other	1.7	2.1
Human Resources	11.7	7.0
Vocational education	5.5	6.8
Housing fund	0.3	0.2
Health demonstration projects	5.9	0
Supplemental Aid	18.5	21.1
Other	1.3	1.3
Total	100.0%	100.0%

Source: Appalachian Regional Commission and Pennsylvania Bureau of State and Federal Economic Aid.

The reason for this emphasis was clearly stated by the President's Commission on Appalachia: "... remoteness and isolation ... is the very basis of the Appalachian lag" and "developmental activity in Appalachia cannot proceed until the regional isolation has been overcome."² The Commission believes the region must be opened up for industries having national markets; links between major centers within and without Appalachia must be established; residents must be able to commute to jobs and health and educational services. To meet these requirements, Congress authorized a 2,700-mile system of highways which, when completed, would put 93 per cent of the residents within one hour of a highspeed road.

The priorities set by the President's Commission are being seriously questioned, however. Some students of Appalachian problems challenge the idea that geographic isolation

is at the root of the region's problems.³ They emphasize indigenous social and economic weaknesses, such as poor use of resources, an unskilled population, and a lack of all types of social and human investment in education, health, and housing. One critic, John Munro, even questions whether the region actually is undersupplied with highways. He finds that Appalachia has more rural highway miles in relation to its area and population than the U.S., and he claims that the present highway system in the region is an adequate means of industrial transportation.⁴

If isolation is not the main cause of the lag in Appalachian development, a sizable commitment to transportation may not help the area unless investment in transportation facilities

² *Appalachia, A Report by the President's Appalachian Regional Commission* 1964, p. 32.

³ See Niles M. Hansen, "Some Neglected Factors in American Regional Development Policy: The Case of Appalachia," *Land Economics*, February, 1966, pp. 1-9, and John Munro, "Planning the Appalachian Development Highway System: Some Critical Questions," *Land Economics*, May, 1969, pp. 149-161.

⁴ Munro, *Land Economics*, pp. 157-160.

ties generates increased demand for local goods and services. Recent studies in other countries point out that transportation investment by itself may not stimulate the local economy to any great extent⁵. Transportation investment, like any other type of investment, may be a key element in specific cases of development. However, it possesses no magical qualities, and cannot be depended upon to initiate sustained growth in every depressed area. In short, access will accomplish little if people and industry do not take advantage of it.

In addition, improved access could have unanticipated effects on the Appalachian economy. Many forget that roads go two ways. Although new highways will open Appalachia to the nation, the nation will also be opened to Appalachia. Better highways will make it easier for Appalachian families to shop outside the region. Then too, as Appalachian residents become familiar with other areas and with improved transportation, out-migration might rise further.

Whether out-migration would be good or bad depends upon one's viewpoint. If the Appalachian economy cannot support adequately its present population, as some people believe, Appalachian residents may improve their standard of living by moving to other parts of the country. However, many Appalachian migrants would be ill-equipped for life outside of Appalachia, especially in the big cities. Furthermore, if Appalachia develops a self-sustaining economy, as the Appalachian Act intends, the region will need a labor force. Even today, in parts of the Appalachian portion of Pennsylvania, past out-

migration has created a bottleneck to development.

It is too soon to tell whether the "highway-first" program will be successful. As of June, 1968, only 4 per cent of all Appalachian Development Highways had been completed. Nevertheless, new roads have already cut down travel time and opened up new job opportunities in at least some areas. The experience of Hazard, Kentucky, is an example. Hazard is a mountain community with an excess labor supply. But before 1968, it took three and a half hours to drive from Hazard to Lexington, an industrial area with a tight labor market. Today, travel time is down to one and one-half hours, putting Lexington within commuting distance of Hazard. In this case, job opportunities have been brought closer to Appalachian workers through highway development.

The program does not stop with highway construction. The Appalachian Development Highway System and the Interstate Highway System serve as the framework for other public expenditures in Appalachia. For instance, Pennsylvania, Maryland, and West Virginia are jointly building a recreation center close to two Appalachian expressways. The expressways will connect the center to the Baltimore-Washington and Pittsburgh-Cleveland areas. Along Interstate 80 in north central Pennsylvania, a 50,000-acre resort is planned for a previously isolated area. Close by, 14,000 acres are being developed as industrial sites. Whether public investment in highways also will stimulate private development on a large scale remains to be demonstrated.

Reclaiming resources—natural and human. Although highway development has been given top priority, a large block of Appalachian funds

⁵ George W. Wilson, et al., *The Impact of Highway Investment on Development*, (Washington, D.C.: Brookings Institution, 1966). Niles Hansen, "Regional Planning in a Mixed Economy," *Southern Economic Journal*, October, 1965, pp. 176-190.

has been used to improve natural resources. In Pennsylvania, mine reclamation has been of primary importance.

Mine fires are one major problem. The Laurel Run fire in the Wilkes-Barre area has been burning since 1915. During the sixties, three mine fires in the Carbondale-Scranton area endangered over 200,000 people and \$60 million in property. At the same time, fires in the Shenandoah-Centralia area threatened over 77,000 people and property valued at \$118 million. The expense of controlling or extinguishing these fires may exceed several million dollars. Four and a half million dollars have been spent on a mine fire in Scranton alone. The depth of the mines, the difficult topography, and the problem of shutting off surface oxygen make control costly.

Cave-ins also pose a serious threat in mine areas. Deep underground mining has been practiced for over 100 years. Consequently, many houses, stores, and streets are located over mine tunnels and shafts. Cave-ins may occur at any time, as shorings give way. The solution is to drill holes from the surface and pump non-combustible material into the mines.

Still another problem is soil erosion. Under the Appalachian Act, individual farmers can contract with the Federal Government to conserve and build up the soil. Last year, average contracts ranged from \$315 in North Carolina to \$1,784 in Pennsylvania. Other environmental funds have been used for timber development, water resources, and sewage treatment.

About 12 per cent of expenditures under the Appalachian Act has gone directly to reclaim human resources. Need for this reclamation is great. Statistics can only hint at the wide gulf between the quality of life in Appalachia and that in the rest of the nation. In education, for

example, the drop-out rate before high school graduation is 50 per cent higher in Appalachia than in the nation. The percentage of high school graduates continuing their education is 50 per cent lower. Currently, schools offering 62 vocational courses from horticulture to welding are being aided in order to provide young Appalachians with saleable skills.

Poor housing is also a basic fact of Appalachian life. About one out of every four families lives in a substandard dwelling. Generally, money is lent to sponsors of low- and middle-income housing projects. These loans are used for initial planning costs necessary to obtain financing under the National Housing Act. Of the 1,298 units approved thus far, one-third are in Pennsylvania.

Demonstration health programs have been set up in eight states, not including Pennsylvania, on the basis of need. These programs provide comprehensive health care to persons who did not previously have access to medical services.

The largest remaining category of funds is supplemental aid. As shown in Table 1, this category amounts to 18 per cent of total funds provided by the Appalachian Act to the region, or almost \$142 million. This aid helps to finance everything from airports to water systems. Supplemental funds enable Appalachian states to participate in traditional Federal grants-in-aid, which require states or local areas to share project costs with the Federal Government. Because of depressed economies and inadequate tax bases, many Appalachian communities, prior to the Act, were unable to pay their share. Too often state funds were not forthcoming, so communities could not take advantage of these grants. For instance, under the grant-in-aid program, the Federal Govern-

ment pays 30 per cent of the construction cost of sewage treatment plants for communities in the United States. Although there was often need for these plants, many Appalachian communities were unable to raise the remaining 70 per cent. Today, the Appalachian Act brings the Federal share up to 80 per cent for almost all grant programs. In Pennsylvania, 89 per cent of supplemental funds, or more than \$20 million, has been invested in human resources—education and health (see Table 2).

Finally, about 1 per cent of money channeled to Appalachia has been used for regional research and for setting up local development districts.

WHAT'S THE PAYOFF?

A little over three-quarters of a billion dollars has been appropriated for Appalachia since 1965. In Pennsylvania, over \$110 million has been invested through the Act. Associated funds push the total public commitment in the state past \$350 million. At the same time, the nation has been enjoying the longest period of

economic prosperity in its history. Have national growth and public investment led to any improvement in economic conditions in Appalachia?

Economically, Appalachia is better off today than in 1960. In the region as a whole and in Pennsylvania in particular, employment has increased and unemployment declined. As the national economy boomed, demand for Appalachia's traditional products of coal, steel, and timber increased. The number of jobs in construction and services also climbed.

In Pennsylvania's Appalachia, unemployment plunged from 10.1 per cent in 1960 to 3.6 per cent in 1968, almost double the drop in the U.S. rate. Furthermore, the unemployment rate posted last year equalled the national rate. While employment fell in the fifties by 1 per cent, it grew by 8 per cent from 1960 to 1968, as shown in Chart 1. Every category of employment except finance, insurance, and real estate performed better in the sixties than in the fifties. Greatest growth occurred in construction and in government.

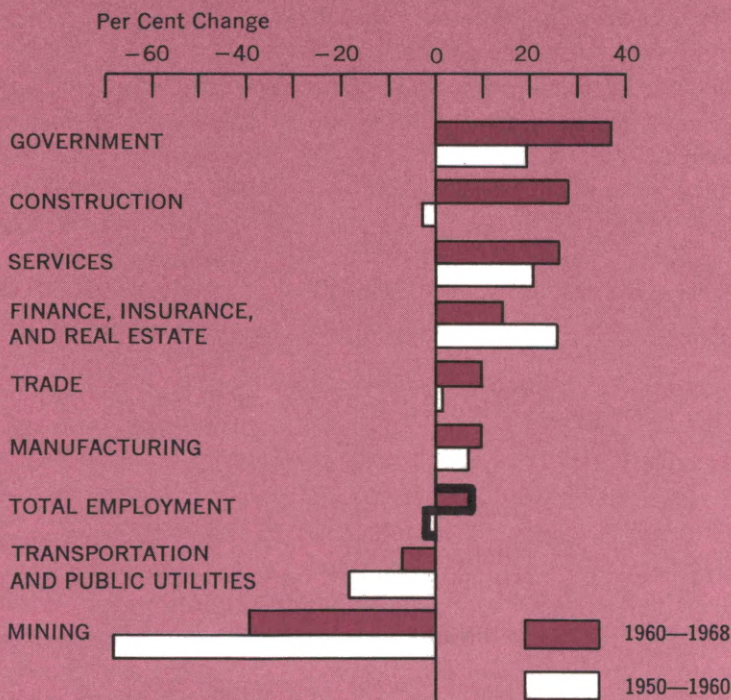
TABLE 2
How Supplemental Aid Was Used in Pennsylvania
(Fiscal 1965-1969)

Project	Distribution	
Human Resources		88.6%
Elementary and secondary education	2.0%	
Higher education	23.7	
Vocational education	12.3	
Libraries	6.9	
Hospitals and nurses training	37.3	
Mental health	6.4	
Natural Resources		6.8
Sewage treatment	2.9	
Small water sheds	1.0	
Water systems	2.9	
Airports		4.6
Total		100.0%

Source: Pennsylvania Bureau of State and Federal Economic Aid.

CHART 1

Employment Growth in the Appalachian Portion of Pennsylvania
Was Better in the Sixties Than in the Fifties.



Source: Estimates based on data from U.S. Dept. of Labor and Penna. Dept. of Labor and Industry.

The rise in job opportunities in Pennsylvania prevented the labor force from declining as in the fifties. However, the work force grew by only 1 per cent compared with a 13 per cent gain nationally. This small increase in the local labor force indicates a continued out-migration of the working-age population. If, instead of this out-migration, the labor force had grown at the national rate, a quarter of a million more people would have had to have been employed in the Appalachian portion of Pennsylvania in 1968 than were actually at work last year in

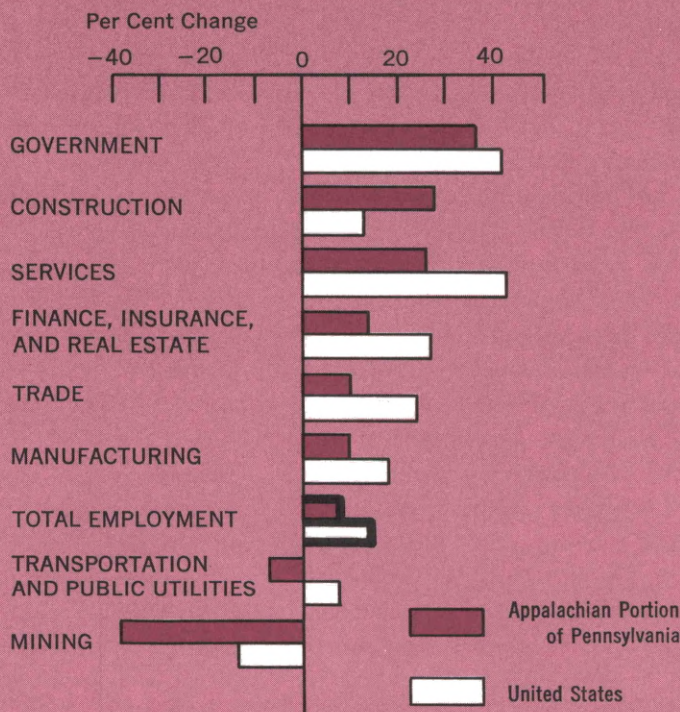
order to have held the unemployment rate at 3.6 per cent.

Such a large increase in employment was not forthcoming (see Chart 2). Only in construction jobs did Pennsylvania surpass the United States. Therefore, the dramatic drop in the unemployment rate was caused not only by increased job opportunities but also by a large out-migration of people who could not find work in Appalachia.

Although the region is far from healthy, it has improved over the last nine years. What proportion of this improvement can be traced

CHART 2

Employment in the Appalachian Portion of Pennsylvania Failed to Increase at the National Rate From 1960 to 1968.



Source: Estimates based on data from U.S. Dept. of Labor and Penna. Dept. of Labor and Industry.

to the Appalachian Act?

Appalachian Act—success or failure? At this early stage, it is impossible to determine definitively whether the Act has been a success or a failure. To ascertain precisely even the short-run influence would require a controlled test with a comparison of growth rates in the region during the same time period with the Act in effect and without the Act in effect. Unfortunately, this test cannot be made. The Appalachian Act became law in 1965 and has remained law ever

since. There is no way of knowing exactly what growth, if any, would have occurred in the region if the Act had not been in force.

However, we can compare rates of growth in the Pennsylvania portion of Appalachia with those of the nation for the 3 years preceding the Act (1962-1965) and the 3 years following the Act (1965-1968) to see what changes have occurred.

Employment climbed 6 per cent in Pennsylvania's Appalachia from 1962 to 1965 and 5 per cent in the 1965-1968 period. Comparable

U.S. rates were 7 per cent in both periods. The nation grew 1 percentage point faster in the period before the Act, and 2 percentage points faster in the period after the Act. Thus, the gap widened slightly.

Table 3 shows employment gaps for major industries in the two periods. A negative number means that the U.S. did better than the Appalachian portion of Pennsylvania, and a positive number means that the Appalachian portion of Pennsylvania did better. From 1962-1965, local employment increased faster than national employment in manufacturing and construction. Job gains in both durables and nondurables surpassed the U.S. Construction growth also was greatest in industry, as demand for Pennsylvania's metals, machinery, and other manufactured goods rose with national prosperity.

From 1965-1968, only construction employment increased at a faster rate in the Pennsylvania portion of Appalachia than in the nation. In this period, institutional, educational, and industrial building rose. This widespread growth in construction in a period when building ac-

tivity across the nation was low may reflect the impact of Appalachian spending. But the Pennsylvania portion of Appalachia improved its relative performance in only two areas other than construction—finance, insurance, and real estate, and services. The better relative standing in these sectors may or may not be the result of Appalachian spending, since the figures in Table 3 show only what happened to employment before and after the Act, and not why changes occurred. However, Table 3 does indicate that, as yet in Pennsylvania's Appalachia, the Act has not succeeded in its purpose of closing the gap in economic growth between the nation and the region. The Pennsylvania portion of Appalachia still has a lot of catching up to do.

For the region as a whole, employment information is more limited, but more encouraging. In the three years preceding the Act, employment growth in Appalachia matched that of the nation. From 1965 to 1967, regional job growth exceeded that of the U.S. by about one-half of one percentage point. This indicates a

TABLE 3
Gaps in Employment Growth between the Pennsylvania Portion of
Appalachia and the Nation

Industry	Percentage Point Difference	
	1962-1965	1965-1968
All industries	- 1	- 2
Manufacturing	+ 1	- 5
Mining	- 5	-15
Construction	+ 7	+14
Transportation and public utilities	- 4	- 7
Trade	- 4	- 4
Finance, insurance, and real estate	- 5	- 2
Services	- 6	- 3
Government	- 2	- 3

Source: Estimates based on data from U.S. Department of Labor and Penna. Department of Labor and Industry.

slight narrowing of the gap. Whether this small improvement is a result of programs begun under the Act is hard to discern. All we can say for sure is that both Appalachian investment and the gain in employment occurred at the same time.

However, as was already indicated, investment under the Appalachian Act was not the only different factor, and therefore, not the only factor that might have influenced employment growth. For instance, the U.S. economy may have affected the Appalachian economy. While both time periods were prosperous nationally, the pull of national growth may have been stronger in the second time period (1965-1967) than in the first (1962-1965). With continued expansion, the U.S. economy requires more and more resources. Eventually, in order to meet this growing national demand, marginal resources, such as those in Appalachia, are pressed into service.

This reasoning would seem to be consistent with the conclusion of the Appalachian Commission: "Most measurable improvements in the Appalachian economy since the Act passed in 1965 can be attributed mainly to the sustained growth of the national economy. . . ." ⁶

However, it is really too soon to ascertain the full effects of the Act. Not all of the money authorized by Congress has been appropriated. A mere one-quarter of the 1,000 projects approved has been completed. Only 4 per cent of the Development Highway System, upon which so much of the program depends, is finished. In addition, many of the problems which the Act seeks to correct are environmental—such as geographical isolation, mine fires, soil erosion,

inadequate health and educational facilities, and a lack of all types of public services. The effects of improvement in these areas may not show up for many years.

WHAT OF THE FUTURE?

The recovery potential in the Pennsylvania portion of Appalachia appears more hopeful than in the past. Old problems in mining and rails are believed to have run their course. Economic diversification is starting to become a reality in parts of the region. Pennsylvania communities are making progress in revitalizing themselves, improving public services, and developing industrial sites. New highways place many Appalachian towns on a direct route from New York to Chicago, offering opportunities for industrialization, distribution, and recreation. Pockets of prosperity, such as those near State College and in the Poconos, already exist. With continued growth, this prosperity may permeate the surrounding area.

One potential hinderance to sustained growth in parts of the region is out-migration. While it reduced joblessness in the fifties and sixties, this exodus may restrict job growth in the future. Just as people need employment to remain in an area, so industry needs a labor supply to expand in an area. In the near future, some areas in Pennsylvania may have difficulty with industrial growth because of labor shortages.

The state government is trying to keep Pennsylvanians at home by emphasizing vocational education. To a certain extent, training and mobility are last-resort substitutes. If local jobs are available, but require new skills, an unemployed worker has two choices—either to move someplace else where his present abilities are in demand or to retrain for a job in his home-

⁶ *Annual Report 1968*, Appalachian Regional Commission, pp. 5-6.

town. Pennsylvania hopes to tip the scales in favor of training by providing ample opportunity for people to learn new skills. Training will aid individuals to find employment. At the same time, a skilled labor force could make the area considerably more attractive to industry. As jobs become more abundant, people will be less likely to leave, and eventually in-migration may come about.

Whether all or most of Appalachia will achieve this type of sustained growth in jobs

and population we do not yet know. Certainly, the Appalachian Act is trying to foster a vigorous economy, but it is not a cure-all. It is only an aid in removing the region's worst handicaps. Once Appalachia has adequate access, a healthy physical environment, and a skilled labor force, the area still will have to compete with the rest of the nation for jobs and income. However, if Appalachians are able to succeed, bleak towns and wasted lives will exist only as dark memories.

**NOW AVAILABLE:
GUIDE TO INTERPRETING
FEDERAL RESERVE REPORTS**

A 43-page booklet entitled, "Guide to Interpreting Federal Reserve Reports," has been prepared in the Research Department of the Federal Reserve Bank of Philadelphia. This booklet is designed to aid readers in understanding significant financial and economic developments as reflected in two Federal Reserve reports which receive wide circulation—the Weekly Condition Report of Large Commercial Banks and the Consolidated Statement of All Federal Reserve Banks.

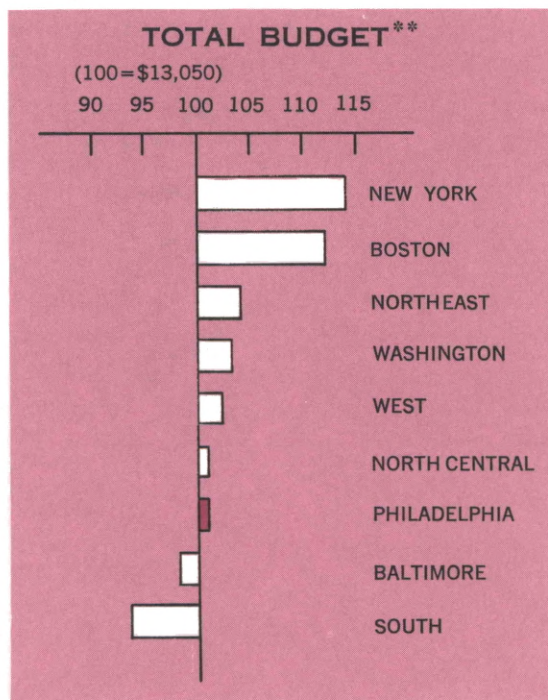
Copies of the booklet are available upon request to the Public Information Department of the Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

The cost-of-living in Philadelphia is an important aspect of the area's attractiveness as a labor market. It affects the real value of each worker's paycheck, and, consequently, partly determines the amount of money employers in Philadelphia must pay to attract workers to the area. Here the cost of living at a high standard in Philadelphia is compared to the cost of living at the same standard in other large cities for the spring of 1967.*

The Value of the Philadelphia Dollar

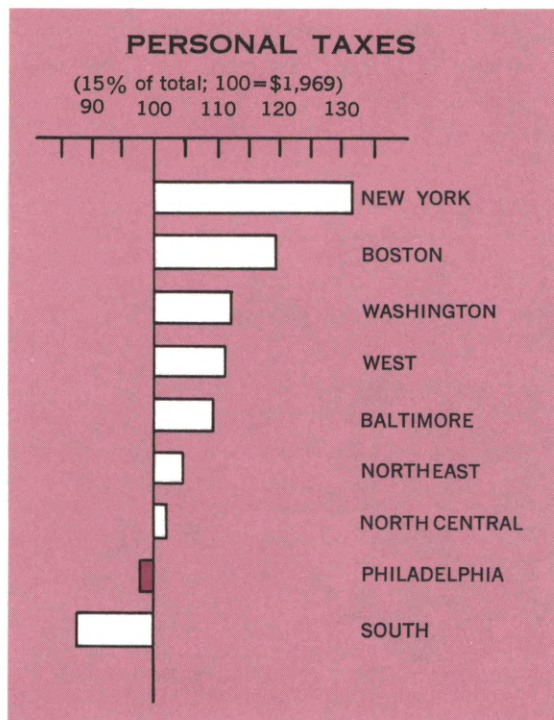
by Anne M. Clancy

The Philadelphia metropolitan area compares favorably with large east coast cities and with regions throughout the nation in total cost of living.



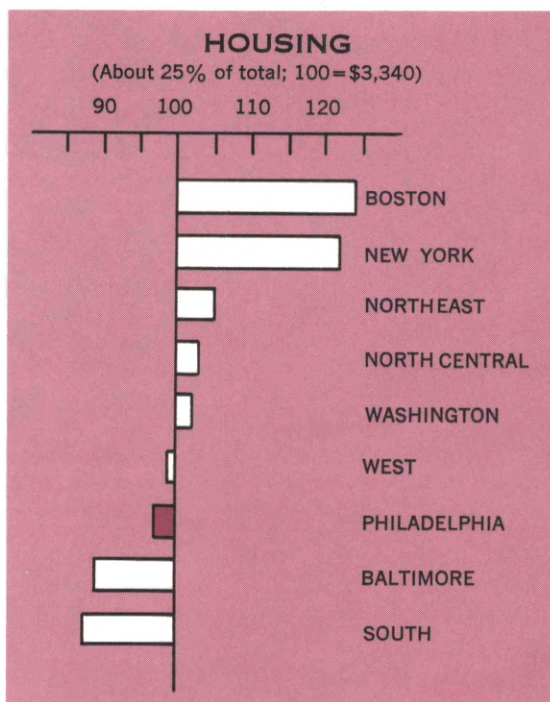
* The high standard corresponds, approximately, to the level of living of highly-trained professional, technical, and management personnel who are most locationally sensitive to differences in living costs. Data for 1967 are the most recent available.

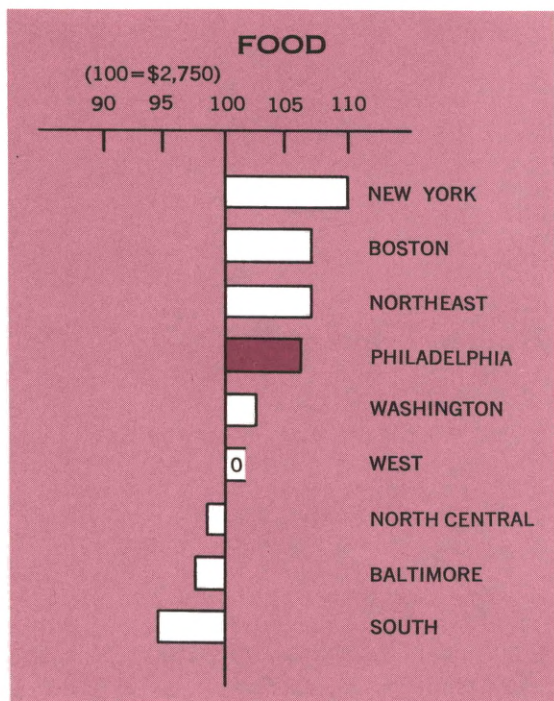
** The total family budget represents the estimated dollar cost required to maintain a family of four, consisting of a husband, age 38, who was employed full-time, his wife who was not employed outside the home, a boy 13, and a girl 8 years of age, at a high standard of living.



The two biggest pluses behind Philadelphia's position are personal taxes

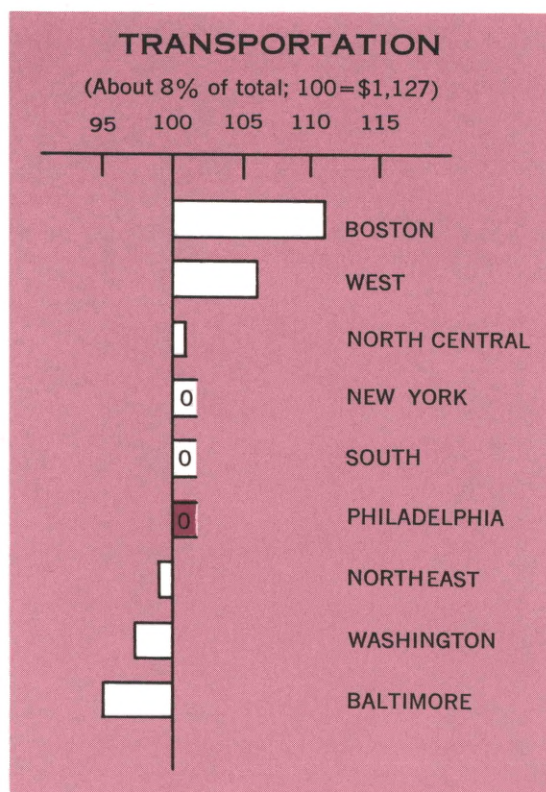
and housing, which together account for 40 per cent of all spending.

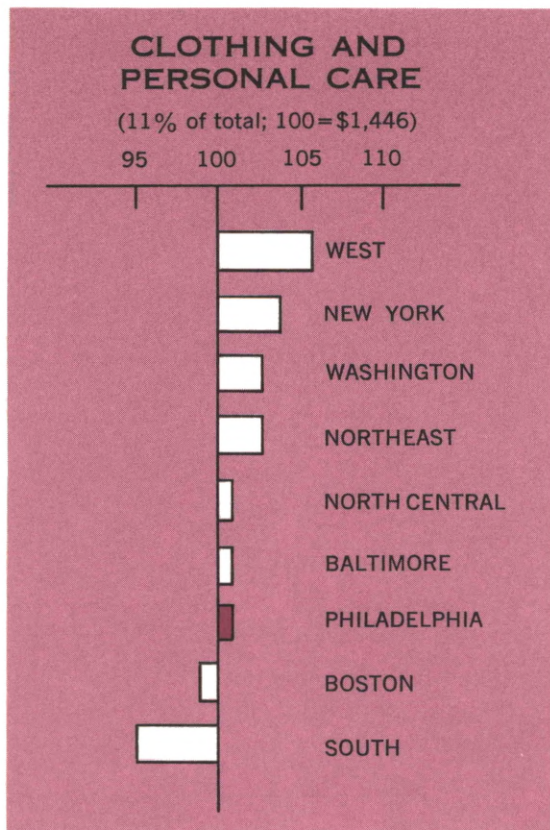




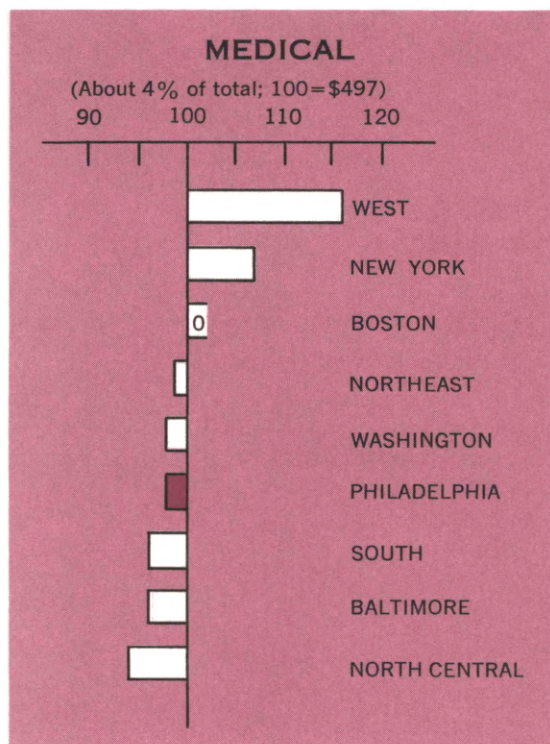
Expenditures for food, amounting to 20 per cent of consumer spending, partially offset the saving on housing and taxes.

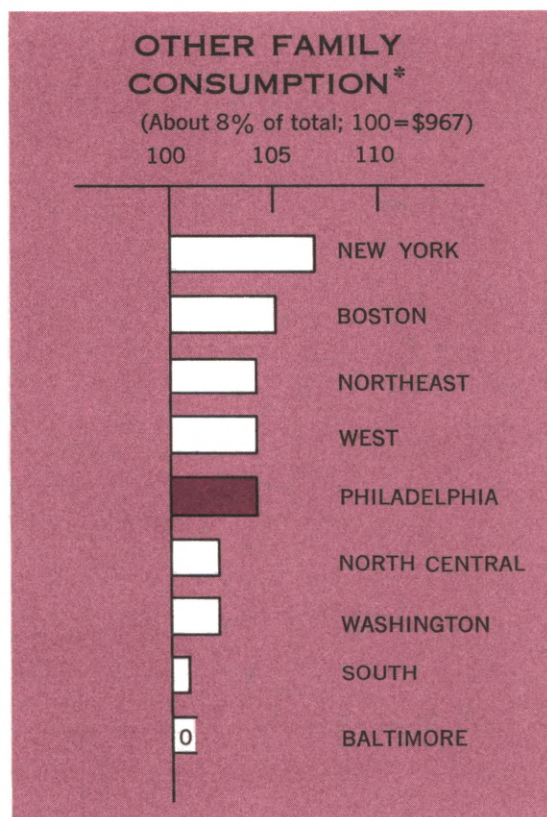
Costs in Philadelphia for other major items are





more in line with the other areas.





This favorable standing for Philadelphia in 1967 has probably been maintained, as the area's index of consumer prices has grown at a rate roughly comparable to that of other urban areas in the nation.

Source: Three Standards of Living, U.S. Department of Labor Bulletin No. 1570-5.

* Other family consumption consists of reading, recreation, education, tobacco, alcoholic beverages, and other costs of leisure.

Balance of Payments- In Deficit or Surplus?

by Mark H. Willes

When an individual looks at his income and expenditures for the past month and finds that they do not match, it does not take an advanced degree in mathematics to conclude that he is *either* in the red *or* black, not both.

This is not true in the international area. When the United States looked at its international receipts and expenditures for the three months ending June 30, 1969, it found it had a deficit of \$3.7 billion *and* a surplus of \$1.2 billion. And that sounds tricky. It is not so strange as it appears, however. Things like this can happen because analysts have devised more than one way to measure the international payments position of a country. The result often is confusion about where the U.S. actually stands in its international dealings.

LIQUIDITY VS. OFFICIAL SETTLEMENTS DEFICITS

Today, primary attention is focused on two gauges of the U.S. balance-of-payments position—the liquidity and official settlements measures. To understand the differences in these two measures, consider the case of the individual who has just calculated his income and expenditures for the preceding month and finds he has run a deficit. He has had to finance that deficit in one of two ways: (1) by reducing his assets (for example, by drawing down the average balance in his checking account), or (2) by borrowing (perhaps formally at a bank or department store or informally by running up a bill with his doctor).

While he may not like the result, there is no ambiguity about his position. In balance-of-payments accounting, things are not so straightforward. The disagreement comes in defining which international transactions *give rise* to the deficit and which ones *finance* the deficit. Differences in treatment can be seen in the table.

U.S. BALANCE OF PAYMENTS

Second Quarter 1969

(Millions of Dollars)

Transactions	Liquidity Basis ¹		Official Settlements Basis ²	
	Net Balance	Financing Item	Net Balance	Financing Item
Goods and Services	722		722	
Unilateral Transfers and U.S. Government grants	- 1,761		- 1,761	
Errors and omissions	- 698		- 698	
U.S. Private Capital Outflows:				
Long-term Assets	- 1,524		- 1,524	
Short-term Assets	- 535		- 535	
Foreign Capital Inflows:				
Long-term Liabilities Except to Official Foreign Agencies	507		507	
Long-term Liabilities to Official Foreign Agencies	- 359			- 359
Short-term Liabilities:				
To Foreign Commercial Banks		4,567	4,567	
To Other Private Foreigners		- 147	- 147	
To International and Inter-regional Organizations		82	82	
To Foreign Official Agencies		- 556		- 556
U.S. Official Reserve Assets		- 299		- 299
TOTAL	- 3,648	3,647	1,213	- 1,214

¹Liquidity deficit is the sum of increases in liquid liabilities to all foreign accounts and decreases in official reserve assets.

²Official settlements deficit is the sum of increases in liabilities to official foreign accounts and decreases in official reserve assets.

Everyone agrees that flows of funds related to exports and imports of goods and services, transfer payments, and Government grants are part of the receipts and expenditures which give rise to the deficit. Most observers also agree that most flows of funds associated with long-term capital movements are in this category too. Each of these categories, therefore, has an entry on the left side of the columns in the table, indicating that each helps determine the size of the deficit.

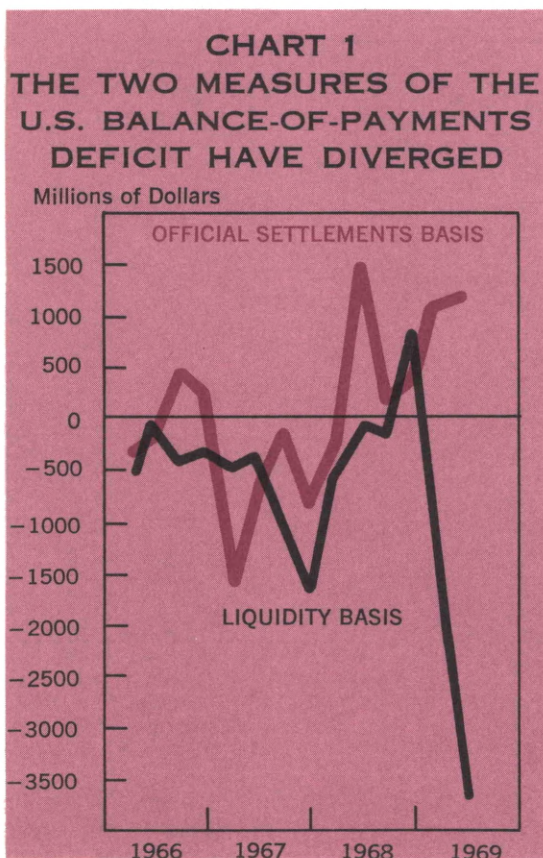
There is also complete agreement that gold, convertible foreign currencies, and borrowing

rights at the International Monetary Fund (IMF)—that is, official reserves—are assets which can be used to finance a deficit. This is indicated by the entries on the right side of the columns in the table.

Disagreement comes primarily over how funds flows associated with short-term capital movements are treated.¹ On both the liquidity and

¹One area of disagreement not discussed in the text relates to the treatment of long-term liabilities to official foreign accounts. Usually they are relatively minor. On the liquidity basis it is considered as part of the deficit, while on the official settlements basis, it is put into the financing category, as seen in the table.

official settlements bases, short-term capital outflows are considered part of the transactions which give rise to a deficit. Short-term capital inflows are treated quite differently under the two methods, however.

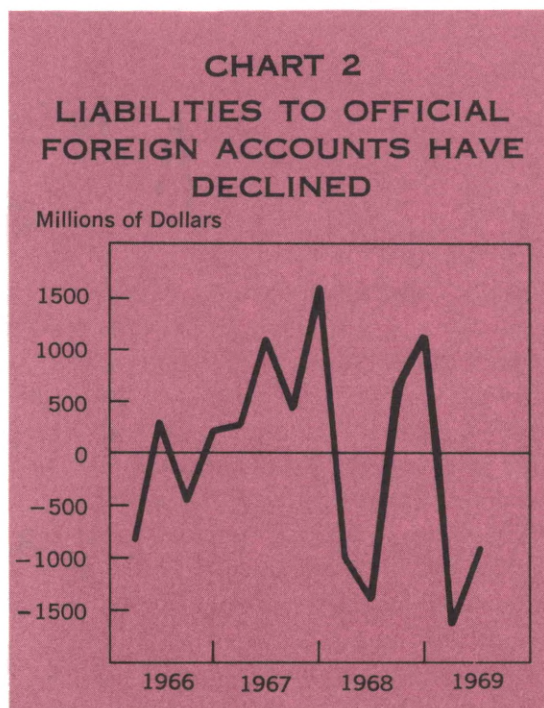


Analysts who consider the official settlements basis as the best measure of the U.S. payments position argue that a deficit is financed by drawing down official reserve assets or by borrowing (increasing liabilities) only from foreign official agencies. The rationale is that dollar liabilities held by official foreign agencies represent the only direct claim on U.S. reserves, since the U.S. will only sell gold to such agencies, not to private individuals or firms.

Those who prefer the liquidity basis as a measure of the U.S. payments position argue that non-official holders of short-term dollar claims can easily turn them into their central bank, so that these claims, too, represent a significant potential claim on gold. Consequently, these analysts argue that a deficit is financed not only by borrowing from foreign official agencies, but also by short-term borrowing (in other words, increasing short-term liabilities) from *private* foreign individuals and organizations as well, as shown in the table.

SCHIZOPHRENIC 1969

The divergent behavior of the liquidity and official settlements measures can be seen in Chart 1. While both indicated an improvement in the international payments position of the U.S. dur-

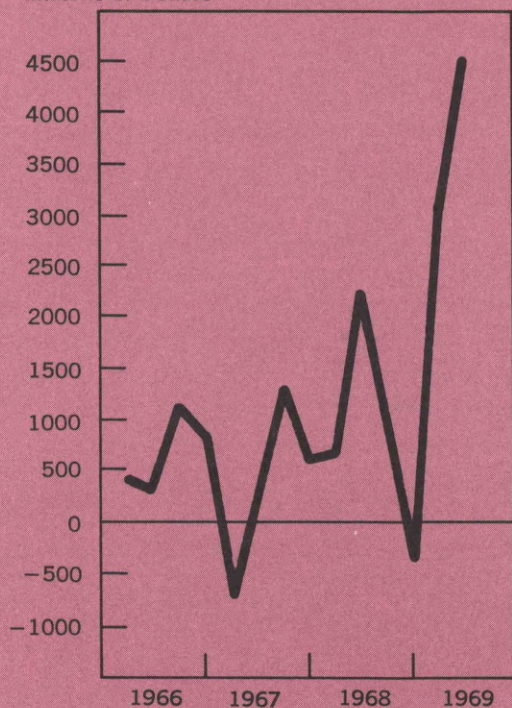


ing most of 1968, for the first half of 1969 the measures moved in opposite directions.

Chart 2 shows a sharp decline in liabilities to official foreign accounts occurring in 1969. This decline in borrowing from official sources was the "cause" of the surplus on the official settlements basis. Chart 3 shows the marked increase

CHART 3
LIQUID LIABILITIES TO
FOREIGN COMMERCIAL BANKS
HAVE CLIMBED RAPIDLY

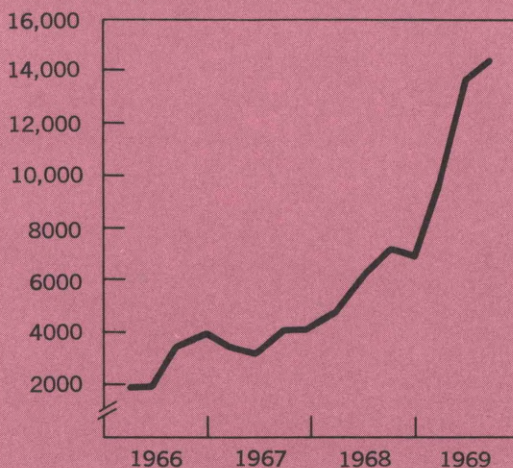
Millions of Dollars



in liquid liabilities to private foreign commercial banks during the first half of this year, reflecting primarily increased liabilities of U.S. banks to their foreign branches which, for

CHART 4
LARGE COMMERCIAL BANKS'
BORROWING FROM THEIR FOR-
IGN BRANCHES HAS SOARED

Millions of Dollars



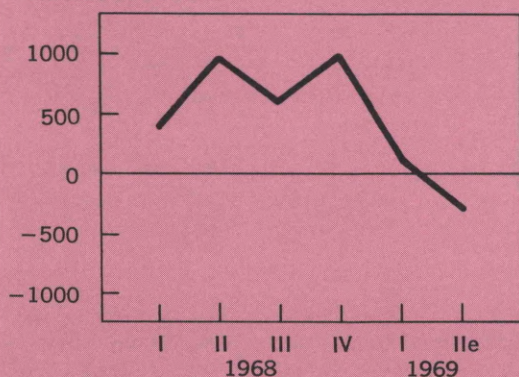
balance-of-payments purposes, are considered foreign banks (see Chart 4). This increase in liabilities was the primary "cause" of the deep liquidity deficit in the first half of 1969.

Both the decrease in liabilities to official foreign accounts and the increase in liquid liabilities to foreign commercial banks were caused by vigorous bidding by U.S. banks for Euro-dollars as they sought funds in a period of restrictive monetary conditions. By bidding for Euro-dollars, U.S. banks boosted liabilities to foreign commercial banks and, at the same time, attracted into the Euro-dollar market (because of high rates) some funds that otherwise would have gone into the holdings of foreign central banks. The result is a worsening of the liquidity deficit and an improvement in the official settlements deficit.

One additional factor that helps explain the worsening of the liquidity deficit is the Government's decision not to engage in "special transactions." In earlier periods, these special transactions primarily stemmed from efforts to get foreign holders of short-term liabilities of the United States to switch into liabilities with maturities of more than one year, thereby taking them out of the liquidity deficit. As seen in Chart 5, the volume of these special transactions has declined sharply in 1969, removing a prop from under the liquidity deficit.

**CHART 5
"SPECIAL" GOVERNMENT
TRANSACTIONS HAVE
DROPPED OFF**

Millions of Dollars



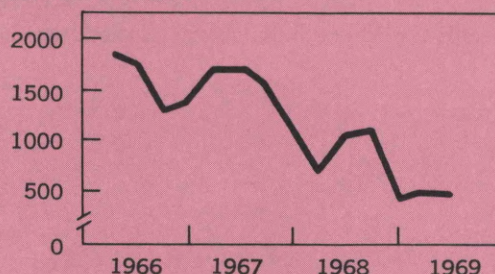
WHERE ARE WE?

When the two measures of the U.S. payments position give conflicting signals, the question is: What is the real position? While any estimate is hazardous, the answer probably is that the true position is somewhere in between the liquidity and official settlements markers.

On the one hand, the payments position has probably not been so rosy as suggested by the official settlements measure. The account on

**CHART 6
BALANCE ON GOODS AND
SERVICES CONTINUES TO
SLUMP**

Millions of Dollars

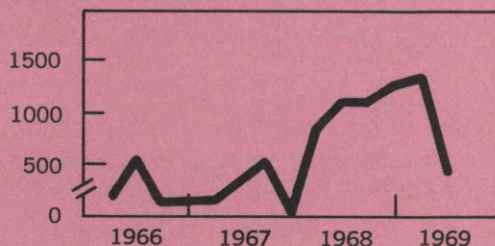


goods and services is weaker now than it has been for years (Chart 6). Although the long-term capital account was strong for a while as foreign investors rushed funds into a rising stock market, these inflows have dropped off in the last few months (Chart 7). Extremely high Euro-dollars rates have lured dollars away from official foreign accounts, but this might be only a transitory by-product of the current assault on inflation. The basic long-run position has not been so strong, therefore, as it should have been.

On the other hand, the international position

**CHART 7
FOREIGN PURCHASES OF U.S.
SECURITIES (EXCLUDING
TREASURY ISSUES)**

Millions of Dollars

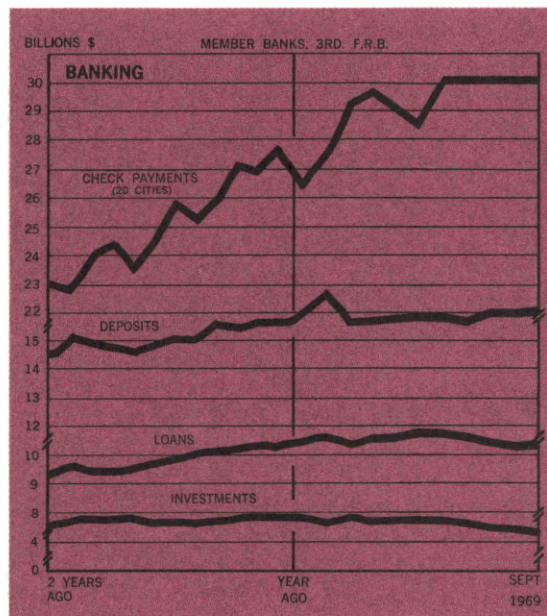
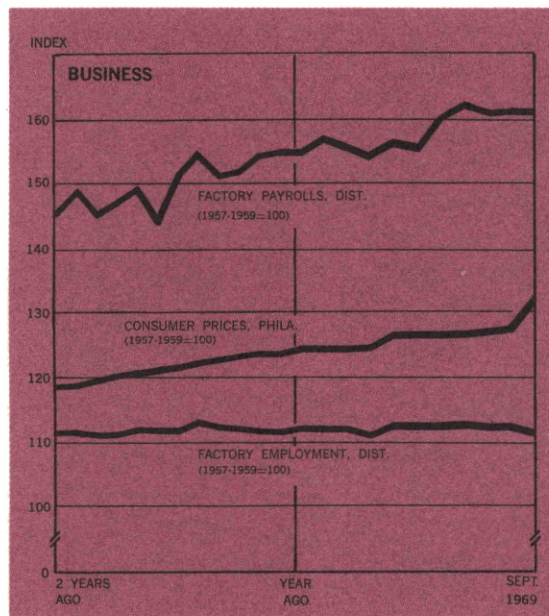


of the U.S. has not deteriorated so much this year as the liquidity deficit suggests. For some time prior to this year, special Government transactions made the liquidity deficit look better than it was. In 1969, lack of these special transactions has artificially caused the deficit to worsen. The change in the fundamental position of the U.S. between 1968 and 1969 has not been so great, therefore, as the figures suggest. In addition, high Euro-dollar rates have caused some short-term funds which would otherwise have stayed here to flow out of the U.S. into the Euro-dollar markets. Presumably this outflow

is a temporary phenomenon which will be reversed once Euro-dollar rates fall more in line with domestic rates. In the meantime, this outflow will continue to make the liquidity deficit appear larger than it otherwise would be.

Solid figures for the third quarter of 1969 are not yet available. Early indications are, however, that the U.S. must continue to wrestle with the stubborn problem of correcting its international payments position. And to compound the difficulty, this effort must often proceed in the face of considerable uncertainty as to how big the problem really is.

FOR THE RECORD ...



SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	Sept. 1969 from		9 mos. 1969 from	Sept. 1969 from		9 mos. 1969 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
MANUFACTURING						
Production .....	.....	.....	.....	+ 3	+ 5	+ 5
Electric power consumed	+ 2	+ 9	+ 7	.....	.....	.....
Man-hours, total*	- 1	0	0	.....	.....	.....
Employment, total	- 1	0	- 3	.....	.....	.....
Wage income*	0	+ 7	+ 7	.....	.....	.....
CONSTRUCTION**	-19	-54	+ 2	-21	- 1	+12
COAL PRODUCTION	- 2	- 6	- 1	- 2	- 5	- 4
BANKING						
(All member banks)						
Deposits	- 1	0	+ 5	+ 1	0	+ 5
Loans	+ 1	+ 8	+11	+ 1	+12	+13
Investments	- 2	- 4	+ 3	- 1	- 7	+ 1
U.S. Govt. securities..	- 5	-14	- 7	- 3	-17	- 9
Other	+ 1	+ 5	+11	0	+ 2	+ 9
Check payments***	†	†	†			
PRICES						
Wholesale .....	.....	.....	.....	0	+ 4	+ 4
Consumer	+ 1‡	+ 6‡	+ 5‡	0	+ 6	+ 5
*Production workers only **Value of contracts ***Adjusted for seasonal variation						
†15 SMSA's ‡Philadelphia						

LOCAL CHANGES	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
	Per cent change Sept. 1969 from		Per cent change Sept. 1969 from		Per cent change Sept. 1969 from		Per cent change Sept. 1969 from	
	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago	mo. ago	year ago
Wilmington ..	0	0	+ 7	+ 4	0	+36	- 1	+ 3
Atlantic City..	.....	.....	.....	.....	+ 2	0	0	+ 6
Trenton	0	+ 2	+ 2	+ 1	- 6	+17	- 9	0
Altoona	- 2	0	- 3	+ 4	+ 8	+16	0	+ 7
Harrisburg ...	- 2	- 1	- 2	+ 8	+ 6	+16	+ 2	+10
Johnstown ...	0	+ 6	- 1	+24	+ 6	+16	0	+12
Lancaster ...	- 1	+ 2	0	+12	+ 9	+20	+ 1	+10
Lehigh Valley.	- 1	0	0	+10	0	+ 9	+ 1	- 7
Philadelphia .	- 1	- 2	0	+ 5	- 1	+14	- 1	- 2
Reading	- 2	- 1	- 1	+ 2	+ 4	+16	+ 1	+10
Scranton	- 1	+ 1	+ 1	+ 6	+ 4	+ 4	+ 1	+ 2
Wilkes-Barre .	- 2	+ 2	- 1	+ 8	- 1	+14	+ 1	-20
York	- 1	+ 3	0	+10	+ 9	+20	+ 1	- 7
*Not restricted to corporate limits of cities but covers areas of one or more counties. **All commercial banks. Adjusted for seasonal variation. ***Member banks only. Last Wednesday of the month.								