

**STATE DOLLARS
TO SCHOOL DISTRICTS**

**POPULATION GROWTH IN THE
THIRD DISTRICT: SCORECARD
FROM THE CENSUS**

THE HOUSEHOLD AS A SAVER

THE FED IN PRINT



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. . . A heady combination of programs characterize Commonwealth attempts to equalize educational opportunities across the state, but criticisms remain.

**Population Growth in the Third District:
Scorecard from the Census**

. . . Recent trends reveal new areas of growth and relative decline in both District and nation.

The Household As A Saver

. . . Expected changes in family characteristics suggest that financial institutions may be put to a further test in the race for household savings.

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State Dollars To School Districts

by Kathryn L. Kindl

The United States public education bill more than doubled in the last decade. Rapidly rising costs, as well as increasing demand for quality education, spelled faster paced spending. In Pennsylvania alone, expenditures for public education charted an upward course from \$353 million in 1950 to \$821 million in 1960, and in 1970 reached \$2.052 billion.

Local school districts shoulder the responsibility of actually providing education services, but, individually, most school districts cannot or are not willing to generate enough new revenues to meet mounting expenditure pressures. Since Federal funds offer only minimal aid, local educators turn to state governments for fiscal relief. And the response has been impressive. So steady has been the growth of state support that Commonwealth aid currently covers almost 50 per cent of the nonfederal public education bill (see Chart 1).

Additional State dollars certainly help school districts meet burgeoning costs and

responsibilities. But the impact of these funds depends both upon their amount and the way they are distributed. On both counts, critics are outspoken. Many protest that the local share of education costs continues to exceed limited district resources. Some authorities dispute the way in which State funds are funneled to school districts. Municipal officials, in particular, claim many of their special problems require more consideration.

WHY STATE SUPPORT AT ALL?

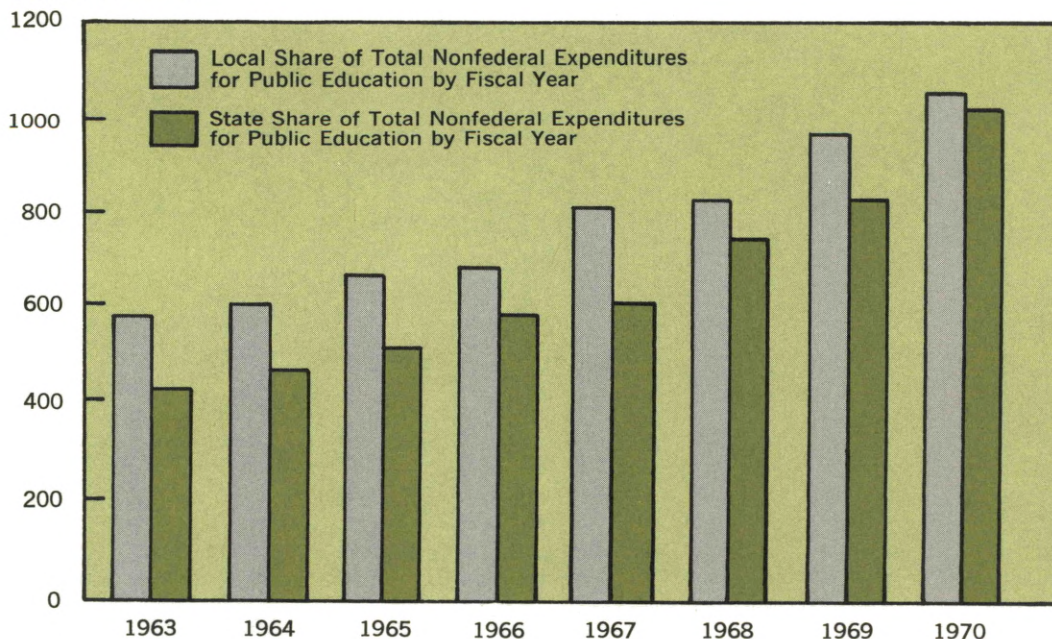
"The General Assembly shall provide for the maintenance and support of a thorough and efficient system of public education to serve the needs of the Commonwealth."¹ To fulfill this Constitutional obligation, and to assure a measure of equality of educational opportunity across the state, Com-

¹ Constitution of the Commonwealth of Pennsylvania 1968, Article III, Section 14.

CHART 1

COMMONWEALTH COFFERS ABSORB A LARGE SHARE OF THE PUBLIC EDUCATION BILL.

Millions of Dollars



Source: Statistical Report, Pennsylvania Department of Education, 1970.

monwealth goals include provision of at least a minimum education offering to all Pennsylvanians. Two problems facing local jurisdictions, however, may thwart achievement of this goal. First, many of the benefits of education provided in one locale may spill over into nearby and distant communities, making the original area less willing to support single-handedly its public school programs. Second, local jurisdictions are not equally capable of financing even a minimum of education opportunities.

Benefit Spillovers. School districts hire teachers, purchase texts, and construct buildings in the rendering of education services. The return on each of these investments takes the form of a more productive and wealthy citizenry. Not only does each young

student chalk up lifetime income gains, but the community at large benefits from his increased tax payments, reduced demand for public programs, and perhaps greater participation in local government.

Population mobility spreads benefits of education — sometimes far beyond spending district boundaries. A draftsman trained in York, for example, may choose to settle and apply his skills to a job in Erie. Indeed, increasing migration results in more and more of each community's students departing for distant towns and cities — before repaying their hometown economy, in the form of taxes, for what they received in education services.

When many returns on a community's investment in education do not benefit local

taxpayers, sole reliance on local support may jeopardize both quantity and quality of services provided. Less schooling than the total amount desired by all beneficiaries may be provided unless all of those beneficiaries pick up part of the bill. Efforts to shift public school financing to higher levels of government reflect one attempt to encourage allocation of resources to education despite local spillovers. Because states encompass many locales, benefits are less likely to spill out of these larger areas than out of local school districts. And, utilizing broader taxing powers than those available to local units, states can reimburse local areas particularly hard-hit by education outflows.

Unequal Fiscal Capacity. Sizable differences often exist among local districts in resources that can be taxed to raise revenue for education. Aging urban areas, with declining tax bases but growing low-income populations, are hard pressed to keep up public service levels. These and other municipalities also may contain vast acres of tax-exempt real estate, depleting the base upon which property taxes, the mainstay of local finance, can be levied. Some rural communities, too, face declining property values and find supporting a full-fledged education program increasingly difficult. Yet, at the same time, property-rich suburban enclaves easily meet the costs of more and better public education services.

In Pennsylvania, a school district's "fiscal capacity" is legally determined by the value of its "taxable real property per pupil," standardized across the state for differences in assessment. Although the statewide average value of this measure stands at \$16,700, wealthy districts report real property values per pupil several times greater than those of poor locales.² Certainly, without outside aid, such inequalities may severely influence

local tax efforts. Community X, with an available tax base of only \$9,500 per pupil, may resort to onerous levies to support a level of education expenditures Community Y, with a base of \$32,000 per pupil, easily maintains. In the extreme, districts with bumper enrollments but ailing tax bases may not be able to support even a minimal offering.

To lessen the burden of these inter-district inequalities, and to assure some predetermined level of expenditures per pupil, a state may aid some or all of its school districts. In fact, equalization of local tax burdens in support of a basic package of education services is an explicit goal of the subsidy plan in Pennsylvania, as in many other states.

ABC'S OF THE PENNSYLVANIA SUBSIDY

The Commonwealth relies upon a heady combination of programs to lessen the uncertainties of benefit spillovers and to insure that less wealthy areas are able to meet their education responsibilities. A basic or "foundation" program of services, financed by Pennsylvania and each school district according to its ability, lies at the heart of the subsidy plan. As shown in Chart 2, over 65 per cent of State funds for public education team up with local dollars to offer each child a minimum bundle of education opportunities. Another 9 per cent of Commonwealth school aid helps local districts cope with special cost problems associated with providing education services to both low-income and very concentrated and very sparse populations. And the remaining State education dollars, more than 25 per cent of the total, help support special programs, such as construction and transportation services.

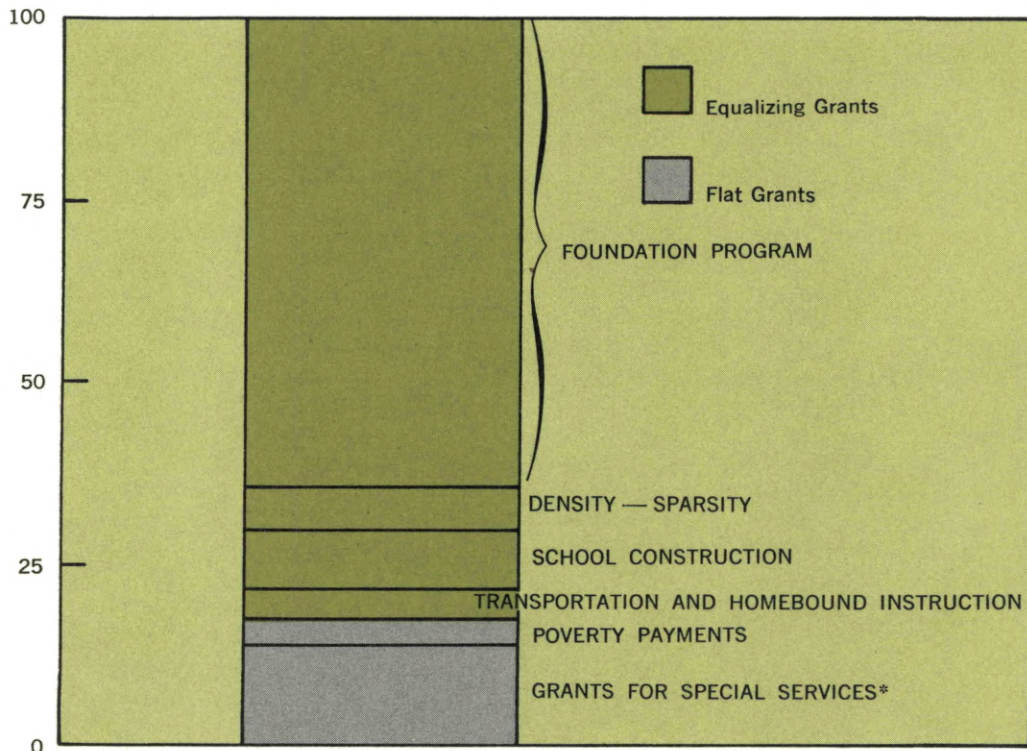
The "Foundation" Program. A foundation package ideally encompasses all of the education services essential to each student's development. Actually, in the Pennsylvania program, "equal opportunity to education"

² Taxable real property ranges below \$10,000 per pupil in some school districts, above \$70,000 per pupil elsewhere.

CHART 2

MOST STATE DOLLARS TO SCHOOL DISTRICTS TAKE ACCOUNT OF LOCAL FISCAL CAPACITY.

Per Cent



Source: Pennsylvania Public School Finance 1969-70, Pennsylvania Department of Education and U.S. Office of Education.

*These include grants for special education programs; community colleges and technical institutes; vocational education; health services; education of the deaf, blind, and palsied; tuition for nonresident orphans and foster children; county supervisory expenses; drivers' training; education of children of migrant laborers; sanitary sewage disposal plant operation; aid to financially distressed districts; and payments in lieu of tax funds. In 1970 special funds also were granted to Philadelphia and Pittsburgh. Payments for public school employees' retirement and social security are not included.

is measured in *dollar* amounts. The foundation level included in the subsidy system approximates the average amount spent per pupil, throughout the state, on basic instruction costs — teachers' salaries, supplies, and other schoolroom costs.³

³ Actual instruction costs, for purposes of subsidy grant determination, include all General Fund expendi-

On the whole, the Commonwealth aims to shoulder half of foundation program expenditures. The exact share of a particular

tures except health service, transportation, and homebound instruction costs, debt service, capital outlay, and outgoing transfers to community colleges and technical institutes. From this subtotal, tuition payments received and intergovernmental transfers for special programs must be deducted.

district's instruction costs that may be charged off to the State depends upon the relative ability of that local unit to carry its own load. If a district's fiscal capacity falls below that of the "average district," Commonwealth aid will add up to more than 50 per cent of local instruction expenses. Conversely, should the local fiscal base exceed the "average," State aid will fall short of half basic expenditures. Although districts with higher ability receive only limited aid, then, poorer units may reap substantial benefits.

In short, the foundation program clearly establishes a commitment to at least a minimum opportunity for education within the Commonwealth. Pennsylvania contributes to the basic instruction program of each student in a district in inverse proportion to the local unit's ability to pay. This local tax capacity is measured by the market value of taxable real estate per pupil relative to the statewide average. Because the Commonwealth will share only those basic expenses below some maximum dollar amount, one final provision allows any district to choose to offer, and finance independently, a more extensive program of instruction services.

Density, Sparsity, and Poverty Grants. These subsidies are designed to tackle special cost problems including transporting students in far outlying communities, adequately compensating urban school staffs for higher costs of living and poorer working conditions, and operating educational enrichment programs for disadvantaged youth throughout the state. In addition, temporary supplements, such as 1970 "Operation Bootstrap" payments to jack up expenditure levels in low-spending districts, sometimes boost total public instruction outlays.

According to provisions of the *density* payment plan, districts with more than 10,000 people per square mile are reimbursed for a share of instruction expenses over \$400 per pupil. Districts whose enroll-

ments exceed 50,000 pupils receive a special boost — a "super-density" payment of 15 per cent of total instruction costs. And rural jurisdictions may benefit from *sparsity* subsidies, grants available to districts with less than 50 residents per square mile, regardless of school district size.

Both density and sparsity subsidies are designed to reflect varying fiscal capacities. The *poverty* payment, however, is a flat grant per pupil, distributed without regard to the relative wealth of any local district. The Commonwealth allocates a subsidy of \$120 to each district for every school-age child in the area whose family receives annual income of less than \$2000 or Aid to Dependent Children funds.

All of these grants are functional subsidies, limited only in that they must be used to beef up education services. In some areas they pack a heavy punch. Philadelphia, for example, expects to gain over \$34 million in 1971 density payments alone. Overall, however, these grants account for less than 9 per cent of State support of public elementary and secondary education.

Grants for Special Services. Fifteen other subsidies are earmarked for special programs. Three of the 15 — the subsidies for construction, transportation, and homebound instruction — reflect varying fiscal capacities among local jurisdictions, and total over 40 per cent of all special purpose funds. The remaining categorical grants are flat grants, based on quantitative measures, for example, numbers of pupils or a percentage of total costs. Services such as driver education, special education of exceptional children, health care, vocational education, and community college and technical instruction are all supported, in part, by these State dollars.

CHALKING UP THE CRITICISMS

The "how" and "how much" of the Pennsylvania subsidy system underline the Commonwealth's commitment to provide education services to all Pennsylvania youth. But

many educators and financial planners give the current State system less than an "A" rating. Some remain unconvinced that real estate values best measure local ability to support education. Other authorities fault some of the subsidy's cost-related features, and municipal officials strive for more effective recognition of the problems facing urban educators. Rural educators, too, stress that their expenditure problems merit more attention. Still others question whether or not the Pennsylvania plan, as presently designed, can ever achieve "equality of educational opportunity."

Real Estate — the Best Yardstick? In each school district, the State aid package depends in great part upon the value of local real estate. But is this measure really the best gauge of all resources available to support education? Real estate levies tap only one part of each community's wealth. Stocks, bonds, and savings accounts, for example, are other means of holding wealth. Moreover, to the extent that wealthy individuals hold more of their assets in these non-real-estate forms than do poorer citizens, taxes on land and buildings may capture much more of the wealth of poor than of rich locales. Consequently, the State plan, in effect, may favor wealthy districts.

Equity considerations aside, however, administrative problems associated with a tax on real estate are numerous. The market value of real property often is difficult to measure and, hence, may be subject to political manipulation. Assessment procedures may vary from community to community. Thus, the assessed value of real estate, and its market value as determined by the State Tax Equalization Board, may be by no means equalized. And because no State agency has the power to change local assessments, entrenched practices may limit access to potentially taxable resources. In view of all of these problems, many observers urge investigation of other levies.

Too Little, Too Late? Several provisions of Pennsylvania legislation governing grants to

public schools may thwart achievement of State subsidy goals. Two in particular—cost measurement and cost reimbursement patterns—may shortchange less wealthy or high-cost areas.

In the foundation plan, the State aid formula applies to actual instruction expenses per pupil or a maximum amount fixed periodically by the General Assembly to represent average instruction costs per pupil. Currently, the level of State support is limited to the first \$550 of basic instruction expenses. No matter how steep the costs of a district's program, and how limited that district's resources, the State share will be cut off at the \$550 level.⁴ Moreover, because no built-in mechanisms take account of increases resulting from inflationary pressures, which have dealt education and other public services a particularly hard blow, maximum State aid may fall below even average instruction costs.

A delayed reimbursement schedule compounds these troubles. Most State reimbursements are based on the previous year's expenditure pattern and are not paid until these tallies are in. For example, 1969-70 appropriations were payable on the basis of 1968-69 attendance data. Such lags in measurement of burden may mean that State payments in any one year fall short of the State share of expenditures incurred during that year. And, in order to meet current costs, a district may have to resort to the costly procedure of deficit financing.

We cannot conclude that because these and other limitations exist, they always come into play. But when such constraints do operate, they hamper efforts to achieve a reasonable match between local resources and expenditure responsibilities, and, in combination, may prove extremely powerful.

⁴ At the other end of the resource spectrum, a district may recoup a minimum of \$55 or 10 per cent of basic instruction costs per pupil, whichever is lower, although its fiscal capacity ranks several steps above that of any other area.

For instance, not only did average instruction costs across the state reach over \$600 per pupil in 1970, but also estimated 1971 instruction expenses run even higher.

The Urban Complaint. Other problems which are concentrated in certain geographic areas also may dampen education activities.⁵ In particular, city school officials claim that State subsidies do not attack several major problems associated with urban education. Municipal overburden and the specialized needs of a disproportionately large number of pupils top the list.

Municipal Overburden. Urban officials in areas such as Philadelphia face the problem of financing "over-used" municipal services — and, as a result, education may suffer. Central cities not only must serve a highly concentrated and diverse residency, but also must respond to the demands of a large nonresident population. Many metropolitan dwellers crowd city streets, work in mid-town business firms, and enjoy city recreation and cultural centers. If nonresidents' city tax payments fall short of nonresidents' use of in-town services, the municipal service burden grows. "Municipal overburden" takes over as relatively larger and larger proportions of tax resources are preempted to finance police and fire protection, street maintenance, sanitation, and other custodial services.

Currently, some urban Pennsylvania governments, particularly Pittsburgh and Philadelphia, allocate two-thirds of their total tax revenue to maintain municipal services. Meanwhile, nearby suburban locales use only 40 cents of each tax dollar for

these purposes.⁶ In the present subsidy plan, however, it is implicitly assumed that every jurisdiction has access to all, or an equal percentage, of its tax revenue to meet the costs of public education. No special compensation is tendered to those areas suffering greater-than-average pressures on their tax dollars because of "municipal overburden."

Specialized Needs. The demand for education is far from uniform. In part because of poverty, insecurity, language barriers, and other deprivations, significant numbers of public school students require special attention. And, as has been shown for Philadelphia and Pittsburgh, a great many of these disadvantaged youth are "city kids."⁷ The school districts in urban locales, then, and in other areas facing comparable problems, are pressed to exert extra effort at added cost. And, if equal opportunity to education is indeed a Commonwealth goal, the State must be willing to absorb a significant share, if not all, of these added costs.

The Pennsylvania subsidy plan, however, does not directly admit of the possibility that *unequal* expenditures well may be necessary to provide equal opportunities. The density and poverty payments, at best, are gross and inadequate substitutes for enrich-

⁶ In Philadelphia, taxes for education amount to 28 per cent of total collections; taxes for general services, 72 per cent. In Bucks County, 57 per cent and 43 per cent, respectively; Montgomery County, 57 per cent and 43 per cent; Chester County, 63 per cent and 37 per cent; and Delaware County, 48 per cent and 52 per cent. These figures are for 1968.

⁷ Government Consulting Service, Fels Institute of State and Local Government, "Special Education and Fiscal Requirements of Urban School Districts in Pennsylvania," University of Pennsylvania, Philadelphia, 1964. Twelve per cent of all state pupils but over 40 per cent of pupils in low-achieving districts attend Philadelphia public schools. Suburban students account for proportionally fewer students in low-achieving areas, while students in rural areas account for approximately one-quarter of all state pupils and of pupils in low-achieving districts.

ment programs for disadvantaged youth. Population density affects the costs of school site acquisition and construction, but only indirectly expenditures for instruction. The poverty payment also may miss its target. Not only is the amount small and eligibility criteria very selective, but no guarantee exists that the funds will aid only those students for whom they are intended.

TOWARDS THAT "A+"!

State legislation in support of public education treads a narrow line between political feasibility and economic reality. Consequently, the subsidy system often may fail to meet effectively the problems encountered in school planning policy. And popular suggestions for reform reflect far-ranging criticism.

Proposals focus on both improved allocation of education resources currently available and increased financing of instruction programs. Suggested changes include adjusting the State aid formula to include consideration of municipal overburden, and more closely coordinating State poverty funds and Federal programs which compensate for education problems rooted in social and economic deprivation. Alternatively, it is suggested that the current plan be replaced by one reimbursement based

upon total costs of educating each public school pupil. Observers who question the adequacy and equitability of real estate as a measure of wealth propose personal income taxes, direct taxes on total wealth, Federal block grants, and even complete State financing. Other critics note that the development of adequate information and measuring systems would enable more realistic evaluations of the effectiveness of all education expenditures.

State officials are aware of the shortcomings of school subsidy financing. Accordingly, the General Assembly this year set up the Pennsylvania Commission on School Finance. In addition to determining whether the subsidy system fosters equal opportunity to education throughout the state, this Commission has investigated the merits of the real estate wealth measure, categorical aid programs, and accountability in education activities.

As the demand for education services continues to rise, so also will costs. Yet high tax burdens and steadfast resentment of new encumbrances militate against easy solutions to the problems of school planning policy. Growing attention to the state-wide benefits of education and education expenditure problems is an important step towards bringing "equality of educational opportunity" to fruition. ■

THE STATE SHARE

More than three of every four Commonwealth dollars in aid of education work to equalize differences between local resources and expenditure responsibilities. The share of these funds each district will receive is partially determined by the following formula:

$$\text{STATE AID RATIO} = 1.00 - \frac{\text{District market value per weighted pupil}}{\text{State market value per weighted pupil}} \times .50$$

State aid, then, depends upon both the number of pupils in a district and the wealth of the district compared to other areas across the state. District expenditures are computed per pupil, or more precisely, per weighted pupil. In the Pennsylvania subsidy plan, weights reflect the assumption that costs increase as a student matriculates to higher levels. For example, a weight of .5 is assigned to a kindergartner, 1.00 to an elementary pupil, and 1.36 to a high school student. A district's enrollment is defined as its Weighted Average Daily Membership (WADM).

Fiscal capacity is measured by market valuation of taxable real property, as computed annually for each district by the State Tax Equalization Board. Each unit's relative capacity is determined, as shown above, by dividing district market value per weighted pupil by the comparable statewide average. And, the constant terms reflect the Commonwealth's commitment to support, on the average, 50 per cent of basic instruction expenses.

Having determined the aid ratio, a simple calculation yields the amount of basic instruction aid each district stands to gain. The aid ratio is multiplied by the actual instruction expense per WADM or \$550, whichever is less, and then by the total WADM of the district.

Population Growth In The Third District: Scorecard From The Census

CHART 1

POPULATION GROWTH SLOWED IN MOST METROPOLITAN AREAS OF THE THIRD DISTRICT DURING THE 1960'S.

Per Cent

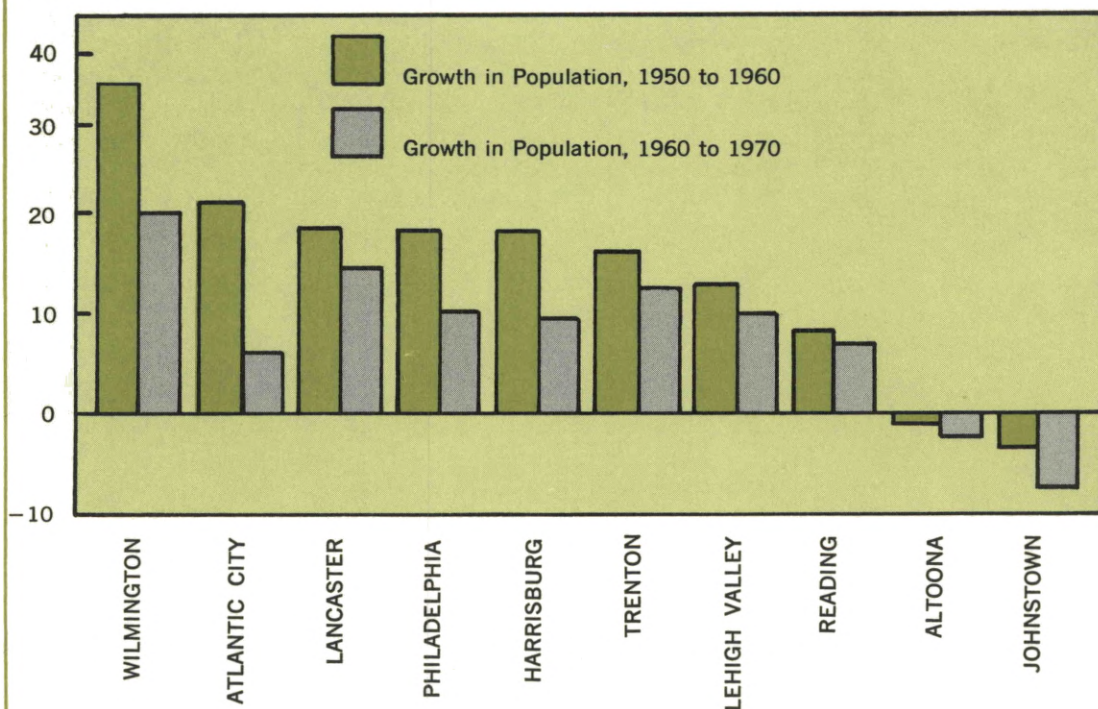


CHART 2
BECAUSE THE NATION
SLOWED ITS EXPANSION . . .

Percentage Change in Population

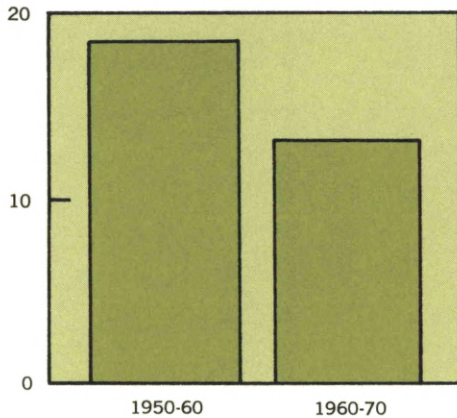


CHART 4
AND POPULATION GROWTH
SHIFTED TO THE SOUTH.

Percentage Share Total National
Population Growth

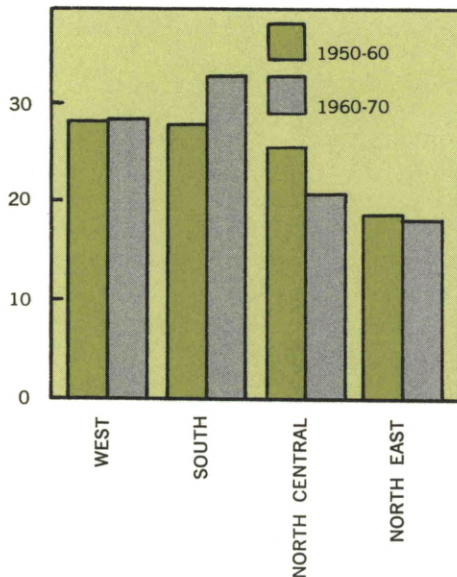


CHART 3
MIGRATION FROM THE
NATION'S RURAL AREAS INTO
METROPOLITAN AREAS
DECLINED . . .

Percentage Rate of Migration

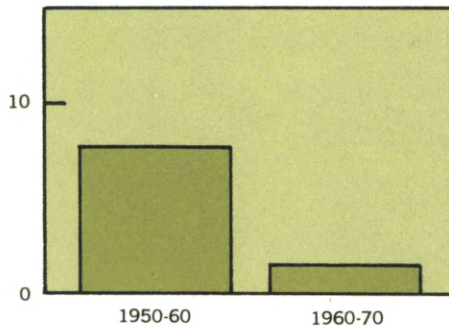
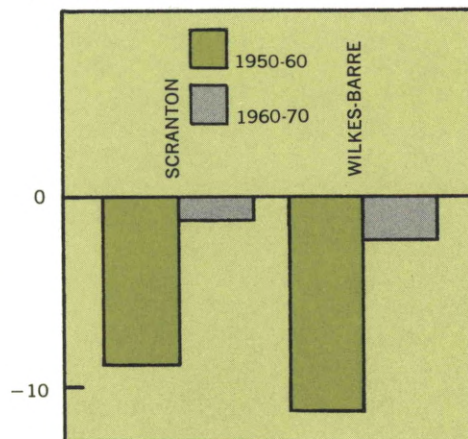


CHART 5
BUT TWO AREAS WITHIN THE
THIRD DISTRICT, BENEFITING
IN PART FROM INTENSE
INDUSTRIAL DEVELOPMENT
EFFORTS, FOUGHT THE
TREND, LARGELY TURNING
AROUND FROM A DECADE
OF DEEP DECLINE.

Percentage Change in Population



Source: Bureau of the Census, United States Department of Commerce.

The Household As A Saver

by James M. O'Brien

In this age of "affluence," a great deal of time is devoted to studying the buying habits of the individual. The producers of our nation's goods and services continuously try to learn about the makeup and preferences of their customers. For financial institutions, however, it is not just how the individual spends, but how he saves which is important. Yet the marketing analyst has been less active in this area. The information that exists is widely scattered in academic journals and specialized studies. By pulling together a good part of this information, we should be able to sharpen our view of the saver.¹

Looking at the composite picture of the saver from one angle suggests that the competitive edge of a financial institution in

attracting the savings of individuals will be related to its ability to provide the saver with assets which serve a variety of purposes. The current attempts of savings and loan associations and mutual savings banks to win checking deposit privileges may, therefore, play an important role in their competitive position in the market for individuals' savings. From still another angle, the significance of the role of interest rates in the saver's portfolio decision becomes apparent. Moreover, it is likely that in the future the average saver will be taking even a closer look than he has in the past at the spread between what he can earn by holding stocks and bonds and what he receives by putting his funds into savings deposits.

THE BUNDLE OF ASSETS — A REFLECTION OF GOALS

The typical individual accumulates wealth for a variety of reasons, and he usually finds

¹The description of the individual's savings behavior to be presented is taken from a review of mostly empirical research undertaken by economists over the last 20 years. A selected bibliography is presented in the Appendix.

that no one asset will adequately do the job.² As a result his saving will flow into at least several assets — the variety increasing with the level of saving. To be sure, the distinction among the character and uses of some assets is more sharply drawn than among others. Nonetheless, there are enough common denominators in asset usage so that patterns between accumulation motives and asset preferences do emerge.

All individuals need to keep some balances on hand to meet regular weekly or monthly expenditures for things such as food, utilities, and recreation. The typical individual relies almost exclusively on checking deposits and, to a lesser extent, currency to fill this need. But goods and services are not the only regular purchases a household might make. A small but important group of households — the wealthy — buy and sell stocks and bonds regularly, and for this purpose checking deposits are likely to prove a useful medium.³

Thus for his regularly recurring transactions, the saver has found the convenience of the checking deposit more important than the interest return he might receive by trying to manage his budget with some other type of financial asset.

While some balances are held by all individuals to meet day-to-day expenditures, the biggest chunk of the savings of most people serves longer run objectives. Retirement is perhaps the most important of these aims, but children's education, the purchase of a home, and a long vacation are other

important motives. Even without these goals, the uncertainty of what tomorrow might bring prompts the typical saver to keep something in his financial cupboard. For most individuals, the product to satisfy these needs is a savings account. Unlike a checking account, it pays the saver some reward, and, unlike equity, there is almost no chance of capital loss.

Savings deposits are also used to finance durable purchases. In this case the saver treats his savings deposits as a "revolving fund." Savings earmarked for longer run purposes is temporarily drawn down to make or help make a durable purchase, such as a new auto or home furnishings.

Insurance reserves also comprise an important share of the wealth of many households. However, few savers consider these reserves as a good means for meeting their long-term savings objectives; rather, they take out insurance primarily to reduce risk.

FAMILY'S CHARACTERISTICS AFFECT ITS SAVINGS DECISIONS

Since families adapt their asset holdings to their needs, we should not expect each family to hold the same bundle of assets. Among other things, differences in circumstances create differences in goals and potentialities for the family's savings. For example, the larger family has a relatively greater demand for durable goods; older households have had a longer time to accumulate financial assets; and wealthier households have more opportunities for profitable investment in stocks and bonds. Looking at households in terms of some of their characteristics reveals definite patterns of asset composition. (The evidence is summarized in the Table in the Appendix.)

Wealth. As its wealth increases, the household devotes a larger share of wealth to investment assets (stocks, bonds, and real estate) and a smaller share to liquid assets (checking deposits, savings deposits, and

² The terms *household*, *individual*, and *family* are used interchangeably here to refer to all persons living in a single dwelling unit. Total assets or wealth is defined to include financial assets and real assets but exclude human wealth and the business assets of proprietorships and closely held corporations.

³ Approximately 3 per cent of the household sector owns about 42 per cent of household wealth. The estimate is based on data from D. S. Projector, "Survey of Financial Characteristics of Consumers," *Federal Reserve Bulletin* (March, 1964), Vol. 50, No. 4, pp. 285-293.

savings bonds), life insurance, housing, and durable goods.⁴

Investment assets become more important as wealth increases because wealthier households face a different situation than their poorer counterparts. The prospect of having a significant share of wealth here today and gone tomorrow, even though not too likely, must weigh quite heavily on the asset decisions of the less wealthy. However, as wealth rises, the rules of the game change perceptibly. To some degree the dice become loaded as the wealthier household, with more to invest, can spread its investment around and reduce the odds against taking a capital loss. But unfavorable movements in securities prices is a catching illness so that diversification as an explanation can only take us so far.

What may be even more relevant in understanding the greater importance of investment assets to the wealthy is the differences in incentives offered to the different levels of wealthholders. Investing costs money — brokerage fees, subscribing to *The Wall Street Journal* — and takes time — getting advice from your broker, reading *The Wall Street Journal*. However, the more you want to invest, the smaller is the cost *per dollar* of investment since significant economies in time and expense are realized when the size of the investment increases. Also, the preferential tax treatment of capital gains set against rising income tax rates provide even more incentive for the wealthy family to put a larger share of its funds into investment assets. The economies realized in costs of investing and the tax laws make the monetary reward *net* of costs associated with investment assets rise with wealth. This induces the wealthier household to put a larger share of its wealth into these assets.

Occupation. While costs and risk act to deter households from holding stocks and

other investment assets, they do not affect all households equally. Individuals in managerial and professional occupations tend to be more familiar and in closer touch with securities markets than those in other occupations. The corporate executive or lawyer thus finds it somewhat less expensive and time-consuming, and perhaps less risky, to hold securities than does the blue-collar worker. Consequently, those in managerial and professional occupations tend to put a higher share of their wealth into investment assets than do those in other walks of life, even with the same level of wealth.

Self-employed businessmen are also in relatively close contact with financial markets, but their preference for marketable securities is not so strong as that of salaried executives or professionals. The self-employed businessman is, however, different in one important respect — the major share of his *total* wealth tends to be in his own business, that is, as equity in an unincorporated business or closely held corporation. Given optimism in his own business prospects and a desire for some stability in his wealth, he tends to put the major share of his saving back into the business and a hefty part of the remainder into liquid assets.

Age. The younger generation behaves differently than the older generation in many ways. Not the least of these is how they allocate their wealth. The older household — the age of the head greater than about 45 years — tends to put a high share of its savings into liquid and investment assets. Meanwhile, the younger household exhibits a relatively strong preference for durables, housing, and life insurance. One possible explanation is that the old have acquired different savings habits than the young. More likely, the differences in their asset demands primarily reflect differences in their position in the “life cycle.” In the formative years, when the household’s savings is relatively low, it keeps up its consumption standards partly by devoting a

⁴ Housing and possibly life insurance increase as a proportion of wealth in the lower wealth ranges.

large share of its savings to assets high in consumption services — housing, durables, and life insurance — and a correspondingly smaller share to assets relatively high in savings services — savings deposits, stocks, and bonds. In the middle and later middle years, the household takes advantage of its higher income and savings to build up its stock of savings assets, especially for retirement purposes.

In retirement years the household keeps a large part of its wealth in liquid form to meet current expenditures not covered by its sharply reduced income. That part of its consumption assets, such as housing and durables, not sold or cashed in is directly consumed by allowing the asset to depreciate. This asset behavior of the retired reflects the final stage in the household's life cycle. The continuing importance of investment assets in the wealth of the oldest age groups is more difficult to explain. The large holdings of investment assets among retired households may partly reflect savings habits built up during middle-age.

Children. The family with more children demands more insurance, living space, and durables. Add these higher demands to the increased difficulty of accumulating savings, and it is not surprising to find that the share of its savings devoted to savings deposits, stocks, and bonds falls as the number of children increases.

Just as was the case with age, the relatively low level of savings assets of large families may reflect an attempt to maintain a consumption standard *per dependent*. During that time interval when there are more children, the savings *per dependent* is lower than during other times, such as after the children have left home. As a result, relatively little saving is devoted to long-term objectives, such as retirement. The dearth of long-term savings may be made up when income and savings per dependent are higher; in other words, when there are fewer children.

THE BUNDLE IS SHUFFLED IN RESPONSE TO INTEREST RATE CHANGES

In the aggregate, asset holdings of households change in response to interest-rate changes. There are several reasons for this.

First, while the typical saver may generally regard interest rates as a minor factor in his asset decision process, the wealthy saver does not. For him the return on his wealth is important, and, accordingly, he is more sensitive to changes in interest rates. This relatively small number of wealthy households owns such a large proportion of total wealth that it plays an important role in the asset behavior of the household sector as a whole. Second, some assets serve similar purposes, and here even the typical saver can be expected to take into account changes in interest rates.

Both of these reasons make savers willing to substitute across a relatively wide spectrum of assets. Higher interest and dividend rates paid on various savings deposits, stocks, or bonds will induce the household sector to hold a smaller amount of checking deposits. The continuous increase in the rates paid on savings deposits over most of the past 20 years has reduced the attractiveness of the highly liquid checking account to even the typical saver. Moreover, it is not too surprising to find checking deposits responding to the yield on marketable securities, since an important share of the checking deposits of wealthy families may serve as a short-term alternative to holding securities.

Since banking and savings institutions issue liabilities of essentially the same character, most savers take a pretty close look at the interest rates offered by these various institutions before deciding in which institution to put their money. In addition, if all such institutions raise their savings deposits rates relative to rates paid on other types of assets, they will witness an influx of funds not only at the expense of household checking deposits, but also of marketable securities.

Bonds compete for the savings of the wealthy not only with deposits but also with stocks. Since both stocks and bonds are held primarily for their monetary return, it is not surprising to see household holdings of these assets respond to changes in their respective yields.

Finally, it may be that the rates paid on savings deposits influence not only the household's demands for other financial assets but also its demand for durable goods. The "revolving credit" function of savings deposits for durable purchases, noted earlier, opens the door to the possibility that such purchases may be sensitive to rates paid on savings deposits. When these rates rise, impromptu decisions to withdraw funds from a savings account may be less frequent, or planned purchases may be postponed.

COMPETITION FOR THE SAVINGS DOLLAR — PROSPECTS FOR THE FUTURE

On the whole the saver appears to be quite strongly motivated by family goals in deciding how to accumulate wealth, but he also keeps in mind the return paid on various assets. These dual considerations suggest that the issuers of liabilities, such as financial institutions and corporations, will compete with each other for a place in the household's portfolio on two levels.

First, there will be an incentive for borrowers to tailor their liabilities to satisfy the particular savings goals of wealthholders. For example, the ability of savings institutions to capture a significant part of the saver's wealth rests on the importance most savers attach to having a significant part of their funds readily available. In addition, the borrower who is able to provide savers with an asset which can satisfy multiple goals will have a special advantage. The "full service" characteristic of commercial banks provides one such example. By making available to its customers different types of deposits plus other services, the commercial bank, in

effect, gives the saver an "asset" having a variety of uses. The current attempt of savings and loan associations to obtain checking deposit privileges is simply a way for them to gain or possibly just hold their own in the race for the household's savings.

Second, since savers respond to interest-rate changes, corporate and institutional borrowers can, and do, compete on another level. For example, banking and savings institutions compete, via interest rates, both among themselves and also with corporations and government who issue stocks and bonds. Consequently, ceilings on the interest rates of checking and savings deposits put these institutions at a competitive disadvantage when economic activity is at a high level. During periods of generally high interest rates, savers may shift their funds from deposits to the high-yielding marketable securities.

The extent of each of these two kinds of competition will depend not only on household preferences, but also on the ability of borrowers to compete in either way. The corporation generally is less willing to tailor its issues to the saver's goals. For this reason, it is forced to offer the saver a relatively high return. On the other side, restrictions on interest payments have probably tended to force financial institutions to compete more in the form of non-interest-rate services than otherwise would have been the case.

In days ahead the inventiveness of financial institutions to woo the saver with non-monetary services in lieu of interest payments may be tested even further. Projections on the characteristics of U.S. families indicate that the numbers in managerial and professional occupations relative to other occupations will continue to rise; family size, decrease; the proportion of young households to older households, increase; and, most important, per capita real wealth, continue to increase. The net effect of these changes is likely to be that the average saver will be more attracted to the high

yields of marketable securities than he has been in the past.⁵ It may just be that the ability of existing financial institutions to pay competitive rates on their liabilities will be crucial in determining whether they can hold on to their present share of household wealth.

⁵ It is doubtful that the projected change in the

age structure would, by itself, be sufficient to offset this tendency. An important underlying assumption in this forecast is that changes in the various characteristics will be distributed among U.S. households in a manner which is similar to their previous distribution. For example, an increase in wealth might not have the expected effect if it also changed its distribution in such a way that younger households received a larger share of the increase than was previously the case. ■

APPENDIX

a. Asset Demands and Household Characteristics

The Table presented below summarizes some of the major findings that studies of the composition of household wealth have produced. Some of the household characteristics not included whose effects on asset behavior have been studied are income, education, race, marital status, and location. These variables were omitted from consideration here because the evidence of their effect on asset composition was judged inconclusive: either there were too few studies and contradictory results or a failure to isolate sufficiently their effects from that of other factors. The characteristics that were considered are those which

have received the most attention and generally appear to have the greatest effect on the composition of the household's wealth. The defining of the various asset categories was to a great extent dictated by the procedures used in the studies which were reviewed.

It should be kept in mind that what is being considered are the effects of household characteristics on the *proportion* of wealth held in the various types of assets rather than the effects on the absolute amounts held. Also the relations described in the Table are *ceteris paribus* types of relations. That is, they represent the results of attempts to measure the "pure" effects of changes in particular household characteristics on the various asset proportions by holding other things constant.

TABLE

EFFECTS OF CHANGES IN HOUSEHOLD CHARACTERISTICS
ON ASSET COMPOSITION*

		INCREASES IN:					
		WEALTH	OCCUPATION**		AGE OF HEAD		CHILDREN
			Professional Technical Management	Self- employed	Up to 45 Yrs.	Over 45 Yrs.	(less than 4)
	Liquid Assets	Decreases	?	Increases	?	Increases	Decreases
	Investment Assets	Increases	Increases	Decreases	?	Increases	Decreases
Means that the share of wealth held in:	Life Insurance	Decreases	?	?	Increases	Decreases	Increases
	Housing	Decreases (but increases if wealth remains below approx. \$30,000)	?	?	Increases	Decreases	Increases
	Durables	Decreases	?	?	Decreases	Decreases	Increases

*See below for definitions of terms used in the Table. Some of the references used to make up this Table are included in the selected bibliography below.

**Compared to other occupation categories.

DEFINITIONS*

Assets**

Liquid:	Demand deposits and savings deposits of all financial institutions.
Investment:	Publicly traded common and preferred stock in corporations other than closely held corporations, marketable private and government bonds of all maturities, real estate. Holdings in stock dominate investment assets.
Life Insurance:	The premium or cash surrender value of the life insurance policy.
Housing:	Estimated market value of housing for personal use.
Durables:	Estimated market value of household durables including automobiles.
Miscellaneous:	Assets held in trust, withdrawable amounts from profit-sharing and deferred-income plans, and assets such as royalties, patents, and commodity contracts.

Household Characteristics

Wealth:	The total value of the asset components defined above of net outstanding debt.
Age of Head:	The age of the head of the household, usually the principal income provider.
Number of Children:	The number of dependents in the household less than 18 years of age.
Management and Professional:	Households where head is classified as being in a managerial or professional occupational category.
Self-employed Business:	Households where the head is classified as being in a self-employed business occupational category.

*Different studies do not always employ the same definitions so that these definitions represent those most commonly used and are generally close approximations to other definitions used.

**Assets refer to the value of the asset net of any debt associated with the asset.

b. Sources of Reference

The information used to make up this review comes from the largely empirical literature dealing with household asset behavior. In all, some 40 references were

used, dating from the early 1950's to the present. The vast majority of these references relied on data provided by surveys of households to produce their results. A selected bibliography is presented below.

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The Fed in Print

Business Review Topics Selected by Doris Zimmermann

For the first time analytical articles appearing in the *Federal Reserve Bulletin* are included in this compilation, beginning with the January 1971 issue. Copies of the *Federal Reserve Bulletin* are available from the Federal Reserve Board for sixty cents each, mailed to the Washington address on page 29. You may send for Business Reviews of the Federal Reserve Banks, free of charge, by writing directly to the *issuing banks*, whose addresses also appear on page 29.

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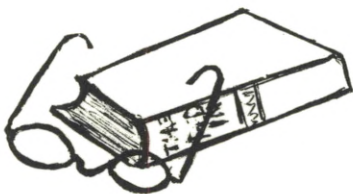
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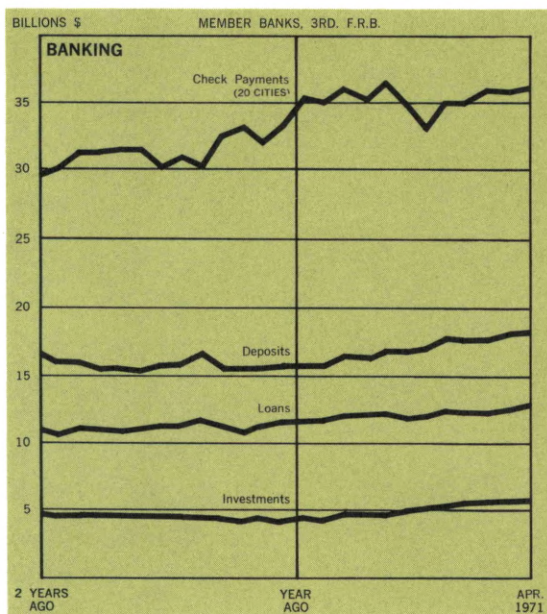
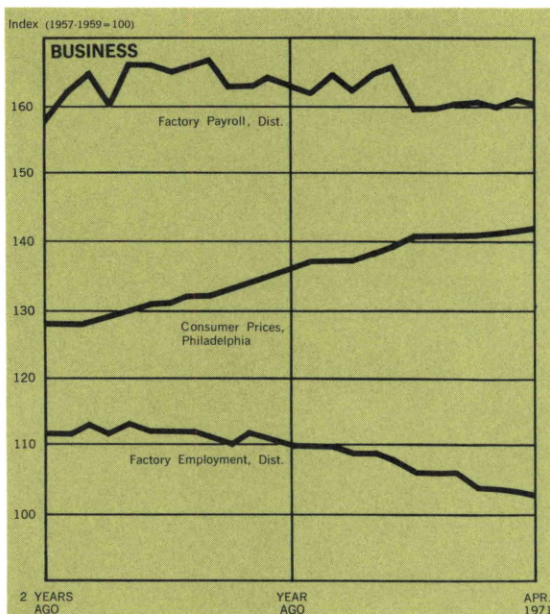
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REPRINT AVAILABLE

Since current interest in inflation continues unabated, we have reprinted the February, 1971 issue of the *Business Review* containing "Fight Against Inflation: Barebone, Jawbone, or Lawbone?" Also included in this issue are "Services: Bridge Over Troubled City Waters?" and "The Wage-Profit Battleground." To obtain copies, direct your request to Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania, 19101.

FOR THE RECORD ...



SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	April 1971 from		4 mos. 1971 from	April 1971 from		4 mos. 1971 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
MANUFACTURING						
Production				0	- 4	- 4
Electric power consumed	- 1	+ 2	0			
Man-hours, total*	- 2	-10	- 9			
Employment, total	- 1	- 7	- 7			
Wage income*	- 1	- 2	- 2			
CONSTRUCTION**	+211	+27	+ 2	+21	+17	+ 4
COAL PRODUCTION	+ 2	+13	+ 6	+ 4	+16	+13
BANKING						
(All member banks)						
Deposits	0	+15	+14	- 1	+16	+15
Loans	+ 1	+10	+10	0	+ 7	+ 6
Investments	+ 2	+27	+24	0	+22	+23
U.S. Govt. securities	0	+13	+11	- 3	+ 4	+19
Other	+ 3	+37	+33	+ 3	+27	+26
Check payments***	+ 3†	+ 9†	+ 1†	+ 2	+15	+15
PRICES						
Wholesale				0	+ 3	+ 3
Consumer	0‡	+ 6‡	+ 6‡	0	+ 4	+ 5

*Production workers only
 **Value of contracts
 ***Adjusted for seasonal variation

†15 SMSA's
 ‡Philadelphia

LOCAL CHANGES Standard Metropolitan Statistical Areas*	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
	Per cent change April 1971 from		Per cent change April 1971 from		Per cent change April 1971 from		Per cent change April 1971 from	
	month ago	year ago	month ago	year ago	month ago	year ago	month ago	year ago
Wilmington ...	- 1	- 5	- 4	+ 6	+14	+ 1	- 5	+16
Atlantic City					- 9	+ 7	+ 1	+29
Trenton	- 1	- 4	- 2	- 2	-42	- 5	+ 5	+26
Altoona	+ 1	- 6	0	0	+ 2	+ 6	+ 1	+14
Harrisburg	0	- 4	- 1	- 2	+ 6	+ 9	+ 2	+13
Johnstown	+ 1	- 5	+ 9	+12	+10	+23	+ 1	+18
Lancaster	0	- 6	- 1	- 4	- 2	+ 5	+ 1	+87
Lehigh Valley	- 1	- 6	0	- 1	+ 3	+14	0	+16
Philadelphia	- 1	- 9	- 1	- 1	+ 5	+12	- 1	+14
Reading	0	- 6	+ 2	- 4	- 3	+18	0	+13
Scranton	- 1	- 9	- 2	- 7	+ 9	+10	+ 4	+20
Wilkes-Barre	+ 1	- 1	0	+ 4	+ 4	+ 8	+ 1	+14
York	- 1	- 4	- 1	+ 3	- 4	- 3	+ 1	-40

*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.