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The Very Controversial Tax on Value Added

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By now almost everyone has heard or read at least something about the tax on value added (or, as commonly abbreviated, the VAT). The aura surrounding the tax has often made it appear to be a panacea for many economic problems. Indeed, numerous advantages have been claimed for the VAT as a substitute for many of the not-so-popular taxes in the nation. For example, much of the early attention given to the VAT in the United States centered around its possible use as a substitute for all or part of the corporation income tax. It was alleged that its use in lieu of the corporation income tax would improve economic efficiency. Many also argued that improvement in the balance of payments would result from this substitution. More recently, however, the alleged improvement in the balance of payments has been strongly questioned. But the VAT has remained in the spotlight—now as a possible substitute for some of the burden of property taxes employed heavily by state and local governments. The tax has recently been under study by the Administration and the Joint Economic Committee of Congress.

Despite the considerable attention given to the tax in the press, there remains much misunderstanding about it. This article is to provide a general overview of the value added tax and the various uses proposed for it in the United States. It briefly reviews earlier and current experiences with the tax in this country and in Europe. We shall see that the reasons for its adoption by the nations of the European Common Market differ significantly from many of the advantages claimed for its use in the United States. The article next discusses the concept of value added and the tax on it. This serves to illustrate the similarity between the value added tax and many other already-existing taxes. Finally, the various pros and cons over the possible uses of VAT in the United States are reviewed.

The Value Added Tax in Other Nations

In simple terms, the VAT is a tax levied on the value added to a commodity at each stage of its production. The VAT is not an American invention.

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It is now in common use in many European nations. France adopted the first VAT in 1954, but the tax was limited to manufacturers and wholesalers and did not apply at all to retailers. Wholesalers had the option of paying either the VAT or a wholesale sales tax. In 1967, Denmark adopted the first comprehensive VAT. The Danish tax includes all stages of production, including the final retail sales. With the ratification of the Treaty of Rome, the member nations of the European Common Market committed themselves to adopting a VAT as a first step toward eventually harmonizing their various tax structures. France and Germany adopted VAT's in January 1968. In Germany, the VAT replaced an existing turnover, or gross sales tax, as had the earlier, less comprehensive French VAT. The Netherlands and Belgium followed suit in 1969. Only Italy of the Common Market nations and Britain, the newest member, have not yet adopted VAT's. Italy is scheduled to change in January 1973. Britain has announced its intention to substitute a VAT for two present taxes—the purchase tax and the selective employment tax. Among the nonmembers of the Common Market, the tax is also popular. In addition to Denmark, Norway and Sweden have also adopted VAT's. Ireland, Austria, and Switzerland are considering its adoption.

The European VAT's use both multirate and single-rate structures. In general, the Common Market members have adopted multirate VAT's. In Germany, the rate is generally 11 percent, but an increase to 12 percent is planned. For foodstuffs, however, some raw materials, some professional services, and a few other items, the rate is only 5.5 percent. The French VAT has four different rates. The general rate is 23 percent on value added, but farm products and food are taxed at only 7.5 percent, while fuel and electricity are taxed at 17.6 percent. Luxuries are taxed at 33.3 percent. Rates in Belgium vary from 6 percent on necessities to 25 percent on luxuries, with 18 percent being standard. In the Netherlands, the rate on necessities is 4 percent, and the standard is 14 percent. In Luxembourg, the rates are 5 percent and 10 percent, respectively.

In the Scandinavian nonmember nations, a single-rate VAT has been employed. In Denmark, the VAT was introduced at a 10-percent rate. The rate was later increased to 12.5 percent and still later raised to 15 percent. In Sweden, the initial 11.1-percent rate has been raised to 17.65 percent. In Norway, the rate is currently 20 percent on value added.

Generally, the European VAT's apply to both goods and services. There are exceptions, however. Some professional services are not always taxed, but the VAT's in the various European nations are not uniform in this regard. For example, doctors' and lawyers' fees are exempt in Denmark,

but architects' and veterinarians' fees are not. Medicines are usually subject to the tax. Barbers' and hairdressers' fees are exempt from the tax in Denmark, but not in Sweden. Rents are generally exempted. Farm products are generally not. The most important exemption, however, is a particular class of goods—capital goods. Taxes paid on capital goods may be credited by the purchaser against his other tax liability. Consequently, there is no tax on capital goods.

The VAT applies to taxable goods and services at all stages of an economy's production process. Producers, manufacturers, wholesalers, and retailers are required to collect the tax where applicable. Thus, administration of a VAT differs substantially from that of the more familiar single-stage sales taxes, such as the retail sales tax, which is widely employed in the United States. Finally, the European VAT's apply to imports as well as domestically produced goods and services. It does not, however, apply to exports. Export-destined goods are either exempted from the tax, or taxes paid on them are rebated at the time of exportation. This feature led to claims in the United States (which are, at best, only partly true) that the tax creates an unfair competitive advantage for European nations in international trade.

It is now generally accepted, however, that any international competitive advantage would be only temporary. Nor was it the reason that European nations adopted the VAT. The primary reason for the adoption of VAT's was to enhance the efficient use of economic resources. In Europe, most nations adopted VAT's to replace existing sales taxes of one form or another. The most prevalent form replaced was the multistage gross turnover, or cascade tax, but many nations replaced single-stage sales taxes. European studies concerning potential improvements in their tax structures began as far back as 1953, when the Tinbergen Report documented the problems of turnover taxes in a common market setting. In 1963, the Neumark Report to the European Common Market studied the problems raised by different tax systems within an economic union and the gains in efficiency that would result from tax harmonization among the various member nations. Both reports sought to determine tax structures that would result in the greatest gains to economic efficiency, and both reports recommended substitution of VAT's for existing turnover taxes.

The turnover tax formerly used in Europe—as will be shown more clearly later in the article—is considerably different from the VAT. In effect, the turnover tax applied to gross sales at each production stage, whereas the VAT does not. As a result, the turnover tax at the second stage applied not only to the value of the product created in

the second stage but also to the value created in the first stage and the tax levied on it in the first stage. This meant that firms and industries with a high degree of vertical integration paid a lower effective tax rate than firms and industries with less vertical integration, even though the legal tax rate was the same on both.¹ As a result, the effective tax rate varied among firms, among products, and among industries. Such differential taxation can greatly distort the efficient allocation of an economy's resources. Thus, the European nations' initial concern was to eliminate an inefficient tax and to substitute a better tax for it. The secondary question was whether to continue use of a national sales tax, but in a different form, or to adopt some form of a national income tax.

Several reasons suggested that continued use of a national sales tax was preferable, both in the Common Market nations and in the nonmember nations. One of the more important reasons was that income taxes were already used extensively in these nations and further increases in them might have been detrimental. Some form of national sales tax, however, would have been more familiar and also would probably have had considerably more potential as a revenue raiser. An additional reason for avoiding higher income taxation was that income tax evasion is almost a tradition in many European nations. Business organization patterns, such as the prevalence of small shopkeepers, made collection difficult and evasion relatively easy.

Of the various forms of sales taxation, a general VAT was considered to be the least likely to result in distortions to the economy and was administratively enforceable. Yet, it was recognized that the VAT is probably not general even in nations with a uniform tax rate, if for no other reason than the numerous exemptions from the tax. Thus, the VAT was not expected to be truly neutral with respect to economic activity, and, consequently, the uses of economic resources probably are influenced by the tax. In nations with both exemptions and rate differentials, the VAT would be even less neutral. Nevertheless, as a form of sales taxation, it does not discriminate in the unintended and capricious manner of the turnover tax. Thus, the shift to the VAT was expected to and probably did result in some gain in economic efficiency. The reason for preferring the VAT to a single-stage sales tax was similar to that for income taxes. The records required for firms to minimize their individual VAT burdens could be used by the governments to prevent

evasion that might be possible with a single-stage tax. Quite simply, the required records made evasion more difficult with the VAT.

Finally, within the Common Market nations, there was a desire to harmonize tax structures and rates. Although this could conceivably be done with other taxes, it was probably much more feasible to harmonize taxes by adopting entirely new taxes. The VAT appeared to be the best available.

The VAT in Michigan

In 1953, the Michigan legislature adopted a tax called the Business Activities Tax. Despite its name, the tax was essentially a tax on value added within Michigan. Thus, the VAT is not entirely new to this country. The tax, however, lasted only until 1967, when it was repealed and replaced by a corporate net income tax. A similar tax was narrowly rejected by the West Virginia legislature in 1967; no other states have employed this tax form. It is instructive to review some of the reasons for the adoption of the Business Activities Tax in Michigan and for its repeal 14 years later.

The immediate reasons leading to Michigan's adoption of the tax were primarily fiscal and political. The state had been faced with inadequate revenues. Confronted with this need, a political battle ensued over whether a corporate income tax should be adopted, the State's corporate franchise tax increased, or the sales tax increased. As a compromise, the Business Activities Tax was enacted.

The tax was reasonably successful in Michigan. Most of the total tax bill was paid by corporate manufacturers, but the tax extended up to the retail level and applied to noncorporate businesses as well. The tax was a highly productive revenue raiser, bringing in about \$23.4 million during its first year of existence. In its fiscal year, it raised over \$128 million. Thus, in 14 years the tax yield increased more than fivefold. During this time, rates had increased but by only twofold. In addition, the tax base had been eroded as additional exemptions, deductions, and loopholes were added. Clearly, the tax was an effective revenue raiser and was responsive to economic growth in the State.

The tax had some undesirable aspects, which at least partly led to its demise. For example, utilities were taxed at a lower rate. Moreover, capital expenditures and depreciation were inadequately treated. The treatment of interest and dividend earnings tended to favor debt financing over equity financing. These, however, were not the primary reasons for the repeal of the Business Activities Tax. One of the principal arguments raised against the tax was that if a firm makes no profit, it should pay no tax in order to avoid

¹Vertical integration refers to the amount of involvement of a single company in the entire production process of a commodity. For example, a company that manufactures, wholesales, and retails shoes would be more vertically integrated than a company that merely manufactures shoes.

additional hardship to the firm. It is possible for a firm to "add value" and to suffer a loss at the same time. If this happens, the firm would incur a tax liability. Supporters of the VAT replied that even a money-losing firm receives benefits from government services and should be taxed to pay for them. Nevertheless, the no profit-no tax argument was very influential in the repeal of the Business Activities Tax. A final reason for its repeal was to ease the sting of introducing a state income tax. These factors seemed to have been sufficient to bring the downfall of the United States' only experiment with a value added tax.

What Is a Value Added Tax?

Experience with the VAT has proved it to be a popular and effective form of taxation. It could be used as an addition to or as an alternative to several existing taxes in this country. Let us look, therefore, in somewhat greater detail at the tax

An example may clarify the concept of value added. Table 1 depicts a production process involving four stages—raw materials production, manufacturing, wholesaling, and retailing. It is assumed for simplicity that the raw materials producer buys no material inputs for his own use other than his capital investment. He sells raw materials to the manufacturer for \$100. The difference between his sales and purchased inputs is \$100, which is his value added. From this amount, he must pay wage, rent, and interest expenses totaling \$80, thus leaving a profit of \$20. The manufacturer converts the raw materials into products that he sells to a wholesaler for \$500. The difference between this amount and his \$100 worth of purchased materials leaves his value at \$400, which again must equal the sum of wages, rent, interest, and profit. Similar columns summarize the activities of the wholesaler and the retailer.

Some general characteristics should be noted from Table 1. First, at any particular stage in the process, value added is equal to either (1) the difference between sales and material purchases or (2) the sum of factor payments including profits (wages, rents, interest, and profits). Second, the sales value at any one stage equals the sum of value added at that stage and all previous stages. Thus, the \$1,000 sales value at the final or retail stage equals the sum of value added at all four production stages (as shown in the cumulative column), and, hence, the sum of factor payments at all stages. It also equals the difference between the cumulative totals of sales and purchased material inputs.

TABLE 1

Value Added in a Four-Stage Production Process

	Raw Materials Producer	Manu- facturer	Whole- saler	Retail- er	Cumu- lative
Sales of Output	\$100	\$500	\$800	\$1000	\$2400
Purchases of Material Inputs	—	100	500	800	1400
VALUE ADDED	100	400	300	200	1000
Wages	60	275	200	100	635
Rent	10	25	40	50	125
Interest	10	50	25	25	110
Profit	20	50	35	25	130

itself. In particular, this section concerns the administration and the base of the tax. That is, we look at the important practical aspects of how the tax is applied and the important conceptual aspect of what is taxed. We shall find that the primary difference between the VAT and existing taxes lies in its administration. In its concept and its base, however, it is closely kin to several existing taxes.

The distinguishing features of a VAT are that it applies at all (or most) stages of production, rather than only one stage, and it applies to only part, rather than all, of the value of transactions at each stage. That is, the tax applies *only* to the value of products that is *added* at each production stage. For a firm, *value added* is the difference between the value of that firm's output when sold and the value of the materials and supplies purchased from other firms for use in producing the output. But value added is a two-sided coin. This same difference in value is also equal to the cost of nonmaterial inputs in the production process. That is, it will equal the sum of the firm's wage, rent, and interest payments, and its residual profit.

The Administration of the VAT

There are two basic methods of determining the VAT liability. These are generally referred to as the *deduction method* and the *addition method*. Under the deduction method, however, there are two different ways to compute the tax liability—the *subtraction method* and the *credit method*. Thus, there are actually three methods to determine the VAT liability, two under the deduction method and one under the addition method.

The credit method acquires its name because the tax rate is applied to total sales and a credit is granted for taxes paid on material purchases. The subtraction method computes value added directly by subtracting material purchases from sales and applies the tax rate to the difference. Finally, under the addition method, value added is computed by adding together all factor

Table 2 depicts how the VAT would be computed under the credit method in a highly simplified economy. The table retains the same four-stage production process shown in Table 1. For simplicity, it is assumed that there is no capital investment and no depreciation. Suppose that the VAT is levied at a 10-percent rate. Under the credit method, the selling firm determines its tax liability by applying the 10-percent tax rate to its total sales. It then deducts from this gross amount the amount of any VAT paid on its purchases of material inputs. The difference is its net tax liability of the firm. In Table 2, for example, the raw materials producer applies the 10-percent tax rate to its sales of \$100. Since it has no purchased material inputs, its gross and net tax liabilities are both \$10. The total cost of the sale to the manufacturer is \$110, of which \$10 is paid to the government and \$100 to the raw materials producer. The manufacturer then converts the raw material into a finished product, thereby adding \$400 in value. In order to determine his tax liability, the manufacturer follows a similar procedure. He sells his output for \$500 and applies the 10-percent tax rate to this sale. His gross tax liability is thus \$50, making the total cost to the wholesaler \$550. The manufacturer, however, deducts from the \$50 gross tax liability the \$10 tax he paid on his purchases from the raw materials producer, leaving his net tax of \$40—or 10 percent of his value added of \$400. Similar procedures are followed by the wholesaler and the retailer until the final sale for consumption ends the production process.

The second deduction method, the subtraction method, is much simpler. In this case, the firm computes its value added by subtracting its purchases of material inputs from its sales of output and applies the VAT rate directly to this amount. The method is shown in Table 3. The addition method, however, takes a fundamentally different approach. As shown in Table 1, the sum of factor payments and profits equals value added. Thus, under the addition method, the VAT liability is computed by adding factor payments and profits and applying the tax rate to the sum. The process is illustrated in Table 4.

payments—including profits—and the tax rate is applied to the sum.

The addition and subtraction methods might seem less complicated than the credit method. (See the example in the box.) However, the credit method is the approach used in the European nations in order to combat tax evasion. With the credit method of computing the VAT liability, records are automatically generated that tend to discourage tax evasion. For example, in order to

TABLE 2
VAT under the Credit Method¹

	Raw Materials Producer	Manu- facturer	Whole- saler	Retail- er
Sales of Output	\$100.00	\$500.00	\$800.00	\$1000.00
Cost of Inputs	—	100.00	500.00	800.00
Value Added	100.00	400.00	300.00	200.00
Tax on Total Sales	10.00	50.00	80.00	100.00
Credit for Taxes Paid on Purchases	—	10.00	50.00	80.00
VAT Liability to Government	10.00	40.00	30.00	20.00
Total Cost of Output to Buyer	110.00	550.00	880.00	1100.00

¹The total cost figures in the table involve several highly simplified assumptions. In general, they assume that taxes are fully reflected in higher sales prices. For broadly based taxes applying to all or nearly all goods and services in the economy (such as a VAT), this is a highly suspicious assumption. The response of sales prices to taxes in such cases would depend not only on the tax but also on numerous other equally important factors, such as monetary policy actions.

TABLE 3
VAT Computation under the Subtraction Method

	Raw Materials Producer	Manu- facturer	Whole- saler	Retail- er
Sales of Output	\$100.00	\$500.00	\$800.00	\$1000.00
Purchases of Material Inputs	—	100.00	500.00	800.00
Value Added	100.00	400.00	300.00	200.00
VAT	10.00	40.00	30.00	20.00

TABLE 4
VAT Computation under the Addition Method

	Raw Materials Producer	Manu- facturer	Whole- saler	Retail- er
Wages	\$ 60.00	\$275.00	\$200.00	\$100.00
Rent	10.00	25.00	40.00	50.00
Interest	10.00	50.00	25.00	25.00
Profit	20.00	50.00	35.00	25.00
Value Added	100.00	400.00	300.00	200.00
VAT	10.00	40.00	30.00	20.00

receive his tax credit and, therefore, reduce his VAT liability, the taxpayer must be able to provide purchase receipts that itemize the VAT actually paid by him on his purchases. This same receipt

provides the tax collector with a record of the seller's sales. Thus, the seller has difficulty understating his sales (and, hence, understating his tax liability). The receipt, which is necessary to help the buyer minimize his VAT liability, also provides a record to the government—which discourages the seller from cheating on his VAT liability. In Europe, these receipts have also proved valuable in checking income tax returns.

Three Types of VAT's

The discussion thus far has not distinguished between purchases of capital and consumption goods. This distinction and the method of handling capital goods for tax computation are important determinants of the tax base and of the relationships between VAT's and other types of taxes. Not all goods that a firm purchases are immediately transformed into a different product. For example, one printing press is not entirely used up in producing one newspaper or even one edition of a newspaper. The printing press is a capital good that is only used up in the production process over a long period of time.

Two primary types of VAT's evolve from the way in which capital goods are treated. If capital goods are fully deductible at the time they are purchased, just as are purchases of other material inputs, then they are excluded from the tax base. The tax applies, therefore, only to those goods produced for final consumption. This type of VAT is referred to as a *consumption type VAT*. On the other hand, if only the depreciation on capital goods is deductible from sales, then the tax base is very similar to what economists call net national income and the tax is referred to as an *income type VAT*. The income type VAT base essentially consists of value added for consumption use plus value added for net additions to the country's stock of capital goods. In Europe, the consumption type VAT is employed.²

VAT Compared With Other Taxes

Using the examples in the boxes permits us to compare the VAT with the retail sales tax and the cascade tax previously popular in Europe. With some interpretation, we may also compare the VAT with a combination of taxes on incomes. Consider a cascade tax levied at the same rate as the VAT in the examples, that is, at 10 percent. Since the tax applies fully to all sales without credit for previous taxes paid, and assuming that cumulative sales are \$2,400 (Table 1), the total

The differences between the computations of value added under these two types and the resulting taxes may be described with tabular examples. Table 5 shows the computation of the tax bases for an income type and a consumption type VAT. Purchases and sales are broken down in the table according to whether the goods sold are used by the buyer as an intermediate or capital good in the production process or as a final consumer good. Value added under the consumption base is simply the difference between total sales and total purchases of inputs, whether used as intermediate or capital goods by the buyer. Value added under the income base is the difference between total sales and the sum of purchases of intermediate goods and depreciation of capital goods. Thus, value added under the income base for the raw materials producer is only \$90, since his capital stock is assumed to have depreciated by \$10. Even though he did not actually purchase any capital goods, he is still allowed a deduction for depreciation. The manufacturer computes his value added by deducting the costs of his intermediate input purchases (\$425) and the depreciation on his capital stock (\$35) from his total sales (\$800). Similar computations are made by the wholesaler and the retailer. The total tax base under the income concept is higher than under the consumption concept by the amount of net investment. The income type VAT base is \$1,040, but the consumption base is only \$1,000.

Table 6 shows how the tax liability would be computed under the two concepts by using the credit method. Computation under the consumption base is the same as was shown in Table 2. For the income base, the taxpayer also computes the tax due on his total sales. In this base, however, he is allowed credit for the tax paid on his purchases of intermediate inputs plus his depreciation. Thus, his credit for a 10-percent tax rate, as shown in the Table 6, is 10 percent of his purchases of intermediate inputs plus 10 percent of his depreciation. As seen in the table, the distribution of the tax burden is changed when the tax base is changed. For example, the manufacturer's tax bill is reduced by \$3.50 when a credit is allowed for depreciation in the tax base. The wholesaler's tax liability, however, rises by \$5 because some of his purchases are for capital investment and these purchases exceed his depreciation claimed. In the aggregate, the tax bill is greater by \$4 under the income base—or 10 percent times the amount of net investment.

tax bill would be \$240. In order to achieve a yield equal to the VAT, the cascade tax rate would need to be only slightly more than 4 percent. This, however, oversimplifies one of the principal disadvantages of the cascade tax. Since there is no credit for previous taxes, the actual result in a multistage production process is that later stage taxpayers would probably pay a tax on taxes that had been paid in previous production stages and

²A third variation of the VAT, known as the product type VAT, is generally considered to be inferior to the consumption and income variations and is consequently not discussed in this article.

Consider Now a 10-Percent Retail Sales Tax

Since final retail sales are assumed to be \$1,000 (Table 1), the tax yield would be \$100—exactly the same as the consumption type VAT. The cost to the consumer would be \$1,100—the same as the consumption type VAT. Indeed, it is usually argued that these two taxes are equivalent in their economic effects when the rates and tax bases are the same. Thus, it is often said that the VAT is merely another method to collect a retail sales tax. In practice, of course, the equivalence would probably not be perfect. One major problem would be how to exempt retail sales from the tax when they are intended for use as productive capital rather than consumption goods.

Now consider a truly comprehensive income tax. The current U. S. personal income tax is not comprehensive since many sources of income, such as capital gains and interest on municipal bonds, are either taxed at lower rates or not taxed at all. If, however, the income tax were applied to all forms of income so that capital gains were taxed as they accrue at the same rate as other income, and if the income from municipal bonds were taxed, and if many other loopholes were plugged, then the income type VAT would be very similar to a proportional income tax. That is, since value added in the simple case is the same as the sum of factor payments and profits, the VAT base would be quite close to the base of a comprehensively defined income tax.

Because of these similarities in tax bases, it would seem that the VAT is not really a new tax. It is more appropriately considered a new form of raising tax revenue. After some initial, but lingering, confusion, the discussion over the possible adoption of a VAT by the United States Federal Government has begun to focus on this aspect of the Tax.

Should the United States Employ A Value Added Tax?

The possibility of using a VAT in the United States is usually put in the context of a tax substitution. Proponents of an American VAT initially favored its use as a substitute for at least a part of the corporation income tax. That is, the revenue lost from a reduction in corporate income tax rates would be replaced with revenue raised from a new VAT. Others have also proposed that a VAT be substituted for part, or all, of payroll taxes currently used for financing the Social Security system. More recently, however, attention has focused upon the possible use of a VAT to replace at least part of existing property taxes.

Proponents of a United States VAT have generally emphasized several arguments in favor of adopting the tax. If the VAT were substituted,

TABLE 5

Tax Bases of Consumption Type and Income Type VAT's

	Raw Materials Producer	Manu- facturer	Whole- saler	Retail- er
Total Sales	\$100	\$500	\$800	\$1000
Intermediate Goods	100	425	750	—
Capital Goods	—	75	50	—
Consumer Goods	—	—	—	1000
Purchases of Inputs	—	100	500	800
Intermediate Goods	—	100	425	750
Capital Goods	—	—	75	50
VALUE ADDED				
Consumption Base	100	400	300	200
Income Base	90	365	350	235
Depreciation	10	35	25	15
Wages	55	255	185	90
Rent	10	25	40	50
Interest	10	50	25	25
Profits	15	35	25	20

TABLE 6

Computation of Consumption Type and Income Type VAT Liabilities

	Raw Materials Producer	Manu- facturer	Whole- saler	Retail- er
Sales of Output	\$100	\$500	\$800	\$1000
Purchases of Inputs	—	100	500	800
Intermediate Goods	—	100	425	750
Capital Goods	—	—	75	50
Depreciation	10	35	25	15
Tax on Sales (10%)	10	50	80	100
Tax Credit on Purchases	—	10	50	80
Consumption Base	—	10	50	80
Tax Credit on Intermediate Purchases and Depreciation	—	—	—	—
Income Base	1	13.50	45	76.50
CONSUMPTION VAT	10	40	30	20
INCOME VAT	9	36.50	35	23.50

that had been included in the product's value at the time of sale or turnover. For example, the manufacturer might pay \$110 for his inputs (\$100 for materials and the \$10 cascade tax), add \$400 in value, and sell his output for \$510 plus tax. The wholesaler, therefore, would pay a total of \$561 or \$510 for the inputs and the 10 percent tax of \$51. The result is that the wholesaler has paid a 10 percent or \$1 tax on the \$10 tax paid by the manufacturer. This piling on of tax on tax leads to the distortions between firms and industries with different degrees of vertical integration that do not appear with the VAT.³

³Taking the piling on effect into account, and assuming that taxes are fully reflected in higher sales prices, cumulative sales would be \$2,618, and the total tax bill would be \$261.80.

in part, for the corporation income tax, the new tax structure would be less distorting in several respects. Labor-intensive methods of production would not be favored over capital-intensive methods. Debt financing would not be favored over equity financing. Efficient and profitable firms would not be taxed more heavily than inefficient, unprofitable firms. And finally, the tax laws would not favor noncorporate industrial organizations over corporate organizations. If the VAT were substituted for all or part of the property tax, discrimination against capital-intensive industries would be reduced. In addition, the relatively heavy property tax burden on central city property would be reduced, thus lowering the tendency for property taxes to distort decisions concerning industrial location. These are only a few of the neutrality arguments given in favor of a VAT. Although some of these arguments are valid only under certain assumptions, they nevertheless form a strong case for VAT adoption.

Another argument frequently given in support of an American VAT is that the tax is administratively simple. The VAT is said to minimize the use of tax exemptions and deductions from those now used with our various forms of income taxation. Similarly, substitution of a VAT would reduce the use of differential tax rates. For example, the current method of levying property taxes often results in sharply differentiated rates on similar property separated by only a few miles.

Perhaps the most significant argument raised in favor of adopting a VAT is the revenue raising potential of the tax. It has proved to be a highly productive tax in the European nations and in the State of Michigan. This argument, however, unless accompanied by an argument that the VAT should *replace* some other particular tax, is essentially an argument that the size of the public sector of the economy should be increased relative to the private sector. In addition, it would imply that the best way to achieve this increase would be by imposing a new VAT to raise the revenue since no other alternative is considered.

Finally, there is one questionable argument often raised in support of a United States VAT. It is often alleged that substitution of the VAT for the corporation profits tax would tend to improve the U. S. balance of payments. Under an existing international agreement, the General Agreement on Tariffs and Trade, a country may charge a surcharge on its imports equal to or less than the amount of indirect taxes (such as VAT's or various sales taxes) it charges on similar products produced at home. Similarly, a nation may rebate from the price of any exported good (or not charge) any indirect taxes it normally levies on the product when it is consumed domestically. Surcharges and rebates may not be applied, however, for direct taxes, such as personal and corporate income taxes.

The contention that substituting a VAT for a corporation income tax would improve the balance of payments rests on an uncertain assumption. That is, it is true only if corporations avoid bearing the burden of the corporate income tax by raising the prices of their products. The economics profession is in a severe state of disagreement about the impact of the corporation income tax on the prices of goods. If traditional economic reasoning is correct, then the profits tax would not affect prices and the contention is wrong. In addition, even if the profits tax does result in higher product prices, it is certainly not clear that removing the tax would result in lower prices. This contention was one of the earlier arguments in favor of the substitution of the VAT for the corporate income tax. As uncertainty about the result became more obvious with additional study, however, the contention has been used less and less in support of the VAT.

For every argument in favor of adoption of a VAT in this country, there is usually a counter-argument against it. Even most critics of an American VAT admit that the tax would be less distorting than the corporation income tax. They also point out, however, some disadvantages to the substitution. For example, the VAT itself would still involve distortions, except in its most ideal form. This would require that the rate be equal for all goods and services. A VAT might improve the neutrality of the tax system with respect to risk taking in business ventures, since it would not penalize successful ventures. On the other hand, it would not involve the aspects of the corporation income tax that allow tax credits for losses and, therefore, somewhat offset the penalty against success. Thus, the VAT may be no more neutral with respect to profitability than is the corporation income tax. Critics also argue that if the corporation income tax were removed or reduced, there might be a windfall gain to corporate profits (whether or not it is shifted). This would mean that substitution of a VAT is essentially the opposite of the corporation income tax—it would favor high profit firms by allowing them to make and retain larger profits.

There are also significant equity arguments against the substitution of a VAT for a profits tax. If a windfall gain accrued to the corporation's earnings and the additional earnings were not distributed as dividends, the value of stock in the corporation would probably rise and create a capital gain for the corporation's stockholders. Thus, critics of the substitution argue that unless capital gains taxation were raised to equal the tax rates on ordinary earned income, then the substitution would benefit owners of capital.

An even more important equity argument against adoption or substitution of a VAT is that the VAT itself is equivalent to a tax on consumption and is, therefore, regressive. At best, an income type VAT

would be equivalent to a proportional income tax, which would violate the common feeling that the rich should pay proportionately more than the poor. In order to offset the regressiveness of the VAT, critics argue that it would be necessary to employ exemptions for low-income persons. Actually these exemptions would probably have to take the form of Government payments to low-income persons. This would be the equivalent of a tax refund and would somewhat offset the regressivity. Critics often argue that since low-income relief would be necessary, adoption of the VAT should be coupled with a thorough program of low-income relief not necessarily restricted to the VAT itself. Even proponents of the VAT seldom dispute this point.

There is another method by which some of the regressivity of the VAT might be offset. Necessities that must be purchased by rich and poor alike could be taxed at fairly low rates. Luxuries that are more likely to be purchased by only the rich could be taxed at higher rates. This approach, however, would mean that the VAT is applied at differential rates. Thus, some of the neutrality advantages would be given up. Distortions would be built into the tax in order to achieve greater tax equity.

Summary and Conclusions

There are many other arguments concerning the VAT and its possible adoption in the United States and its effectiveness in the European nations that have already adopted the tax. At this time, they have not all been resolved. A few concluding remarks may be drawn, however. First, it is clear

that the VAT has worked reasonably, if not perfectly, well where it has been used. On the other hand, the VAT is not the panacea that some of its stronger supporters have come dangerously close to claiming.

The debate over the possible adoption of a VAT in the United States will probably be decided after two fundamental questions are answered. First, there is the question of whether the United States should adopt a form of national sales taxation or substitute it for existing income-type taxes. Perhaps the most important consideration for this question is the tradeoff between efficiency and equity of the tax system. In other words, how much tax equity should be sacrificed for efficiency? If the first question is answered in the affirmative, then the second question becomes: Which form of national sales tax should be employed? In this nation, most of our states have for years employed retail sales taxes. Many economists feel that it would be better to have a Federal retail sales tax than to have a Federal VAT. The European problems with tax evasion are not important in this country, and the administrative mechanism for retail sales taxes already exists. Supporters of the VAT will be challenged to show its superiority over the more familiar retail sales tax.

The answers to these have not yet been agreed upon, and they may be some time in arriving. Indeed, it is not likely that they will ever be conclusively settled. This article has certainly not attempted to answer these questions. It has, however, attempted to give the reader some perspective into these issues so that his own judgments may be more easily formed. ■

Smooth Sailing for Georgia's Economy

by Emerson Atkinson

Georgia's economy has responded to the forces of strong economic winds and appears to be headed for smooth sailing. This contrasts with the economic picture of recent years, when the Peach State's economy first experienced rough going and, then, began to show signs of recovering from the economic slowdown that affected most parts of the nation.

Significant Improvement in the Employment Situation has Provided Fair Winds for Increased Economic Activity

Both nonmanufacturing and manufacturing employment have shown more growth thus far in 1972 than in 1971. But the rate of employment expansion for these sectors has not been the same. In 1971 and 1972, nonmanufacturing jobs increased more rapidly than did jobs in manufacturing. This is not surprising since more than 50 percent of the workers in nonmanufacturing are employed in services, government, and trade—areas not severely affected by economic slowdowns. (Construction employment has also held up well. And for that matter, so did total nonfarm employment, since over 70 percent of all nonfarm jobs are centered in nonmanufacturing.)

On the other hand, manufacturing employment was sluggish until late 1971, with two major industries accounting for this lagging performance. The economic slowdown hit the textile industry hard, and it was not until the third quarter of 1971 that the number of textile workers employed began to pick up. Another big employer, the transportation equipment industry, appeared to be "out of irons" and moving again by early 1971, but as the year went by, employment problems emerged once more. An auto assembly plant in Atlanta trimmed its employment rolls in mid-1971, and Lockheed Georgia continued to reduce its work force. By the end of 1972, Lockheed's employment is expected to fall to 10,000 persons. At its peak production period, the giant aircraft producer employed 32,000 workers. Auto assembly plants, on the other hand, have expanded their work force since early 1972.

In addition, the unemployment situation has continued to improve since mid-1971. In April 1972, the rate stood at 3.7 percent, a sizable decline from the 4.2-percent level reached in July 1971.

Robust Personal Income Gains Played a Vital Role in Enabling the Economy to Make Substantial Headway

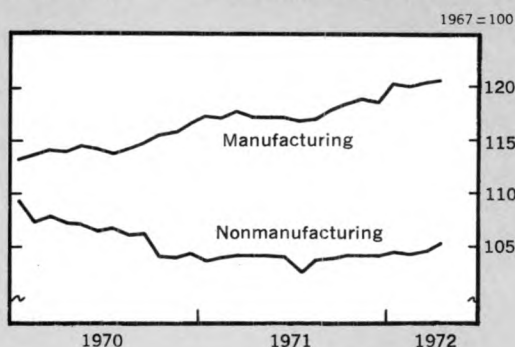
The rate of expansion in personal income was much greater in 1971 than in 1970. In fact, the third quarter of 1971 was the only one in which personal income growth did not exceed the 1970 rate. With the exception of last year's third quarter, the larger personal income components also displayed the highest rates of increase. One of the fastest growing sectors of the economy, services, recorded an annual growth rate of 9.7 percent in wages and

salaries. Government wages and salaries, another major source of personal income, increased at a 7.4-percent annual rate. These components were followed by trade and manufacturing wages and salaries, which grew 8.4 percent and 4.1 percent, respectively.

The Peach State's personal income growth in 1971 (7.8 percent) was not only higher than it was in 1970, but it was a percentage point ahead of the U. S. rate. Georgia's major sources of personal income also increased at a faster rate than those in other parts of the nation. And indications are that personal income has continued to advance at a fast pace thus far in 1972.

Georgia's per capita personal income rose to \$3,547 in 1971, compared with the U. S. figure of \$4,139. Therefore, per capita personal income in the Peach State as a percentage of the U. S. figure has reached 85.7 percent, up from 85.0 percent in

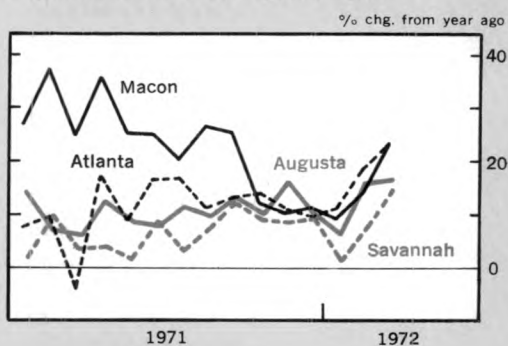
Employment conditions improve. . .



The unemployment situation gets better. . .



Department store sales gather speed



1970, and considerably above the 80.9 percent registered in 1966!

Department Store Sales Provided Auxiliary Power After Running at About Half Speed

Most of the large Standard Metropolitan Statistical Areas (SMSA's) have experienced an uplift in department store sales. In Atlanta, Augusta, and Savannah, department store sales trended upward during nearly all of 1971. But Macon's year-to-year growth steadily declined in 1971, although this trend has reversed itself this year. Recently, sales growth in Atlanta has been outpacing that of the other SMSA's. Sales and use tax collections for the first quarter of 1972 were substantially higher than in the same period one year ago, a further indicator of the upward momentum in retail activity.

Financial Developments "Pointed Up"

Substantial time deposit inflows to banks and savings and loan associations continued into 1972, even though some slowdown in the rate has become evident recently. In 1971, time and savings deposits of individuals, partnerships, and corporations at Georgia commercial banks increased 16 percent, with inflows of large CD's accounting for nearly one-fourth of the increase. Total deposits gained 14 percent. From the lending side, stronger loan demand, particularly for business loans, carried into 1972. During the past year, real estate loans at commercial banks advanced 13 percent, while commercial and industrial loans jumped 19 percent. Consumers continued to rely on borrowed funds to finance their needs, as evidenced by the 18-percent rise in consumer loans in 1971.

Construction Activity Got Off to a Fast Start

Construction activity has been relatively brisk in 1972, continuing the momentum generated in 1971. For the first four months of 1972, residential contracts awarded were up more than 40 percent over the same period one year ago. In 1971, contracts awarded for residential construction

averaged nearly one-third higher than in 1970. For the first four months of this year, all other contract awards—which include building and nonbuilding contracts—were, on the average, up one-fifth. This, however, falls below 1971's monthly rise, which, on average, was up one-third.

Farm Cash Receipts Headed Aloft

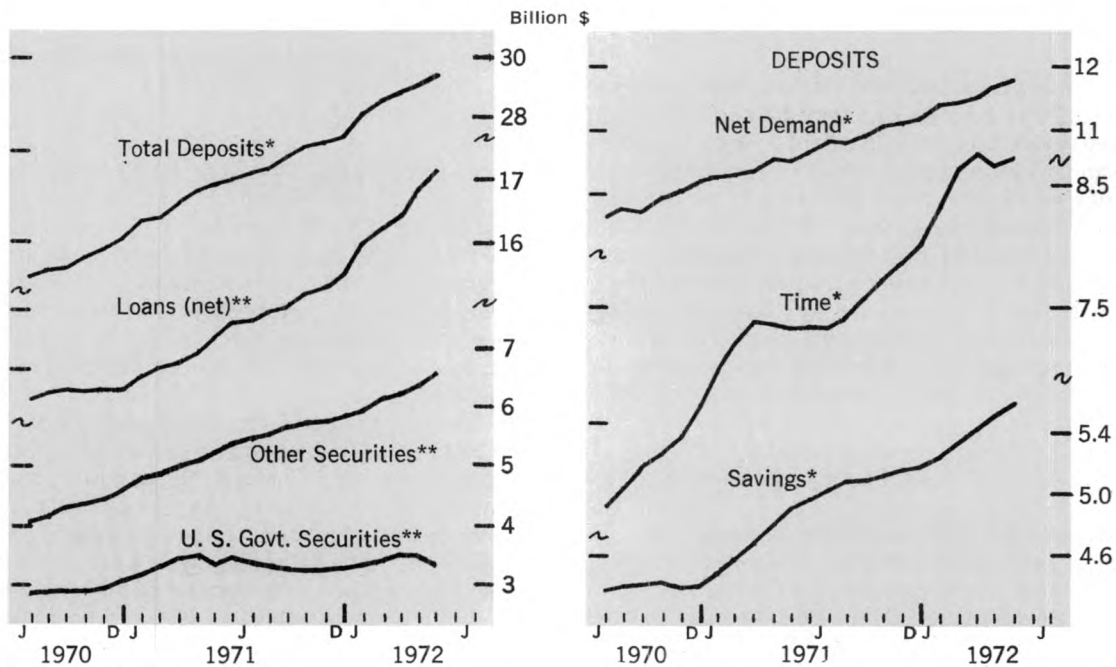
In the first quarter of this year, farm cash receipts were running only slightly ahead of last year's first quarter. Crop receipts fell 12 percent below the first quarter of 1971, mainly because the price of grain settled back to more normal levels after being abnormally high because of a grain shortage. Low prices of eggs and broilers held down the increase in livestock cash receipts, which climbed only 6 percent.

During 1971, total farm cash receipts were \$1,210,300, a 6-percent increase over 1970. Cash receipts from crops showed the greatest increase, jumping 25 percent above the year-ago level. Peanuts, the largest cash crop in the state, registered a hefty 44-percent gain. Corn receipts nearly tripled, primarily because of the absence of corn leaf blight, which in 1970 hit most Southern states hard. But tobacco farmers had a bad year, as receipts from tobacco plunged 16 percent. Then, too, livestock receipts were held down by sagging poultry prices, falling 6 percent below the 1970 level.

Judging by the Performance of the Georgia Economy So Far, it Should Show a Strong Finish by the End of 1972

A capsule view of Georgia's 1972 economic performance would indicate that the employment situation has improved, construction activity is humming, banks' loanable funds are in adequate supply, and loan demand has been relatively strong. Moreover, retail trade is out of the sluggish stage, and indications are that farmers will have a better year in 1972 than in 1971. In essence, Georgia's economy appears well on its way for a stronger finish in 1972 than in the previous two years. ■

BANKING STATISTICS

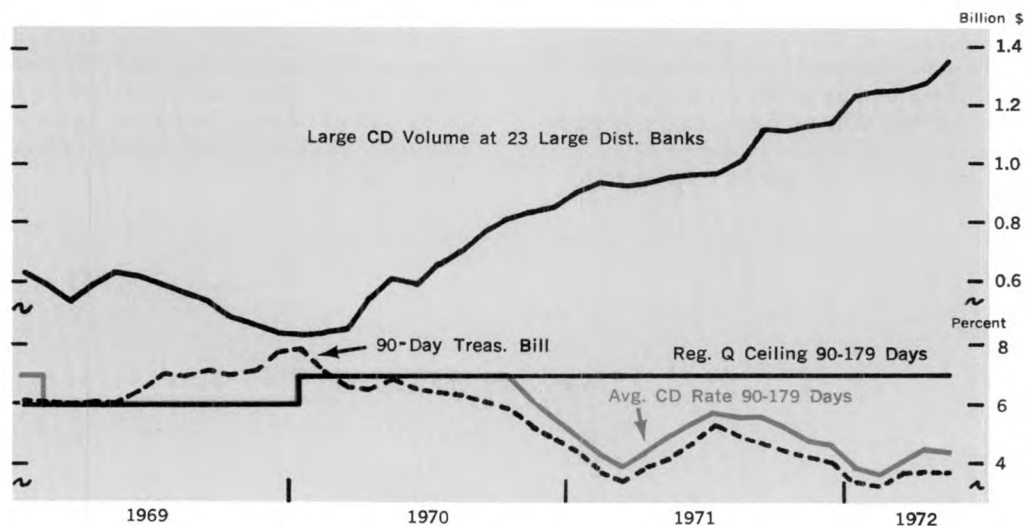


LATEST MONTH PLOTTED: MAY

Note: All figures are seasonally adjusted and cover all Sixth District member banks.
 *Daily average figures **Figures are for the last Wednesday of each month.

SIXTH DISTRICT

BANKING NOTES



NEGOTIABLE CD'S REACH RECORD LEVEL AT DISTRICT BANKS

Large-denomination, negotiable certificates of deposit (CD's) continue to be an important source of funds for many major District member banks. Slightly more than half of the \$800-million increase in total time deposits at these banks during the last 12 months was provided by increased issues of negotiable CD's. Moreover, these large banks have added \$180 million during the first five months of this year, bringing the volume of CD's outstanding to a record level of \$1.4 billion.

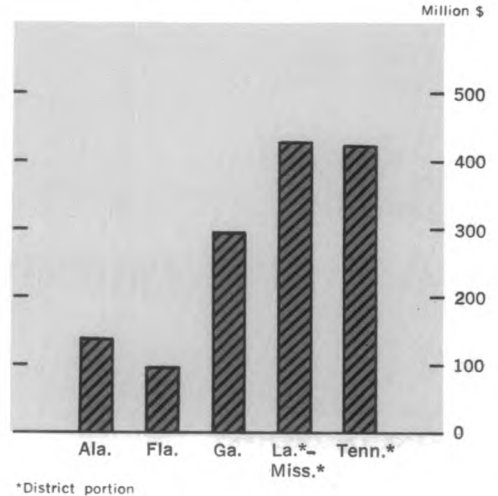
The desire to satisfy a strong loan demand during the last 12 months explains a large portion of the current growth in CD's. While banks in the major cities have experienced favorable inflows of time deposits, including negotiable CD's, these funds alone were not sufficient to satisfy loan demands. Even though business loans have only strengthened appreciably since February of this year, other categories, such as real estate loans and consumer loans, have been strong since the beginning of 1971.

Favorable money market conditions have aided banks in issuing CD's. And in June 1970, the suspension of Regulation Q ceilings on CD's with maturities of 30 days to 89 days enabled banks to compete against other money market instruments of similar maturities, regardless of the money market interest rate level. Furthermore, since the beginning of 1971, rates on money market instruments that compete with CD's maturing in more than 90 days have remained substantially below Regulation Q ceilings. For example, the Regulation Q ceiling on CD's maturing in 90-to 179 days is 6.75 percent, whereas yields on U. S. Treasury Bills with a 90-day maturity have averaged below 4 percent since the beginning of 1972.

Overall, the average maturity of District CD's has been trending downward since April 1970 when the average maturity was 4.6 months. District negotiable CD's had an average maturity of 3.1 months at the beginning of June 1972, compared with a national average maturity of 3.3 months.

Meanwhile, the total number of insured commercial banks in the District that issue negotiable CD's continued to grow (from 512 banks in January 1971 to 552 banks in January 1972). A few large banks, however, still account for the bulk of the District's CD dollar volume. Large banks located in New Orleans, Atlanta, and Nashville account for

LARGE NEGOTIABLE CD'S OUTSTANDING
APRIL 30, 1972



75 percent of the District's CD's outstanding. In addition, although CD's are important to several large banks, the total volume issued by the District amounts to less than 5 percent of the national total.

Because some banks (particularly large Florida banks) prefer to issue large nonnegotiable CD's, the total volume of District negotiable CD's is less than it might be otherwise. Some banks believe that their sales of CD's would not be increased by issuing negotiable CD's. More importantly, others feel there is less chance of a runoff with nonnegotiable CD's, since this type of CD is automatically renewed unless presented for redemption. On the other hand, negotiable CD's must be paid off at maturity and then may be reissued.

Nonnegotiable CD's are an important source of funds for District banks. On January 31, 1972, over \$1 billion in nonnegotiable CD's were outstanding, an amount equal to over 9 percent of the national total.

JOSEPH E. ROSSMAN, JR.

CHANGE IN PAR STATUS

Effective July 1, 1972, all checks drawn on banks located in Alabama may be cleared through the Federal Reserve System at par. This is the result of recent legislation in Alabama.

Bank Announcements

June 1, 1972

BANK OF ZACHARY

Zachary, Louisiana

Began to remit at par.

June 1, 1972

CITRONELLE STATE BANK

Citronelle, Alabama

Began to remit at par.

June 1, 1972

LAMAR STATE BANK

Barnesville, Georgia

Opened for business as a nonmember. Officers: L. E. Hewlett, Jr., president; and Joseph Edwards, vice president. Capital, \$250,000; surplus and other capital funds, \$250,000.

June 7, 1972

JEFFERSON NATIONAL BANK AT KENDALL

Miami, Florida

Opened for business. Officers: Arthur H. Courshon, chairman; Barton S. Goldberg, president; J. W. Carter, executive vice president; and Jerome Belinsky, cashier. Capital, \$400,000; surplus and other capital funds, \$600,000.

June 12, 1972

CITY NATIONAL BANK OF HALLANDALE

Hallandale, Florida

Converted to a national bank.

June 12, 1972

STATE BANK AND TRUST COMPANY OF GOLDEN MEADOW

Golden Meadow, Louisiana

Began to remit at par.

June 15, 1972

CEDAR BLUFF BANK

Cedar Bluff, Alabama

Began to remit at par.

June 15, 1972

CHEROKEE COUNTY BANK

Centre, Alabama

Began to remit at par.

June 15, 1972

FIRST STATE BANK

Carrollton, Alabama

Began to remit at par.

June 19, 1972

TENNESSEE STATE BANK

Gatlinburg, Tennessee

Opened for business as a nonmember.

June 24, 1972

PEOPLES BANK

Red Level, Alabama

Began to remit at par.

Recent Publications

The Discount Rate: Problems and Remedies

William N. Cox, III, June 1972, pp. 94-98

District Banking: Ten Years of Growth and Change

John M. Godfrey, April 1972, pp. 54-61

The 1971 Forecasts Revisited and a Look at 1972

Frederick R. Strobel and William D. Toal, March 1972, pp. 38-41

Liability Management Banking: Its Practice in the Sixth District

Arnold Dill, December 1971, pp. 22-31

People and Places: A Decade of Southern Change

William D. Toal, November 1971, pp. 198-204

The Treasury Debt: Someone Else's Assets

William N. Cox, III, October 1971, pp. 182-185

The Spread of International Banking: A Regional View

John E. Leimone, August 1971, pp. 142-150

Mobile Home Manufacturing: Infant Industry Grows Up

William D. Toal, July 1971, pp. 129-135

1970 Bank Holding Company Amendments: What Is "Closely Related to Banking"?

Charles D. Salley, June 1971, pp. 98-106

These publications are now available upon request to the Research Department, Federal Reserve Bank of Atlanta, Atlanta, Georgia 30303.

Sixth District Statistics

Seasonally Adjusted

(All data are indexes, unless indicated otherwise.)

	Latest	One	Two	One		Latest	One	Two	One		
	Month	Month	Months	Year		Month	Month	Months	Year		
	1972	Ago	Ago	Ago		1972	Ago	Ago	Ago		
5 XTH DISTRICT											
INCOME AND SPENDING					Unemployment Rate (Percent of Work Force)						
Manufacturing Payrolls	May	148	148	146	133	May	5.7	5.4	5.1	5.4	
Farm Cash Receipts	Apr.	133	146	144	119	May	40.9	41.2	41.2	40.9	
Crops	Apr.	140	193	160	117	FINANCE AND BANKING					
Livestock	Apr.	139	143	149	123	Member Bank Loans	May	173	172	168	148
Instalment Credit at Banks* (Mil. \$)						Member Bank Deposits	May	162	157	154	140
New Loans	May	453	450	434	368	Bank Debits**	May	166	169	167	145
Repayments	May	405	380	377	338	FLORIDA					
EMPLOYMENT AND PRODUCTION					INCOME						
Nonfarm Employment	May	116	116	116	112	Manufacturing Payrolls	May	144	144	144	134
Manufacturing	May	108	108	108	106	Farm Cash Receipts	Apr.	131	175	141	101
Nondurable Goods	May	108	108	109	107	EMPLOYMENT					
Food	May	103	104	104	102	Nonfarm Employment	May	126	125	125	121
Textiles	May	105	104	104	103	Manufacturing	May	110	110	113	107
Apparel	May	103	106	107	106	Nonmanufacturing	May	129	128	128	121
Paper	May	110	109	109	110	Construction	May	131	135	130	130
Printing and Publishing	May	115	114	115	113	Farm Employment	May	96	97	102	100
Chemicals	May	105	104	103	105	Unemployment Rate					
Durable Goods	May	107	107	107	104	(Percent of Work Force)	May	3.7	3.9	3.9	4.4
Lbr., Wood Prods., Furn. & Fix.	May	102	102	101	98	Avg. Weekly Hrs. in Mfg. (Hrs.)	May	41.4	41.6	41.6	40.9
Stone, Clay, and Glass	May	111	112	112	107	FINANCE AND BANKING					
Primary Metals	May	106	106	106	105	Member Bank Loans	May	195	190	191	170
Fabricated Metals	May	118	118	117	114	Member Bank Deposits	May	186	177	179	162
Machinery	May	123	122	121	117	Bank Debits**	May	210	208	210	178
Transportation Equipment	May	101	102	104	105	GEORGIA					
Nonmanufacturing	May	119	119	119	114	INCOME					
Construction	May	111	113	113	108	Manufacturing Payrolls	May	144	145	142	133
Transportation	May	116	116	115	112	Farm Cash Receipts	Apr.	128	136	138	129
Trade	May	118	125	118	115	EMPLOYMENT					
Fin., ins., and real est.	May	125	124	124	121	Nonfarm Employment	May	115	115	115	113
Services	May	123	123	123	119	Manufacturing	May	105	105	105	104
Federal Government	May	100	100	101	100	Nonmanufacturing	May	120	120	120	117
State and Local Government	May	125	125	124	118	Construction	May	108	109	111	107
Farm Employment	May	90	89	93	90	Farm Employment	May	87	86	92	90
Unemployment Rate						Unemployment Rate					
(Percent of Work Force)	May	4.3	4.3	4.4	4.8	(Percent of Work Force)	May	3.8	3.7	3.8	4.0
Insured Unemployment						Avg. Weekly Hrs. in Mfg. (Hrs.)	May	41.1	41.2	41.0	40.4
(Percent of Cov. Emp.)	May	2.3	2.3	2.5	2.9	FINANCE AND BANKING					
Avg. Weekly Hrs. in Mfg. (Hrs.)	May	41.1	41.3	41.2	40.6	Member Bank Loans	May	174	166	169	146
Construction Contracts*	May	238	224	193	158	Member Bank Deposits	May	151	146	143	128
Residential	May	259	282	222	181	Bank Debits**	May	197	193	191	168
All Other	May	217	167	165	135	LOUISIANA					
Electric Power Production**	Feb.	176	170	168	167	INCOME					
Cotton Consumption**	Apr.	84	91	89	90	Manufacturing Payrolls	May	139	137	134	128
Petrol. Prod. in Coastal La. and Miss.**	June	124	112	119	124	Farm Cash Receipts	Apr.	120	122	138	128
Manufacturing Production	Apr.	269	268	263	252	EMPLOYMENT					
Nondurable Goods	Apr.	233	231	227	217	Nonfarm Employment	May	107	108	108	104
Food	Apr.	186	184	180	176	Manufacturing	May	102	102	102	100
Textiles	Apr.	266	264	260	239	Nonmanufacturing	May	109	109	109	105
Apparel	Apr.	290	287	279	276	Construction	May	90	93	93	85
Paper	Apr.	214	211	209	201	Farm Employment	May	85	82	83	76
Printing and Publishing	Apr.	164	164	162	166	Unemployment Rate					
Chemicals	Apr.	299	294	292	260	(Percent of Work Force)	May	5.8	5.7	5.6	6.5
Durable Goods	Apr.	311	314	307	294	Avg. Weekly Hrs. in Mfg. (Hrs.)	May	42.0	42.5	42.7	41.9
Lumber and Wood	Apr.	193	190	191	173	FINANCE AND BANKING					
Furniture and Fixtures	Apr.	183	179	178	176	Member Bank Loans*	May	155	154	152	137
Stone, Clay, and Glass	Apr.	184	187	186	167	Member Bank Deposits*	May	154	150	149	136
Primary Metals	Apr.	200	202	200	207	Bank Debits**	May	151	149	151	137
Fabricated Metals	Apr.	267	266	261	240	MISSISSIPPI					
Nonelectrical Machinery	Apr.	397	396	395	378	INCOME					
Electrical Machinery	Apr.	651	652	654	624	Manufacturing Payrolls	May	162	164	160	141
Transportation Equipment	Apr.	413	425	403	387	Farm Cash Receipts	Apr.	169	162	179	140
FINANCE AND BANKING					EMPLOYMENT						
Loans*						Nonfarm Employment	May	114	114	114	111
All Member Banks	May	178	173	175	154	Manufacturing	May	119	119	119	113
Large Banks	May	165	159	161	143	Nonmanufacturing	May	112	112	112	110
Deposits*						Construction	May	95	96	98	96
All Member Banks	May	167	161	160	144	Farm Employment	May	91	88	96	97
Large Banks	May	149	143	143	132	ALABAMA					
Bank Debits**	May	184	182	183	160	INCOME					
ALABAMA					EMPLOYMENT						
INCOME					INCOME						
Manufacturing Payrolls	May	151	151	155	132	Manufacturing Payrolls	May	162	164	160	141
Farm Cash Receipts	Apr.	165	171	185	136	Farm Cash Receipts	Apr.	169	162	179	140
EMPLOYMENT					EMPLOYMENT						
Nonfarm Employment	May	109	108	109	107	Nonfarm Employment	May	114	114	114	111
Manufacturing	May	107	106	108	107	Manufacturing	May	119	119	119	113
Nonmanufacturing	May	119	119	119	108	Nonmanufacturing	May	112	112	112	110
Construction	May	111	113	113	98	Construction	May	95	96	98	96
Farm Employment	May	83	82	89	84	Farm Employment	May	91	88	96	97

	Latest	Month	One	Two	One		Latest	Month	One	Two	One
	1972		Month	Months	Year		1972		Month	Months	Year
			Ago	Ago	Ago				Ago	Ago	Ago
Unemployment Rate (Percent of Work Force)	May	4.2	4.2	4.0	5.1	EMPLOYMENT					
Avg. Weekly Hrs. in Mfg. (Hrs.)	May	40.8	41.0	40.8	40.3	Nonfarm Employment	May	115	116	115	111
FINANCE AND BANKING						Manufacturing	May	108	108	108	105
Member Bank Loans*	May	180	175	184	160	Nonmanufacturing	May	119	119	119	112
Member Bank Deposits*	May	166	160	158	149	Construction	May	119	124	128	108
Bank Debits/**	May	184	173	171	161	Farm Employment	May	91	92	89	86
TENNESSEE						Unemployment Rate (Percent of Work Force)	May	3.7	3.6	3.7	4.7
INCOME						Avg. Weekly Hrs. in Mfg. (Hrs.)	May	40.7	40.9	40.7	40.1
Manufacturing Payrolls	May	151	153	147	136	FINANCE AND BANKING					
Farm Cash Receipts	Apr.	134	147	137	128	Member Bank Loans*	May	174	169	173	151
						Member Bank Deposits*	May	161	156	155	138
						Bank Debits/**	May	154	155	161	140

*For Sixth District area only; other totals for entire six states **Daily average basis †Preliminary data r-Revised N.A. Not available

Note: Indexes for bank debits, construction contracts, cotton consumption, employment, farm cash receipts, loans, deposits, petroleum production, and payrolls: 1967=100. All other indexes: 1957-59=100.

Nonfarm employment data for all District states have been adjusted to new bench marks and to new seasonal factors.

Sources: Manufacturing production estimated by this Bank; nonfarm, mfg. and nonmfg. emp., mfg. payrolls and hours, and unemp., U.S. Dept. of Labor and cooperating state agencies; cotton consumption, U.S. Bureau of Census; construction contracts, F. W. Dodge Div., McGraw-Hill Information Systems Co.; petrol. prod., U.S. Bureau of Mines; industrial use of elec. power, Fed. Power Comm.; farm cash receipts and farm emp., U.S.D.A. Other indexes based on data collected by this Bank. All indexes calculated by this Bank.

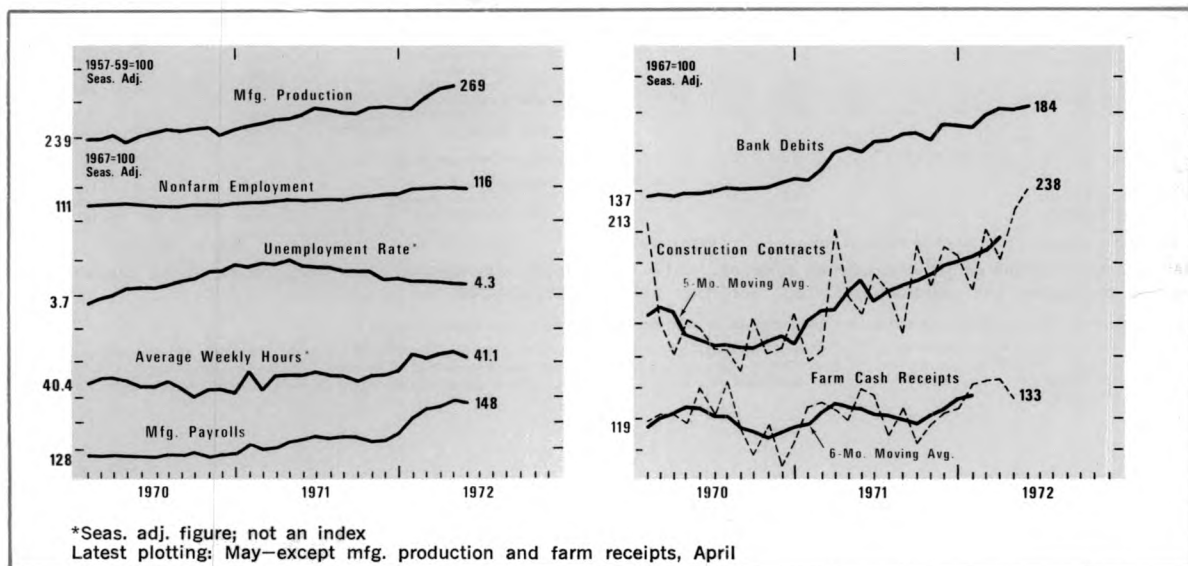
Debits to Demand Deposit Accounts

Insured Commercial Banks in the Sixth District (In Thousands of Dollars)

	Percent Change					Percent Change							
	May 1972	Apr. 1972	May 1971	Year to date		1972 May	Apr. 1972	May 1971	Year to date				
				May 1972 From	1972 from 5 mos. 1971				Apr. 1972 From	May 1971			
STANDARD METROPOLITAN STATISTICAL AREAS													
Birmingham	2,833,438	2,686,666	2,255,817	+ 5	+ 26	+ 28	Gainesville	175,380	166,660	134,861	+ 5	+ 30	+ 21
Gadsden	84,430	80,392	78,021	+ 5	+ 8	+ 3	Lakeland	237,661	217,198	179,035	+ 9	+ 33	+ 20
Huntsville	272,913	240,627r	239,560	+13	+ 14	+ 8	Monroe County	58,614	59,285	48,754	- 1	+ 20	+ 17
Mobile	864,611	834,661	763,780	+ 5	+ 13	+ 19	Ocala	140,249	137,244	114,407	+ 2	+ 23	+ 25
Montgomery	519,443	460,303	486,641	+13	+ 7	+ 10	St. Augustine	29,081	29,492	24,066	- 1	+ 21	+ 18
Tuscaloosa	166,270	149,194	139,736	+11	+ 19	+ 9	St. Petersburg	725,713	715,793	602,827	+ 1	+ 20	+ 17
Ft. Lauderdale—						Sarasota	242,001	251,322	184,153	- 4	+ 31	+ 24	
Hollywood	1,582,039	1,515,806	1,213,395	+ 4	+ 30	+ 20	Tampa	1,488,399	1,431,011	1,191,788r	+ 4	+ 25	+ 16
Jacksonville	3,071,254	2,705,866	2,146,791	+14	+ 43	+ 31	Winter Haven	125,054	129,586	101,814	- 3	+ 23	+ 22
Miami	5,044,354	4,996,580	4,484,125r	+ 1	+ 12	+ 14	Athens						
Oriando	1,230,821	1,235,180	904,510	- 0	+ 36	+ 26	Brunswick	82,093	73,593	61,101	+12	+ 34	+ 21
Pensacola	379,386	354,551	329,304	+ 7	+ 15	+ 14	Dalton	158,848	148,285	117,097	+ 7	+ 36	+ 20
Tallahassee	653,238	584,763	323,228	+12	+102	+115	Elberton	24,025	18,818	15,709	+28	+ 53	+ 20
Tampa—St. Pete	3,064,748	2,995,096	2,345,434r	+ 2	+ 31	+ 22	Gainesville	104,667	101,222	94,186	+ 3	+ 11	+ 5
W. Palm Beach	890,782	896,686	716,234	- 1	+ 24	+ 14	Griffin	58,353	54,413	50,009	+ 7	+ 17	+ 7
Albany						LaGrange	31,078	31,068	51,637	+ 0	- 40	- 5	
Atlanta	11,061,322	9,874,733	8,575,888	+12	+ 29	+ 18	Newnan	43,770	37,505	34,876	+17	+ 26	+ 28
Augusta	423,352	398,412	350,262	+ 6	+ 21	+ 15	Rome	119,340	113,552	95,641	+ 5	+ 25	+ 17
Columbus	369,367	342,346	346,847	+ 8	+ 6	+ 12	Valdosta	80,481	78,666	72,007	+ 2	+ 12	+ 17
Macon	425,540	397,715	362,624	+ 7	+ 17	+ 14	Abbeville						
Savannah	439,209	418,260	356,385	+ 5	+ 23	+ 12	Brunswick	15,130	15,479	12,681	- 2	+ 19	+ 10
Alexandria						Hammond	60,319	57,533	49,978	+ 5	+ 21	+ 11	
Baton Rouge	1,123,759	985,664	904,435	+14	+ 24	+ 12	New Iberia	53,942	47,803	54,178	+13	+ 19	+ 7
Lafayette	230,598	194,711	186,181	+18	+ 24	+ 14	Plaquemine	16,317	14,403	14,263	+13	+ 14	+ 9
Lake Charles	212,938	182,416	184,020	+17	+ 16	+ 10	Thibodaux	34,189	29,414	32,162	+16	+ 6	+ 4
New Orleans	3,470,721	3,154,009	3,096,040r	+10	+ 12	+ 5	Hattiesburg						
Biloxi—Gulfport						Valdosta	80,481	78,666	72,007	+ 2	+ 12	+ 17	
Jackson	1,219,777	984,978	1,009,371	+24	+ 21	+ 11	Laurel	62,771	60,209	53,929	+ 4	+ 16	+ 11
Chattanooga						Meridian	101,847	95,303	79,076	+ 7	+ 29	+ 18	
Knoxville	731,012	718,600	627,369	+ 2	+ 17	+ 11	Pascagoula—	47,957	44,655	46,617	+ 7	+ 3	+ 5
Nashville	2,647,139	2,520,684	2,136,220	+ 5	+ 24	+ 19	Moss Point	139,364	116,030	102,107	+20	+ 36	+ 26
OTHER CENTERS						Vicksburg	58,720	56,114	49,064	+ 5	+ 20	+ 4	
Anthon	96,214	87,234	86,346	+10	+ 11	+ 11	Yazoo City	38,858	39,238	36,050	- 1	+ 8	+ 8
Dothan	134,417	113,469	107,620	+18	+ 25	+ 16	Bristol						
Selma	63,307	54,849	51,985	+15	+ 22	+ 13	Johnson City	123,084	115,233	116,191	+ 7	+ 6	+ 8
Bartow						Kingsport	225,651	209,470	186,380	+ 8	+ 21	+ 13	
Bradenton	144,136	150,537	110,728	- 4	+ 30	+ 25	District Total						
Brevard County	265,811	247,431	201,123	+ 7	+ 32	+ 12	Alabama†	6,839,805	6,341,802r	5,689,969	+ 8	+ 20	+ 21
Daytona Beach	144,337	144,111	108,704	+ 0	+ 33	+ 27	Florida‡	19,846,933	19,120,949	15,699,523r	+ 4	+ 26	+ 20
Ft. Myers—							Georgia‡	15,972,472	14,472,675	12,683,960	+10	+ 26	+ 17
N. Ft. Myers	189,758	172,253	178,946	+10	+ 5	+ 9	Louisiana*	6,360,722	5,670,674	5,465,528r	+12	+ 16	+ 8
						Mississippi*	2,627,258	2,264,309	2,180,043	+16	+ 21	+ 13	
						Tennessee*	6,617,783	6,277,669	5,746,131	+ 5	+ 15	+ 11	

†Estimated ‡Includes only banks in the Sixth District portion of the state; partially estimated. *Partially estimated. NA—Not available.

District Business Conditions



Economic activity in the Southeast continued to strengthen. Residential construction and domestic automobile sales reached extremely high levels. Consumers continued to make heavy use of bank credit. Loan demand showed growing strength at both large and small banks. Good rains and rising prices improved the outlook for high farm incomes. Labor market conditions, apparently still digesting steady gains of earlier months, softened slightly.

Banks became more pressed for reserves in May, as loan demand strengthened. A stronger loan demand at many banks has resulted in their reduced holdings of U. S. Government securities. Despite strong deposit gains since early May, member banks also stepped up their borrowings from other banks and made greater use of the discount window. While demand deposits continued to expand sharply, consumer time and savings deposits increased at a much slower pace than in previous months; however, in June the larger banks attracted CD funds from state and local governments. In late June, major banks raised their prime lending rate from 5 percent to 5 1/4 percent.

May's unemployment rate remained unchanged at 4.3 percent of the civilian work force. Nonfarm employment leveled off, after registering steady gains throughout 1971 and early 1972. Florida and Alabama were the only District States showing significant employment gains. Nonmanufacturing job losses occurred in construction, services, and trade. Manufacturing jobs, which had been advancing smartly since late 1971, leveled off. Average factory hours fell slightly, and manufacturing payrolls declined, halting earlier 1972 gains.

Rains from Hurricane Agnes were an inestimable boon to farmers in the drought-stricken eastern area of the District. Prices of farm products rose from April to May, led by large increases in prices of citrus, hogs, and broilers. Preliminary data indicate that prices of hogs and cattle continued to rise in June.

Consumer instalment credit at commercial banks expanded again in May. However, gains though still substantial were smaller than those in each of the previous three months. Loans for autos and non-automotive consumer goods remained particularly strong. In May, sales of domestically produced autos regained their vigor, after slipping briefly in April.

Construction activity continued its upward trend, especially in Florida. In May, the value of both residential and total contract awards was only slightly below record highs, while the value of nonresidential awards moved up after little change during the last twelve months. Residential mortgage credit continued to be readily available, although savings inflows at thrift institutions diminished somewhat.

Note: Data on which statements are based have been adjusted whenever possible to eliminate seasonal influences.