february

FEDERAL RESERVE BANK OF PHILADELPHIA

Productivity in Urban Areas

Boom in Bank Credit Cards

The Pleasant Predicament of the Corporate Treasurer in '72

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business review

1972

Productivity in Urban Areas
. . . Boosting urban productivity through the combined efforts of business and government can ease the conflict between disillusioned taxpayers and rising demands for more and better public services.

Boom in Bank Credit Cards
. . . Smaller banks have joined big ones in the booming business of bank credit cards.

The Pleasant Predicament of the Corporate Treasurer in '72
. . . The nation's top firms are aiming for a near-record boost in profits and the highest cash flow ever, according to a national survey of corporate treasurers.

On our cover. Towering atop Philadelphia's City Hall is the heroic-sized statue of William Penn, superimposed on a view of the city's ever-rising, ever-widening skyline. Penn founded the City of Philadelphia and the State of Pennsylvania.

BUSINESS REVIEW is produced in the Department of Research. Ronald B. Williams is Art Director and Manager, Graphic Services. The authors will be glad to receive comments on their articles.
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Productivity in Urban Areas*

by David P. Eastburn, President, Federal Reserve Bank of Philadelphia

Not long ago Mayor Rizzo got a good send-off with the business community. Joe Slevin wrote in the *Inquirer* that "the city's business establishment is coming to the surprised conclusion that he may be just what the town needs . . . he is signaling that he will work to revitalize the Philadelphia economy and, without that, there can be nothing."

This is good news for business, and it is good news for everyone in the region, because it is certainly true that without a strong economy there can be nothing. But the new Mayor also will have other matters than industrial development to worry about. One of the things we can do here today is to help him put these problems into some perspective. How much to concentrate on developing industry, as compared with, say, fighting crime, cleaning the streets, upgrading the reading level of the city's children, improving race relations?

The Mayor's main objective obviously must be to get the best results he can with what he has to work with. This is just a common-sense way of saying that he will have to be concerned with productivity — urban productivity. Productivity, after all, is a way of measuring output per unit of input. If he can strengthen the region's economy, reduce crime, clean up the streets, improve reading abilities — all aspects of the urban output — with the limited money and other inputs available to him, then he will have succeeded.

PRODUCTIVITY AND BUSINESS

This general concept of productivity is a start in understanding the problems ahead,

*An address given before the Greater Philadelphia Chamber of Commerce's Mid-Winter Conference, Philadelphia, January 11, 1972.

Boosting Productivity in Local Government: Progress and Problems

by Kathryn L. Kindl

Although expenditures by local governments have skyrocketed, demand for more and better municipal services continues unabated. And balking taxpayers resist tax-rate increases and new tax levies. One avenue out of this municipal finance dilemma — perhaps in the long run the only way — is to increase productivity in local government.

PROGRAMS UNDER PROBE

Clearly, increasing local government productivity is a tough task. Mustering funds for research, attracting talented expertise, and coordinating planning and programs all pose problems. Yet many cities are discovering that their problems are not insurmountable. Progress is being made in developing new technologies, employing more scientific management, and generally upgrading the quality of municipal services.

Scottsdale, Arizona, is a case in point. In trying to mechanize its refuse collection, this city of 70,000 finally won a $100,000 matching grant from the Department of Health, Education, and Welfare. One-man trash trucks, each equipped with a crane to pick up, empty, and return collection containers to the curb, and standardized collection containers (some to be used by four families) were designed and built. Although the first plastic containers fast became brittle, they were replaced by a more durable substitute in short order. Indeed, manufacturers now offer products that Scottsdale officials had once been unable to obtain, and the City itself has reduced the monthly cost of trash collection per family by more than a third — all on the suggestion of a city employee. Moreover, citizen satisfaction with the quality of the service seems to have increased. And most of those men who suffered job displacement because of the innovation have taken advantage of better employment opportunities elsewhere within municipal government.

Other city and county governments as well are searching for ways to increase both the quantity and quality of local government services per tax dollar. The Montgomery County, Maryland, law enforcement agency, for example, has developed a computerized system to pinpoint by small area the incidence of crime and police activity. This knowledge of the county's crime patterns and police workloads will then be used to deploy police resources more efficiently. A few communities are developing elaborate simulation models that predict the effects of decisions to deploy fire, police, and other emergency service personnel before the decisions are implemented, while other metropolitan areas employ new technology, including helicopters, to control crime and cut long-run costs.

As in Scottsdale and Montgomery County, more and more local government functions have come under the scrutiny of the productivity analyst. Economists, engineers, operations researchers, political scientists, sociologists, city planners, and lawyers have been tapped. The projects undertaken, too, have been diverse. Provision of police and fire protection, solid waste collection, recreation, public health, welfare, and criminal justice all have received attention. Resources have been concentrated on narrowly defined problems, including the management activities of community health centers and the operation of preventive disease programs. Other staffs have plunged into analysis of larger problems, for example, more efficient functioning and coordination of police, court, and corrections activities.

Some of this research has been geared to employing or adapting existing technology or management techniques. Other researchers have attempted to develop new decision tools or new technology — for example, better communications systems between fire fighters on the scene or in instant-drying

more durable paint for pavement striping. Vast and comprehensive research programs have examined entire service areas. In these studies goals of the service are defined and developed; alternative modes of operation are examined and the costs and benefits of each evaluated. The technology necessary to implement recommendations may also be developed, or, in some instances, demonstration programs are initiated and planners have a hand in the whole new system.

Perhaps the most comprehensive efforts to improve productivity in municipal government have been made in New York City where an institute for research on that government's problems has been established. Many believe that, through cooperative efforts of City officials and the institute's staff, Gotham's fire and police departments and other city agencies have made long strides toward providing higher quality services and better achieving their goals. Moreover, chiefs of many New York City departments feel that, for the first time, they are able to manage the resources under their control effectively. And, on an annual investment of $2 million in scientific and analytical talent, the City reaps estimated direct economies of $20 million annually — a heftier return than on many blue-chip stocks.

WHO HELPS CITIES HELP THEMSELVES?

To date, attempts to boost productivity in local government have varied not only in terms of the types of issues and programs subjected to analysis, but also according to who has initiated research efforts and implemented recommendations.

Many local officials have displayed initiative both in stimulating in-house research and innovative programs and in attracting expertise from academic and other analytical and technical communities. Mayor Lindsay, for example, late in 1967 asked The Rand Corporation, a California-based think tank, to provide analytical support for certain agencies of the New York City government. The upshot was a research plan, and, in 1969, the establishment of The New York City-Rand Institute, a nonprofit research organization governed by a Board of Trustees appointed jointly by the City and Rand. The Institute is dedicated primarily to researching New York City's problems and derives over 80 per cent of its funding from City government agencies. Officials in many smaller communities which have initiated programs to increase productivity also have enlisted the aid of outside analytical talent. City managers in San José, California, and Kalamazoo, Michigan, for example, are developing strong ties with research foundations and nearby universities.

Elsewhere, much groundwork has been laid outside city hall — perhaps in a nonprofit foundation, a national research or professional organization, or the Federal government. In Dayton, Ohio, citizens have initiated several programs that have been sponsored by the Charles F. Kettering Foundation as community prototype projects. And, in 1969, the National League of Cities, with funds from the Department of Housing and Urban Development and the support both of mayors and scholars, launched urban observatories in ten demonstration cities ranging from Albuquerque, New Mexico (pop. 250,000) to Baltimore, Maryland (pop. 900,000). These observatories are designed to help establish an institutional relationship between each city government and its local academic community as well as to execute research programs to meet the perceived needs of city chief executives.

PROBLEMS . . .

Needless to say, problems, many of them peculiar to local government, hamper efforts to improve productivity. The institutional difficulties are sometimes enormous. An enthusiastic progressive city manager or mayor can be a strong plus, both in promoting public support of innovative government and in generating the political and administrative willpower to push new programs through. Clearly, however, sluggish top management can slow productivity advancement.

Tradition and a large bureaucracy may militate against innovative action. Both union management and city employees may be wary of change and criticism. A city's own research staff may resent outside experts' interference and influence. Elected officials may choose short-term gains over potentially larger long-term benefits. In addition, local governments' hands may be tied by their own city councils or state legislatures. For example, many legal experts believed state law mandated that New York City's police staff be "level-manned" — that the same number of men be on duty at all hours, regardless of crime incidence. Recent legislation has removed this restriction. Legal obstacles to changing firemen's working hours have also countered efforts to distribute firefighting duties evenly and employ fire manpower efficiently.

The problems may not all lie within government offices, however. Financial worries have all too often siphoned valuable time and resources both from government units and private research organizations. Some research consultants have in the past suggested innovations far too costly or impractical or have couched good ideas in unnecessarily complicated language. City managers have been offered technology suited to industrial or military establishments rather than adapted to the demands of local governments. And profit-motivated producers, unsure of municipal market demand, have thwarted municipal efforts to turn ideas to actions.

Finally, one problem — measurement — is shared by municipal governments and all others who strive to increase productivity. What should be measured — output per man-hour, output per dollar, the "quality" of the service, or how the service meets the goals for which it is designed? Data collection and comparability pose other problems. Nevertheless, inroads are being made. And improving evaluation techniques and information dissemination will go a long way toward keeping all cities apprised of the success or failure of innovative actions, thus permitting them to initiate, expand, or cut back operations on a better than trial-and-error basis.

AMID POTENTIAL PAYOFF

Municipal finances are so strained that efforts to increase productivity must be assayed despite the problems. Creating an environment where analysis precedes decision and action remains one way toward better resource utilization. Shaping that environment will require firm action from city hall and, because of local government staff shortages in technical and analytical personnel, a willingness to tap outside research capabilities.

At present, local government participation in productivity increase is limited. Most municipal governments do not employ outside talent to a significant degree. New York City, however, through The New York City-Rand Institute, has pioneered in establishing an extensive long-term commitment to urban government productivity. And already major changes in programs and policies have occurred. Managers, for example, supported by data banks and problem analyses, have become more venturesome. Attitudes toward housing have also been realigned. Rather than building all new rental structures, the City has been trying to use the leverage of intervention in the marketplace to conserve its current rental housing stock.

Although other municipal governments may have neither the magnitude of problems nor the scale of resources as New York City, they all have problems. These urban trouble spots may be alleviated by pooling and mobilizing talents of municipal employees, of business and industry, and of Academe. Current research efforts, such as those of the Urban Observatory Program, have generally stimulated change in local government actions and academic approaches to urban ills. And increased financial and manpower resources have been brought to bear on city government problems. For cities to survive, the commitment must be a sustained effort to apply scientific techniques and analytical aptitudes to problems of local government.

but it isn't a great help in making policy decisions. I can think of two other concepts of productivity that bring us a little closer to reality. One is the way most of you businessmen look at it. You may call it something else, but it really has to do with the productivity of the region as a place to do business.

If this session had been held a few years ago, it probably would have been concerned mostly with such problems as providing space for industry, developing markets, training the work force, financing industrial development. These are all problems of developing the resources needed to manufacture things. And although these were (and still are) problems, judgments about the qualities of Philadelphia as a location for manufacturers would have been (and still are) generally favorable. Many of the unemployed in Philadelphia are unskilled, but years of manufacturing activity in Philadelphia have left the region with a very large skilled work force. Land is readily available, and sites throughout the region provide accessibility to a fifth of the nation's population within two hours' trucking time. Moreover, because of the region's size, it offers manufacturers a long menu of supporting services — advertising, legal services, accounting, repair, subcontracting, and the list goes on.

This way of looking at the region's economic environment, however, is much too limited today. One reason is the dramatic growth of services. In 1966, service industries dominated manufacturing, with 54 per cent of regional employment. This year, services occupy greater than 60 per cent of the region's employed.

This strong shift toward services signals, I think, some change in the kinds of elements that are important in providing business with a productive economic environment in the city. When manufacturing was king, the principal factors included availability of land, a large, skilled manual work force, and good transportation for products. Services depend more heavily on technical and professional work force, and contact among people.

Just what is important to service industries is not clear at this point, but we gained some appreciation of it from a survey we made to find out what factors influence the choice of location for corporate headquarters. I would expect that much the same factors influence the more sophisticated and highly mobile service industries and are quite different from those traditionally believed to influence manufacturers. These were housing for management and professional personnel, air transportation for personnel, community law enforcement, regional public schools, community image, regional political environment, local transportation, major corporate banking services, corporate tax burden, and local availability of management and professional personnel. On the surface this appears to be a very heterogeneous list of factors with no direct connection to the productivity or profitability of the firm. But there's a theme running through most of them, reflecting the need of these new types of firms to attract a highly trained work force, and one that has the income to find and enjoy a very high quality of life.

Some kinds of services, therefore, are directly attracted by quality-of-life factors. Others, like basic medical services, entertainment industries, or banking, follow population or industries which they serve and which, in turn, are drawn to an area with attractive quality-of-life features.

If the Mayor intends to reemphasize economic development, therefore, he will need to think broadly of those things that make Philadelphia a good place in which to live and work. This will be much harder than accomplishing the old idea of industrial development, because the effort cuts across the whole of the region's society. It creates a much larger burden to be borne by the community than was true when things like a good location and available land played a heavy role in drawing growth.

On several factors associated with quality of life, the region ranks high. These are: housing, law enforcement, institutions of higher education, and cultural environment. It ranks less favorably in community image, political environment, highways and internal transportation, air pollution, educational achievement, and public open space. In total, the region gets something of a medium overall rating.

The concept of urban productivity, therefore, becomes much more significant than one of how many goods can be sold by a manufacturer in a favorable location with skilled labor and good financial services. It becomes one of how the entire urban society can draw on all its human resources and institutions to improve the quality of urban life. This is the concept of productivity which the Mayor must deal with.

The role of local government becomes particularly important because most of the factors now associated with development of the region are public in character. Their benefits fall upon all of us, and the cost is borne by all of us. Hence, if economic development is to be improved by raising this region's rating as a place to live and work in, the community will have to get more out of existing resources or devote greater amounts of resources than has been true in the past. In doing so, it comes up against a persistent fact of life — limited funds. Productivity is the key.

PRODUCTIVITY AND GOVERNMENT

The Mayor, therefore, will find it essential to come to grips with a narrower concept of productivity — the ability of government to turn out more and better services at lower cost. This is the concept of productivity the taxpayer has in mind. It is also one that is attracting the attention of more and more experts in urban problems. New York City, for example, has engaged a task force of specialists to measure the government's productivity and to come up with ways of improving it.

The state of the art is still so rudimentary that it is impossible to judge at this point how productive the city's government is as compared with governments of other regions. It is only a bare beginning, for example, to point out that, while the number of city employees (including the school system) has risen by 17 per cent and expenditures have grown by 82 per cent in the last six years, the crime rate has risen 93 per cent, the average reading level of children in Philadelphia public schools remains well below the national average, and city transit and highway facilities are little improved. While taxpayers may be discouraged by such a record, there is little they may conclude from it. Government may have been unproductive, either because of the kinds of programs to which it devoted its employees or the way in which it managed the programs, or the basic problem may have grown faster than the resources at its command. Productivity is a difficult thing to measure in any field, but nowhere so difficult as in the field of public services. The Mayor could make a major contribution to the science of local government, answer many of his constituents' questions, and save taxpayers a good deal of money by putting a group of businessmen and urban experts to work measuring and improving the city's productivity.

Many innovative possibilities should be considered. Careful analysis of the way resources are deployed — operations research —may yield substantial savings. Under a new policy developed for analysis by urban experts in New York City, for example, the amount of fire fighting equipment sent in response to any call is proportional to the probability of the call being a false alarm. Experience under the policy has been good. In Philadelphia, some functions now performed by local government might be taken over by the private sector on a fee basis. This has been tried in the public schools with mixed success. Certainly much of the sanitation work that is carried on by the city could be handled this way. And, where

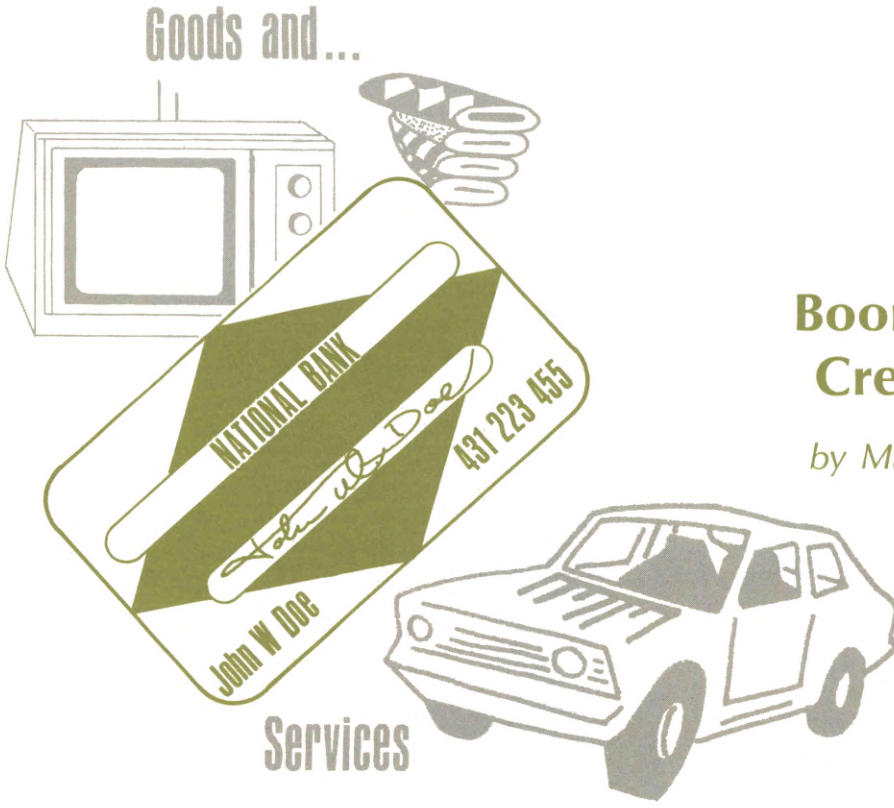
there is question about the way the public sector manages functions, the programs could be given to the firms who would bid for contracts. Neighborhoods in the city, with the aid of government money, might even contract with private agencies for crime prevention.

Improving the productivity of government is so difficult that no immediate breakthroughs are likely. But the needs and potential rewards are great.

CONCLUSION

In conclusion, let me restate in a somewhat different way what I have said. First, it will be important to put renewed effort into strengthening the regional economy. This is basic to the health of the community. But to get a strong economy, these efforts will have to come to grips with the entire urban problem. By this I mean more than just the "getting-the-trains-running-on-time" kinds of problems; the "people" problems — health, education, race relations — will not go away and must be attended to. Economic development these days, in other words, is a matter of urban productivity in its broadest sense, and this is a concern that has become uniquely that of government.

Second, the urban taxpayer is tired and disillusioned. He has watched local government activities escalate, government payrolls and wage rates skyrocket, and taxes go up and up. And yet the problems seem bigger than ever. He is about ready for a rest. This, of course, cannot be permitted to happen. In fact, what I've been trying to say is that he must bear an even greater burden than before. But there is one way in which the job can get done and still hold this burden down — by increasing the productivity of public services. I would hope that the city government and the business community will cooperate to bring this about. ■



Boom in Bank Credit Cards*

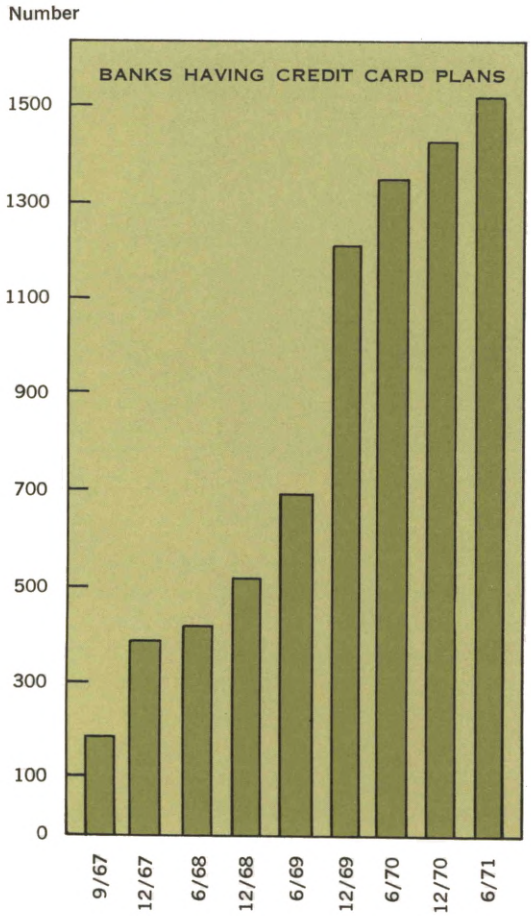
by Marylin G. Mathis

Bank credit card business is booming. Between September 1967 and June 1971, the number of banks participating in card plans jumped from 197 to 1514. During the same period, credit outstanding soared from $633 million to $3.9 billion. This upsurge in the growth of bank credit cards stems largely from the public's increasing acceptance of the card as a "proper" and convenient way to borrow from banks and pay bills.

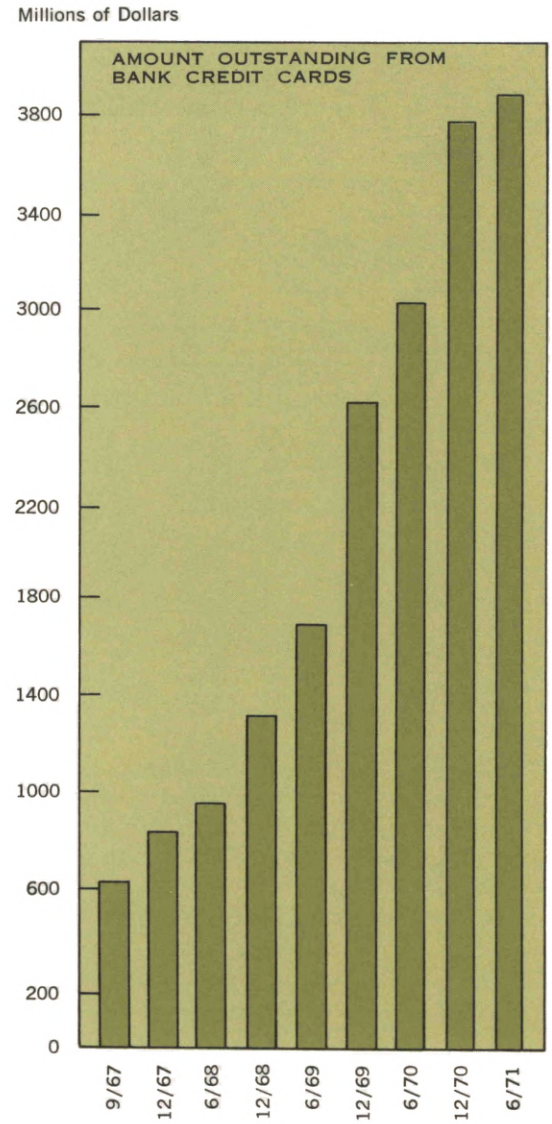
However, a slowdown in yearly growth of bank cards and credit outstanding began in mid-1970, perhaps reflecting the maturation of the bank credit card system in most parts of the nation. Also, the general sluggishness of economic activity may have tempered growth in bank card credit.

*Charts are based on data included in two addresses by Andrew F. Brimmer, Member of the Board of Governors of the Federal Reserve System: "Bank Credit Cards: The Record of Innovation and Growth" presented at the Annual Seminar of the Puerto Rican Bankers Association, Caribe Hilton Hotel, San Juan, Puerto Rico, March 26, 1971; and "Growth and Profitability of Credit Card Banking" presented at the 1971 National Credit Card Conference of the American Bankers Association, Fairmont Roosevelt Hotel, New Orleans, Louisiana, October 27, 1971.

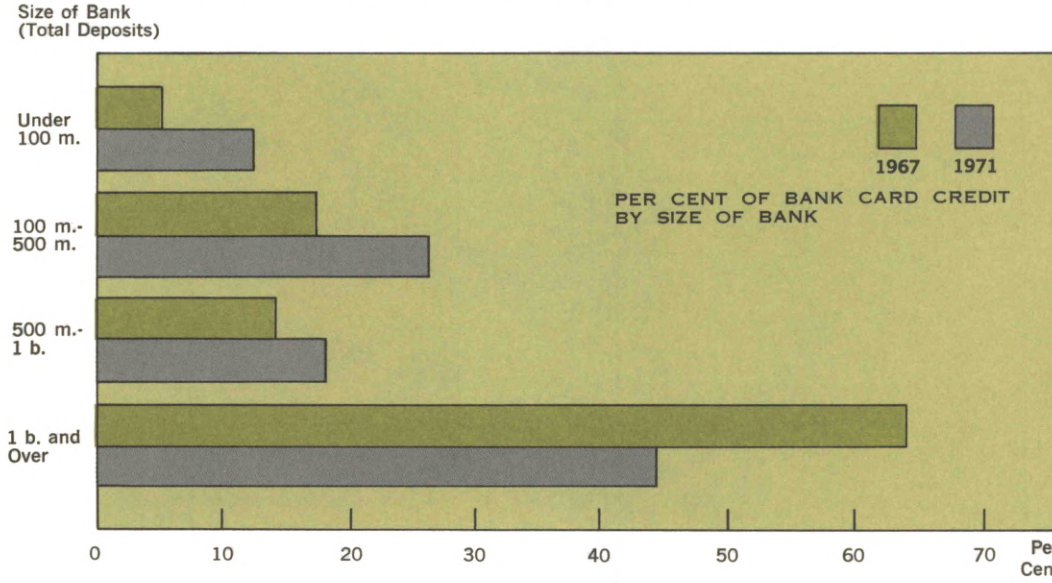
AS BANKS HOP ON THE BANDWAGON TO OFFER CREDIT CARD PLANS . . .



CUSTOMERS RESPOND BY PUSHING CREDIT OUTSTANDING TO NEW HIGHS.

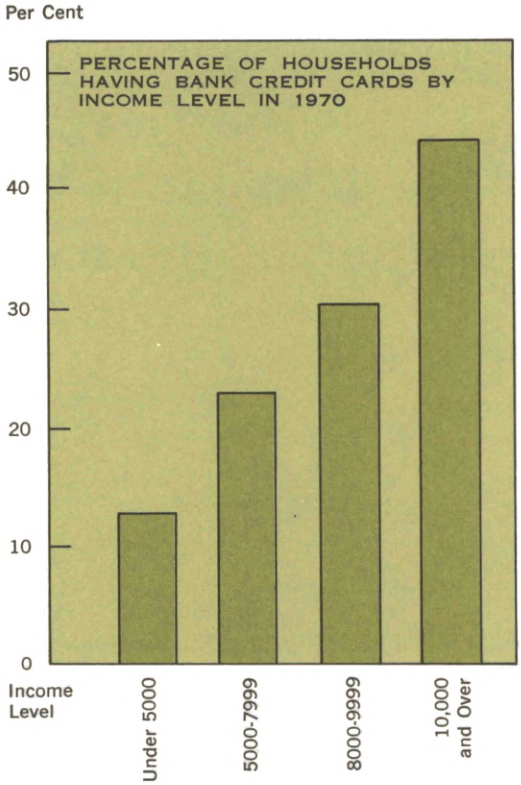


SMALL BANKS, TOO, ARE JOINING THE CARD GAME.

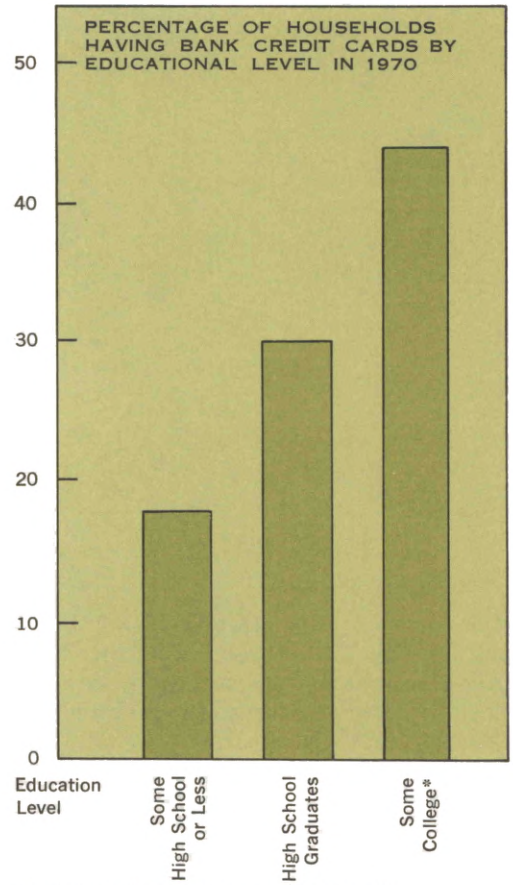


Bank credit cards are no longer mainly a privilege for customers of big banks; smaller banks are also in the credit card business. Although the largest banks (those with deposits of $1 billion and over) still maintain the lion's share of outstanding credit from issuing credit cards, their portion of the market shrank substantially between September 1967 and June 1971. In contrast, each of the smaller size groups enlarged its slice of the credit card business, with the smallest banks more than doubling their proportion of credit outstanding.

THE MAJORITY OF CARD HOLDERS ARE IN THE HIGHER INCOME . . .



AND HIGHER EDUCATIONAL GROUPS.



*Includes college graduates and those with higher education.

But who are the people most responsible for the phenomenal growth of the bank card business? A survey conducted by the Federal Reserve Board in the fall of 1970* revealed that of all bank card holders, the greatest percentage fell in the higher income and higher educational groups. While only 12.7 per cent of the households earning less than $5000 owned bank credit cards, 44.2 per cent of the families earning at least $10,000 held cards. Similarly, just 17.9 per cent of those households with only some high school education or less owned bank cards while 44.0 per cent of the families with at least some college education held cards.

*Federal Reserve Board Survey of Consumer Awareness of Credit Costs

The Pleasant Predicament of the Corporate Treasurer in '72

by Jerome C. Darnell

Corporate profits after taxes are headed for a healthy 16 per cent boost in '72, according to our annual survey of corporate treasurers of the nation's largest firms. If the treasurers' predictions are in the ball park, as seems likely, the gain would be the biggest since 1965, making profits this year one of the best ever.

Corporate liquidity has been another nagging problem, but the persistent liquidity skid of the past few years was reversed in 1971. Most financial managers now feel that liquidity has returned to an acceptable level, and they look forward to more than adequate liquidity this year.

Firms we canvassed plan to increase their plant and equipment spending by around 10 per cent. But there is reason to believe their projections may be on the low side and will be revised upward during the year. Corporate cash flow, undistributed profits plus depreciation, will be generated at a record pace. Unlike '71, a relatively small portion of the cash flow will be needed to reinforce liquidity. Therefore, a sizeable residue should be available for other uses. Given the limited range of spending alternatives this year, the residual cash flow may well gravitate toward capital spending, causing an even greater upswing than corporate treasurers now foresee.

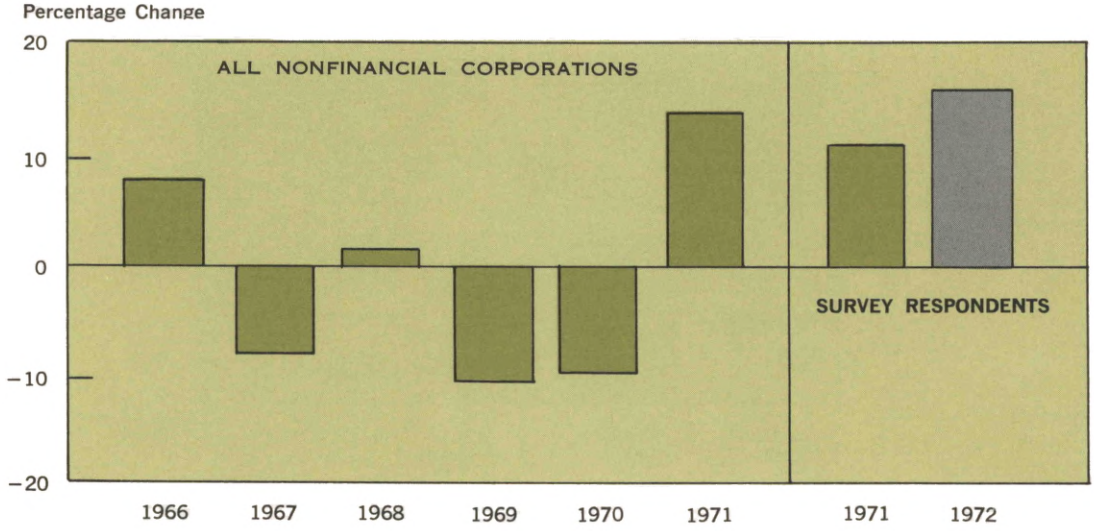
Interest rates, especially at the long end of the rate structure, should be holding fairly steady, say the treasurers. Pressure from the corporate sector should be minimal if internally generated funds live up to current forecasts. Moreover, inflationary expectations are diminishing, which reduces pressure on long-term rates even more. Treasurers expect some upward movements for short-term interest rates, however, as the year progresses.

PROFITS: END OF THE LEAN YEARS

The growth pattern of after-tax profits for all nonfinancial corporations, as Chart 1 shows, has been erratic and generally depressed during five of the previous six years. A rebound of 14 per cent in '71 raised

CHART 1

CORPORATE TREASURERS SEE A HEALTHY 16 PER CENT GAIN IN AFTER-TAX CORPORATE PROFITS.



hopes for a rosier outlook in '72. Corporate treasurers believe that the profit climate will be slightly better this year; on the average, they are predicting a 16 per cent increase in after-tax profits. Since our respondents comprise a broad sample of the major nonfinancial corporations, it is understandable that their profit performance would parallel the performance of all nonfinancial firms. Thus, if the projected 16 per cent increase materializes for our respondent firms in 1972, we can envision a comparable jump

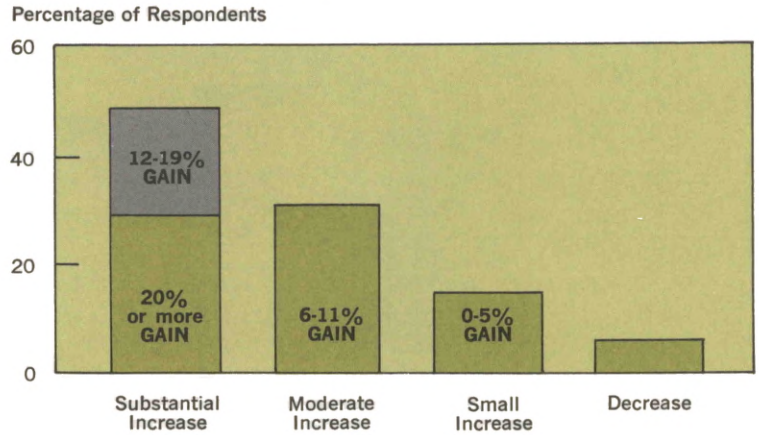
ABOUT THE SURVEY

In early December questionnaires were sent to treasurers of corporations included in *Fortune's* compilation of the largest 500 manufacturing and 150 nonmanufacturing firms. The overall response rate was 60 per cent.

Although surveys for business outlays on plant and equipment are well known, this survey is the only large-scale attempt to determine the financial feasibility of total corporate spending plans. Since firms responding to our survey account for a large share of the corporate sector, a reading of their financial expectations can give us a clue to the general firmness of overall spending plans for next year.

Two caveats should be entered, however. First, the survey is limited to the largest firms in the country, and no attempt was made to ascertain if expectations of smaller firms might differ. Second, probing expectations of the corporate financial mind on a comprehensive basis is relatively new and must be regarded as experimental. The survey is too new, for example, to attempt to remove systematic biases in the respondents' answers.

CHART 2
NEARLY ALL RESPONDENTS EXPECT SOME INCREASE IN AFTER-TAX PROFITS, THREE OUT OF TEN LOOK FOR AT LEAST A 20 PER CENT GAIN.



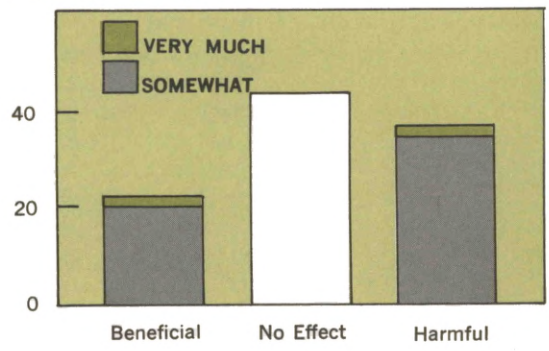
in profits for the total nonfinancial sector.

According to Chart 2, about half of those responding believe a substantial profit increase of 12 per cent or more is in the offing in '72, with nearly three out of ten forecasting a whopping increase of 20 per cent or more. This is one of the best outlooks for profits we have obtained in any of our previous surveys. If these expectations are fulfilled, 1972 will be one of near-record profits. It will also mark the largest gain in profits since 1965.

There is reason to believe that these expectations may be about on target. As the economy gains momentum along the expansion path and business firms cut into their excess capacity, productivity gains should boost profit margins. Productivity advances, and to some extent wage controls, can be counted upon to brake the spiraling unit labor costs of recent years. When these factors are meshed with the overall growth in aggregate demand, foreseen by most economists, the corporate treasurers' outlook for profits seems realistic.

The bullish outlook financial managers hold for profits comes despite, not because of, Phase II wage and price controls. Over a third of the treasurers view controls as actually harmful to their profit position, while 43 per cent believe controls will have little or no effect on their company's profits in 1972 (Chart 3). Only about a fifth feel their profits will benefit from controls.

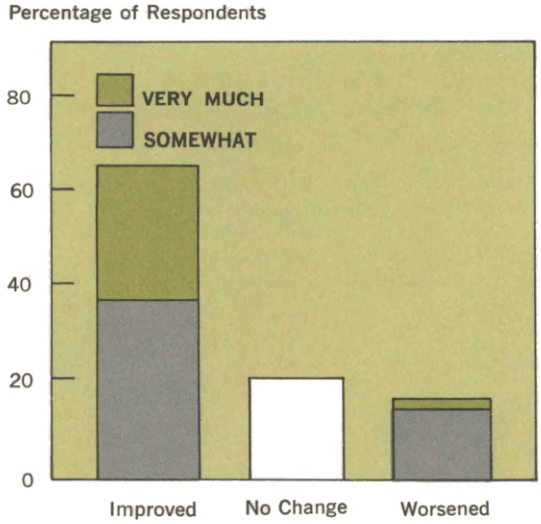
CHART 3
MOST TREASURERS FEEL PHASE II WILL BE NEUTRAL OR SOMEWHAT HARMFUL TO PROFITS.



LIQUIDITY: BACK ON TRACK

Our surveys of the past three years have revealed that skimpy liquidity has been a major concern for financial managers. These past shortages, according to treasurers, have been substantially corrected in 1971 and, except for a very small minority of firms, will not resurface as a problem in '72. When asked how their liquidity had changed during the past year, about two-thirds of the corporate treasurers indicated improvement had occurred. Nearly 30 per cent of this group responded that liquidity was very much improved (Chart 4). Only 15 per cent reported a deteriorated position in the past year.

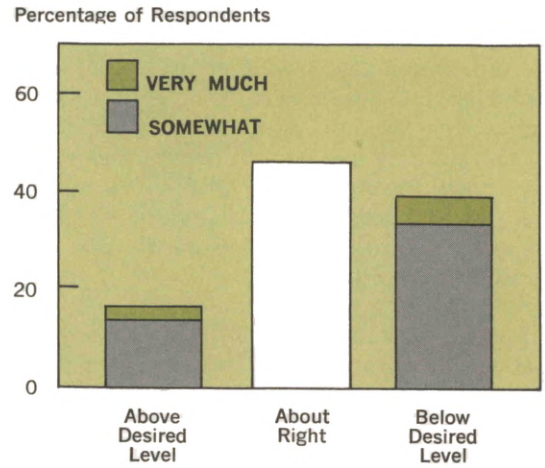
CHART 4
CORPORATE LIQUIDITY IMPROVED FOR SIX OUT OF TEN FIRMS IN '71.



Because of this improvement, 61 per cent now appraise their position as being at a comfortable level, or even above the preferred position, as Chart 5 indicates. Less than 5 per cent feel they have a major liquidity rebuilding job in 1972.

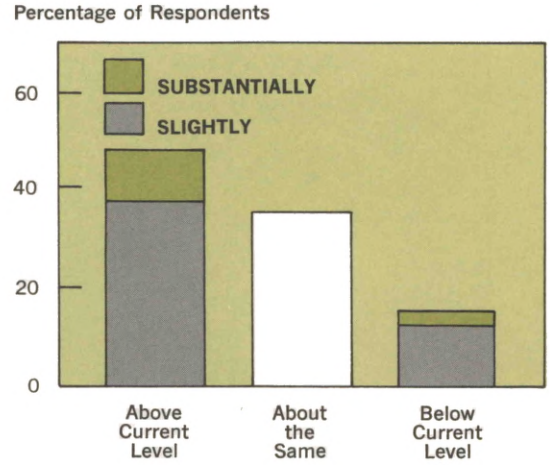
Nonetheless, corporate treasurers have learned some lessons from the past, and

CHART 5
A MAJORITY FEELS ITS LIQUIDITY IS AT A DESIRABLE LEVEL OR ABOVE.



they plan further steps in '72 to avoid squeezes brought on by short liquidity. When asked where they would like their liquidity to be a year from now, about 50

CHART 6
HOWEVER, HALF WOULD STILL PREFER LIQUIDITY ABOVE CURRENT LEVELS BY NEXT YEAR.



per cent replied they would like it to be above present levels (Chart 6). In other words, half would still opt for more liquidity even though less than 40 per cent felt it was now below standards. This desire to hedge suggests that financial managers would prefer to pay the price of being overly liquid rather than risk the more painful costs associated with being caught short.

The primary means of fortifying the liquidity position will be a rise in internally generated funds — profits and depreciation — and to some extent an expansion of bank credit lines. Eight out of ten respondents anticipate a gain in internal sources. In contrast, a substantial majority of those canvassed do not expect an increase in external funds. However, about 30 per cent of the treasurers hope to expand their bank credit lines, apparently to stake an early claim for bank funds in case financial flows shrink.

CAPITAL SPENDING: AN UPSWING IN THE MAKING?

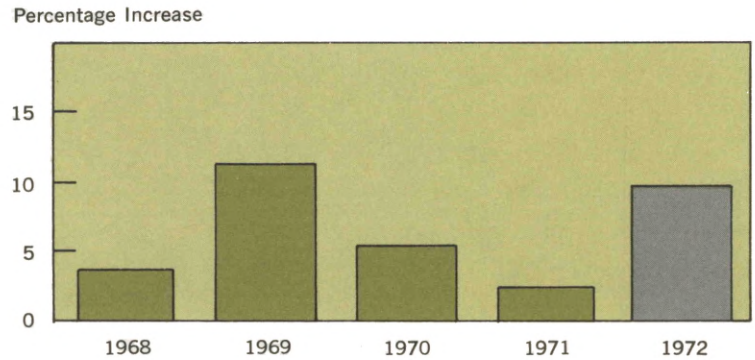
Since 1969 spending on new plant and equipment has been sluggish. The interaction of such factors as rising costs, excess capacity, dwindling profits, and lackluster sales explains most of this softness. As shown in Chart 7, corporate treasurers now report an upturn of about 10 per cent in capital spending is on the drawing boards for 1972.[1] After adjusting for inflation, the increase is not so pronounced since practically all the treasurers believe plant and equipment prices in their own industry will rise 3 to 6 per cent. Despite what can be considered only a moderate increase in capital investment, it is still a welcome contrast to 1971 when price increases more than accounted for the reported gain of 2 per cent.

However, viewing capital expenditures within the framework of the total financial picture, there may be room for an upward revision in current plans. Considering the uses of funds, most firms report that liquidity is now at a comfortable level and will not be a major drain on funds in '72. Conversely, considering the sources of funds, most corporate treasurers see internal funds, including profits, entering a phase of substantial growth. In short, some "extra" cash may be available in '72.

Except for capital investment, there is not a wide range of feasible spending alterna-

[1] The projected rise of 10 per cent received from our surveyed firms compares favorably with the 9.1 per cent increase recently released from a survey taken by the Commerce Department and the Securities and Exchange Commission.

CHART 7
PLANT AND EQUIPMENT EXPENDITURES ARE PROGRAMMED FOR 10 PER CENT INCREASE.

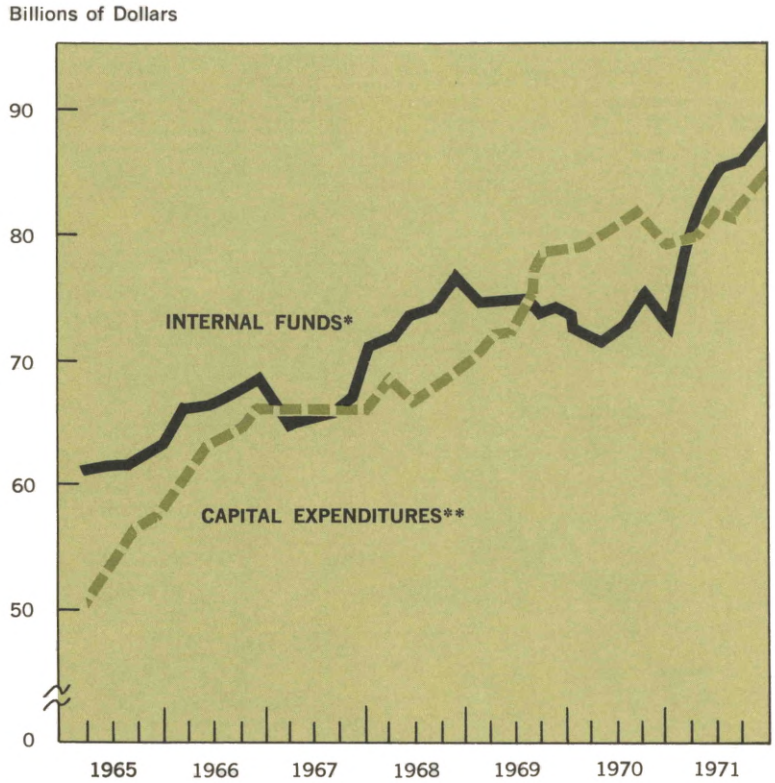


tives available this year. First, a step-up in inventory accumulation is in order this year, but this spending alternative is unlikely to absorb a substantial share of the internal cash flow. Second, retirement of long-term debt and equity is another possibility. However, examination of anticipated changes in these two categories of funds reveals only a modest decline. Finally, because of Phase II, funds cannot be readily diverted into the wage and dividend stream.

Therefore, an upward revision in plant and equipment spending plans may be in the offing, even though a number of industries are faced with excess capacity. Rather than spending on additional capacity, many firms might seize upon this opportunity to overhaul and update their physical facilities. Furthermore, those firms facing pollution-abatement chores may decide that now is the time to allocate more funds in this direction.

CHART 8

GROWTH OF INTERNAL FUNDS AFFECTS CAPITAL EXPENDITURES.



Note: All figures are seasonally adjusted annual rates.

*Profits after taxes and dividends plus capital consumption allowances for all corporations.

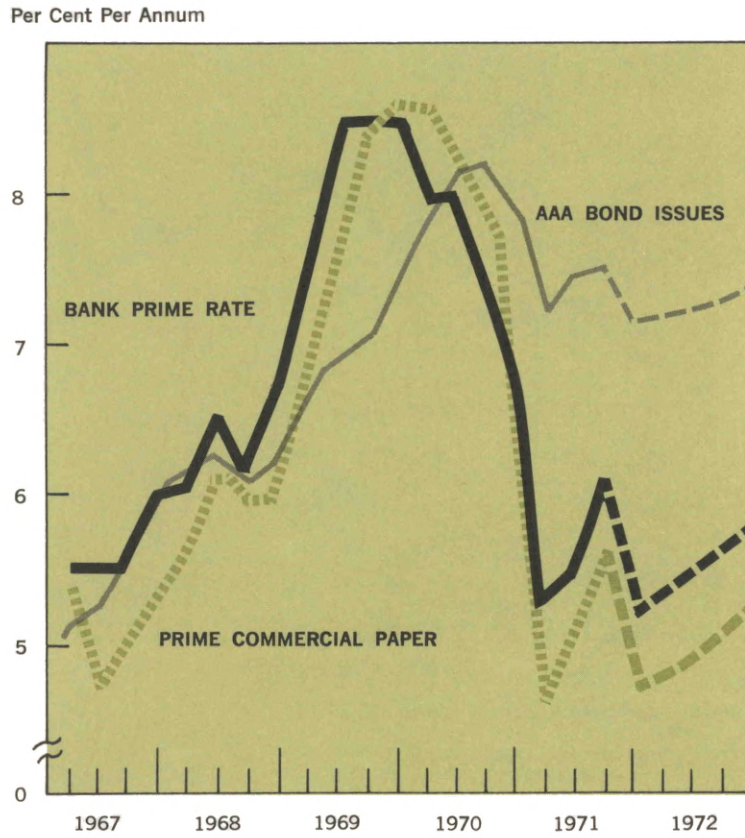
**Includes total business plant and equipment expenditures except those in agriculture.

Moreover, the historical relationship that has prevailed between internally generated funds and capital spending seems to point to bigger outlays. Chart 8 reveals that a slowdown in cash flow tends to signal a lull in capital spending, and an increase in cash flow usually is a forerunner to a pickup in investment outlays. Cash flow began accelerating last year after being in the doldrums for two years. The recently passed investment tax credit and more liberal depreciation rules along with a bright profit picture almost insures that cash flow will reach record heights this year. With cash flow moving at such a fast pace, capital spending probably is not far behind.

INTEREST RATES: ON THE LEVEL

According to the projections of corporate treasurers, interest rates at the long end of the rate spectrum should remain fairly steady. A small dip is expected early in the

CHART 9
INTEREST RATES WILL DIP SLIGHTLY BEFORE RISING DURING SECOND HALF OF '72, SAY CORPORATE TREASURERS.



year, followed by a slight upward trend; but the range from trough to peak should be no more than 20 basis points for the year (Chart 9).[2]

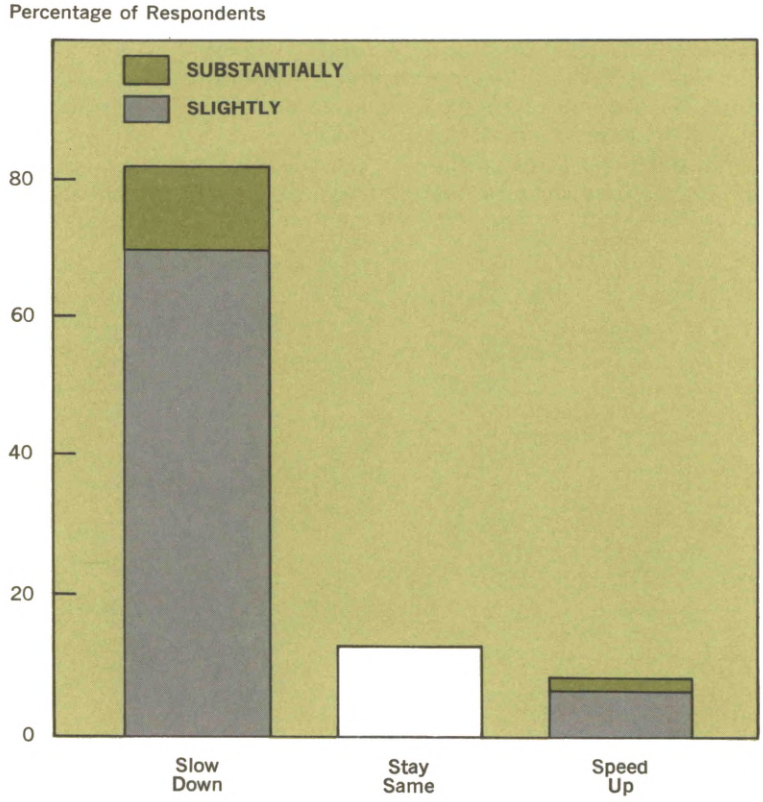
As we have already noted, financial managers expect a healthy gain in internally generated funds, which will enable them to finance much of their current needs. If these expectations are realized, they will not have to tap the bond market as much as in '70 and '71. Thus, demand pressure on long-term rates from the corporate sector will be diminished.[3]

[2] Nearly all the questionnaires were completed and returned during the first part of December 1971. Since then all rates have fallen below the projected levels. The direction of change forecasted by treasurers is turning out to be correct; the depth and timing of the change is off somewhat.

[3] Although corporate treasurers believe the pressure on long-term rates will subside, their expectations are not entirely consistent with the aggregate responses we received to one particular question. When asked for their anticipated changes in various external sources in '72, two-thirds responded with "little or no change" from 1971 in new bond issues, which would imply a third consecutive year of unusually high offerings. One must be skeptical of such a high proportion of firms reporting "no change" in bond issues in '72. During 1970 and 1971, bond issues set records, primarily because proceeds were needed to build up liquidity. Given that liquidity is now adequate, cash flow is projected at an all-time high, and with only moderate capital spending planned, the likelihood of bond issues being maintained at the high levels of the past two years seems questionable.

CHART 10

EIGHT OUT OF TEN RESPONDENTS BELIEVE RATE OF INFLATION WILL SLOW DOWN.



Defusing of inflationary expectations is another good omen for steady long-term rates. The pressure on rates arising from an inflation premium appears to be dwindling. As evidenced by Chart 10, corporate treasurers agree for the most part that the worst inflation hurdle is now behind us. Two-thirds of them see the rate of price increase for the economy as a whole declining slightly, while an additional 12 per cent believe there will be a substantial slowdown.

Short-term rates are expected to dip more sharply than long-term ones during the first part of the year, then rise about 50 basis points as the year progresses. Short-term rates usually rise as the economy gains momentum. By past standards, however, a 50-basis point hike is not large during periods of business recovery.

Interest rates, of course, are not solely determined by supply and demand pressures in the corporate sector. For example, the impact of the government, international, and mortgage sectors, as well as Federal Reserve actions, could influence the rate structure and level. However, it is the assessment of our respondents that, on balance, these influences will also help keep a damper on rates.

SUMMING UP

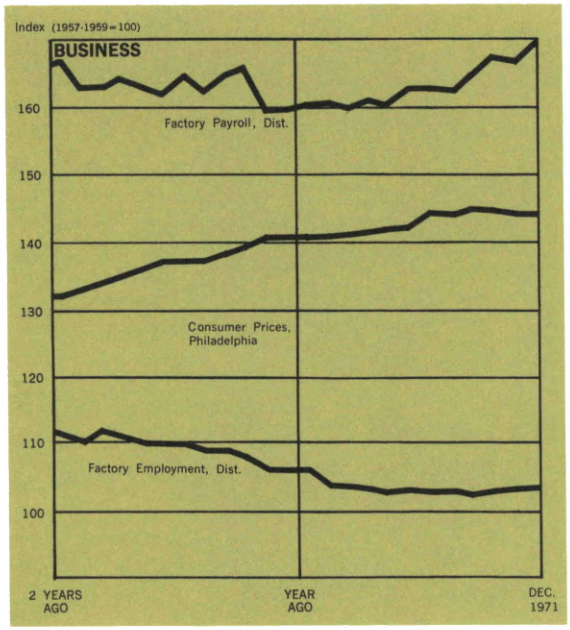
Two years ago treasurers were bullish about spending plans for plant and equipment, but these plans were suspect because they were conditioned upon rising profits at a time when the economy was heading downward. The cash flow did not materialize, and capital spending had to be pared.

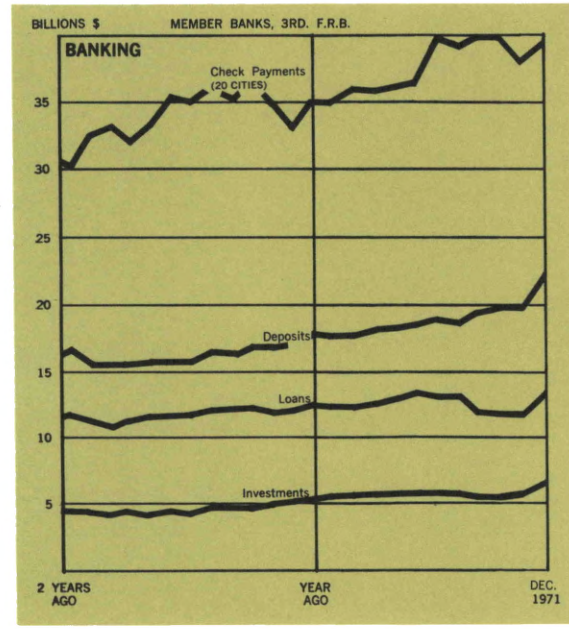
Fortunately, it's the other side of the coin for '72. The economy is moving upward, and there are favorable signs pointing to a substantial increase in after-tax corporate profits. To brighten the picture, deficient liquidity of the past has been essentially corrected, and only minor liquidity reinforcement is likely to be needed this year.

Although corporate treasurers already project a 10 per cent increase in capital investment, their spending plans may not be ambitious enough to keep pace with the expected record flow of internally generated funds. The upshot is that plant and equipment spending plans will likely undergo upward revisions periodically as the year unfolds.

A pleasant predicament for the corporate treasurer in '72? It appears so. ■

FOR THE RECORD...





SUMMARY	Third Federal Reserve District			United States		
	Per cent change			Per cent change		
	Dec. 1971 from		12 mos. 1971 from	Dec. 1971 from		12 mos. 1971 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
MANUFACTURING						
Production	....	....	....	− 4	+ 3	N/A
Electric power consumed	− 3	+ 3	+ 1	....	....	....
Man-hours, total*	0	− 2	−14	....	....	....
Employment, total	0	− 3	− 5	....	....	....
Wage income*	+ 2	+ 5	+ 1	....	....	....
CONSTRUCTION**	− 7	+19	+19	− 2	+19	+17
COAL PRODUCTION	+119	− 2	− 8	+93	−13	N/A
BANKING (All member banks)						
Deposits	+ 6	+13	+14	+ 4	+11	+14
Loans	+ 3	+ 9	+ 9	+ 3	+ 8	+ 8
Investments	+ 3	+21	+26	+ 3	+14	+20
U.S. Govt. securities	+ 6	+ 7	+10	+ 6	+ 5	+11
Other	+ 2	+29	+36	+ 2	+20	+26
Check payments***	− 3†	+13†	+ 8†	− 4	+13	+15
PRICES						
Wholesale	....	....	....	+ 1	+ 4	+ 3
Consumer	0‡	+ 3‡	+ 5‡	0	+ 3	+ 4

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

†15 SMSA's
‡Philadelphia

LOCAL CHANGES	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
Standard Metropolitan Statistical Areas*	Per cent change Dec. 1971 from		Per cent change Dec. 1971 from		Per cent change Dec. 1971 from		Per cent change Dec. 1971 from	
	month ago	year ago	month ago	year ago	month ago	year ago	month ago	year ago
Wilmington	0	− 3	+ 6	+ 7	−11	+26	+18	+17
Atlantic City	....	....	+ 4	+15	− 6	+ 8	+ 1	+28
Trenton	− 3	− 4	+ 7	+ 4	− 4	+21	+ 4	+16
Altoona	− 5	− 7	− 4	− 3	+ 3	+14	+ 1	+13
Harrisburg	0	− 1	+ 1	+ 5	− 1	+20	+ 2	+10
Johnstown	+ 2	− 2	+12	+24	0	+22	+ 4	+13
Lancaster	− 1	− 5	+ 1	+ 5	+ 3	− 6	+ 2	+15
Lehigh Valley	− 1	− 4	+ 5	+11	− 3	+11	+ 3	+16
Philadelphia	0	− 2	+ 2	+ 4	− 1	+ 9	+ 8	+12
Reading	+ 1	+ 2	+ 3	+14	− 1	+ 8	0	+ 9
Scranton	− 1	+ 1	+ 1	+ 8	− 2	+ 6	+ 2	+16
Wilkes-Barre	− 1	− 3	− 2	+ 6	− 5	+44	+ 2	+22
York	− 1	+ 1	− 1	+10	+ 8	+22	+ 2	+12

*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.