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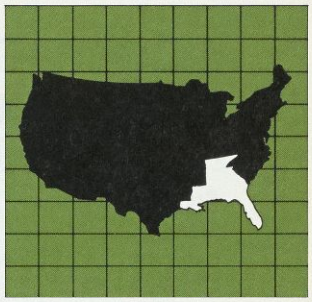


FEDERAL RESERVE BANK OF ATLANTA MAY 1981

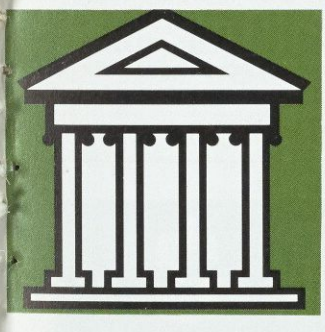
1990 S.E. Demographic Outlook

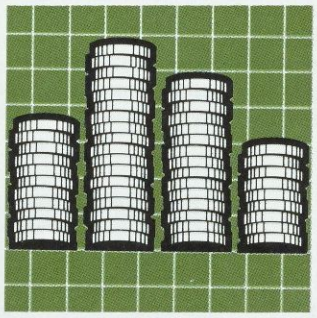
GNP REVISIONS How Important?

MIAMI Foreign Deposit Profile

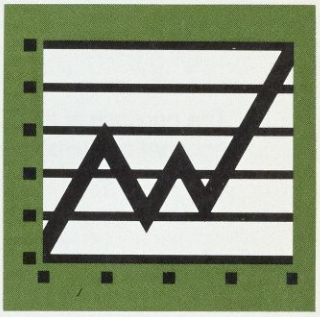
CHRYSLER Regional Repercussions

AGRICULTURE Forces of Change







Economic Review

FEDERAL RESERVE BANK OF ATLANTA

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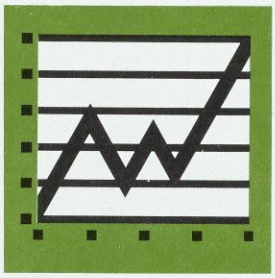
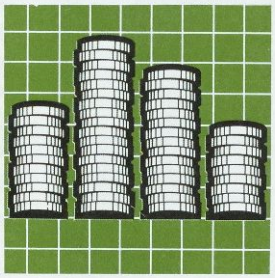
The purpose of the *Economic Review* is to inform the public about Federal Reserve policies and the economic environment and, in particular, to narrow the gap between specialists and concerned laymen.









The Southeast in the 1980s

The Southeast will see continued above-average economic growth in the 1980s, but the level of regional income will remain below the national average for some time. With the maturity of the baby boom generation, population growth will slow in the region, but not as much as nationwide. Migration will continue to fuel the region's rising share of the U.S. population.

As the post-World War II baby boomers were growing up and entering the labor force in the 1960s and 1970s, states of the Sixth District were making great strides in attracting population and businesses to the Southeast.[1] Well endowed with sun, water, and other natural resources, yet underpopulated, underurbanized, and underindustrialized relative to northern and midwestern states, the Southeast has benefited from large inflows of capital for investment in plant and equipment in new or expanding industries and from the in-migration of people from outside the region. The inflows of capital and people have simultaneously altered the

[1]In the remainder of this article, the terms, "Sixth District" and "Southeast," will be used synonymously and will encompass the six states which comprise the Sixth Federal Reserve District, including portions of these states located in other Reserve Districts.

Table 1. Establishment Employment

	District % of total			Nation % of total		
	1960	1980	1990	1960	1980	1990
Farm	17.3	4.0	3.0	11.5	3.9	3.2
Manufacturing	21.5	19.5	20.8	27.4	21.6	21.9
Durables	6.8	9.0	10.4	15.4	12.9	13.5
Nondurables	12.9	10.4	10.4	12.0	8.6	8.4
Mining	1.3	1.2	1.1	1.2	1.1	1.0
Construction	5.5	6.1	5.8	4.8	4.7	4.8
Trade	18.6	22.7	23.0	18.6	21.8	22.2
Government	14.9	18.5	17.2	13.6	17.0	16.0
Transportation, Communications and Public Utilities	6.1	5.8	5.6	6.5	5.5	5.2
Services	10.9	17.2	17.5	12.0	18.8	19.8
Finance, Insurance, and Real Estate	3.9	5.1	6.0	4.3	5.5	5.9
Total Nonfarm	82.7	96.0	97.0	88.5	96.1	96.8
Total (In '000, 1972 bench marks)	6,361	11,628	13,690	61,246	94,231	108,422

Sources: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, State Departments of Labor, and Federal Reserve Bank — Atlanta.

region's industrial profile, causing it to more closely resemble that of the nation as a whole and enabled the region to grow more rapidly than the nation as a whole. Population movement has also caused the population profile to diverge from that of the nation.

Can we continue to expect above-average economic growth in the region now that the last of the baby boomers have entered the labor force? To answer this question, we will first take a quick but careful look at how employment, income, and population have changed in the District while these boomers were growing up. We will then age them 10 years (along with everyone else) and explore the major demographic and economic changes which will occur in the 1980s if recent and prospective economic and demographic relationships are extended to 1990. How, under these circumstances, will 1990 compare to 1980? Will the current decade's progress match gains of the 1960s and 1970s? What are the important relationships and issues which will emerge from economic-demographic interactions during the decade?

Changes in Employment, Income, and Population, 1960-80

Dramatic changes have occurred in the Southeast's economy since 1960; it has become more diversified, with an employment mix increasingly favorable to the growth of personal income. Since 1960, for example, farm payroll employment as a percentage of total payroll employment in the District is estimated to have fallen from 17 percent in 1960 to 4 percent in 1980; during the same period, farm employment in the U.S. declined, but by less — from 11½ percent of the total to 4 percent (Table 1). This reduction in farm jobs has occurred as farm operations have become mechanized and as farmers have switched from crop production to less labor-intensive livestock production.

The share of employment in manufacturing also declined in this region and the nation in the period 1960-80, but the relative decline was sharper for the nation, which, in 1960, employed a greater share of workers in manufacturing than did the Southeast. Convergence of the region's employment and earnings mix to that of the nation has been aided by the region's availability of low wage and nonunionized labor. A generally favorable business climate, including low taxes, also helped attract capital to finance expansion of the share of employment in higher paying durable goods manufacture and a contraction in the share of employment in such nondurables as apparel, food, and textiles.

In the same period, the share of employment in trade, services, and government expanded sharply, from 44 percent to about 58 percent of payroll employees, for both the region and the nation — due, largely, to general economic development. This growth has offset the falling share of farm and manufacturing employment.

The changing employment shares partly explain why overall personal income per capita in the region increased relative to that in the nation. In 1960, per capita personal income totaled only 74 percent of the national average; by 1980, it rose to about $4,600 (1972 dollars) and represented 86 percent of the national average. This convergence in per capita personal income was also aided by the fact that the labor force in the District, excluding Florida, was growing more rapidly than population relative to the nation. And, in Florida, personal income per capita is increased by the influx of retirees with above-average income and below-average household size.

A marked increase in the region's economic activity has accompanied the dramatic structural changes in employment since 1960. Total employment in the nation expanded sharply to more than 94.2 million in 1980, up 54 percent from 1960; in that period, Southeast employment rose by 83 percent, reaching 11.6 million in 1980.

The remarkable employment change in this region reflects, of course, the significant migration to the region. Briefly, in the 20 years after 1960, roughly the peak of the baby boom, the District's population has increased by 9.2 million — to a total of 30.4 million in 1980; for the nation, the increase was 48 million — to 226.5 million in 1980. Thus, the region has accounted for almost one-fifth of the total growth of the nation, much of it from foreign and domestic migration to the region. The share of the nation's population accounted for by the Southeast now stands at 13.4 percent, up from 11.9 percent in 1960.

Migration has also significantly affected the region's population age structure compared to the nation. The Southeast has gone from having relatively more young in 1960 compared to the nation — 47 percent versus 45 percent in the age group 0-24 — to having the same relative number of young, 41 percent, in 1980. Meanwhile, the relative number of elderly has increased in the District compared to the nation. In 1960, 9 percent of both populations were age 65 and over, but in 1980, the District's percentage was 13 percent while the nation's was 11 percent (in 1980, 44 percent of the estimated 3.8 million elderly of the region resided in Florida). In both the region and the nation, the population age 25-64 as a share of the total has increased in this period due to the ending of the baby boom.

National and Southeast Changes in Employment, Income, and Population, 1980-90

If recent history serves as a useful guide, the years of this decade will be marked by continued growth of employment, income, and population in the region at rates exceeding the national average.[2] Furthermore, all the region's states will benefit from better-than-average growth, although not all states will benefit equally. Basically, the region has developed considerable growth momentum over the past two decades, and, given the region's existing advantages, that momentum is unlikely to be reversed in the near future. It may slow, however, as flows of

[2]Projections discussed in this article rely heavily on the projections developed by the Bureau of Economic Analysis's Division of Regional Economic Analysis. Those projections were modified to roughly take into account the results of the 1980 Census. Also, our employment projections refer to employment as measured by the establishment survey rather than the more inclusive measure of employment utilized by BEA.

capital and people cause wages and prices of other resources to rise, thus eroding the region's locational advantages. Further, despite the prospect of continued convergence of regional income toward the national norm, the level will remain below the national for some time. Economic and demographic changes on the horizon will also pose new or increased challenges which will require our continuing attention, analysis, and reaction.

Total employment in the Southeast is projected to increase by 18 percent in this decade, a slowdown from the 1960-80 period when the baby boomers were swelling the labor force; the increase for the nation, meanwhile, is projected to be 15 percent (Table 1). Major relative employment gains are likely for the manufacturing and finance, insurance, and real estate industries, while relative declines are expected in farm and construction employment. In 1990, trade, services, and government will employ 58 percent of payroll employees in both the Southeast and the nation, as in 1980.

Manufacturing growth will be spurred by the expansion of durables manufacturing, especially the electronic equipment and nonelectric machinery industries. Meanwhile, due to slower demand growth and outside competition, the growth of production of apparel, textile, and food products will slow; diversification in the region will thus continue. The relatively strong growth of financial employment reflects the growing strength of the Southeast economy and the developing importance of the largest metropolitan areas as financial centers.

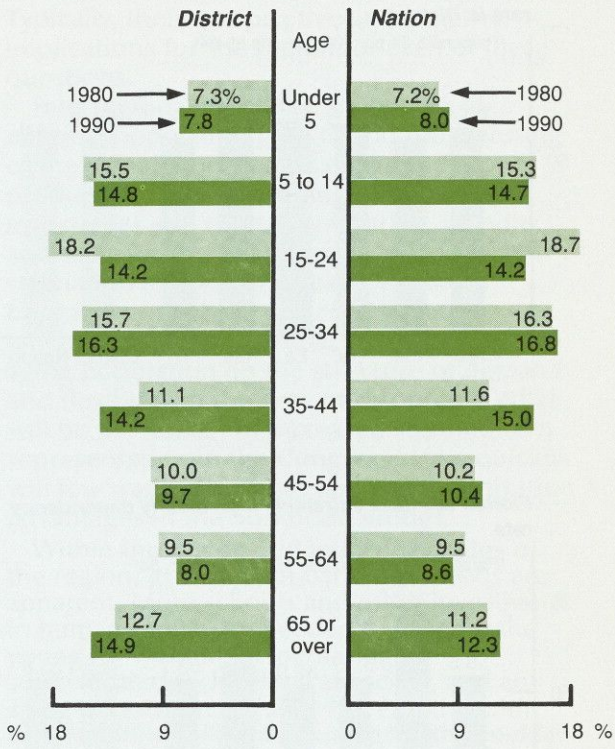
Farm employment in the region, which continues to decline absolutely and relative to the nation, will account for a lesser share of employment than it does in the nation by 1990. Construction's employment share also falls significantly relative to the nation but continues to be large relative to the nation, the trends reflecting the slowdown of the region's population growth and the region's still rising share of the total population due to natural increase and migration.

In part because of the continued convergence of regional employment patterns to the national profile, per capita personal income will also continue to converge to the national average. Per capita personal income is projected to increase from $4,600 currently to $6,600 in 1990 (in 1972 dollars); as a percentage of the national figure, the increase is from 86 percent to 90 percent. Demographically, continued convergence of regional fertility to the national norm will also contribute to continued per capita income convergence.

Significant changes in the national and regional population age structures are in the offing in the 1980s (Chart 1). Regional and national growth is projected to fall from 2.4 percent per year and 1.1 percent per year, respectively, in the 1970s to 1.5 percent and .9 percent, respectively, in the 1980s. The relative slowdown in population growth in the

Chart 1
Population and Age Structure

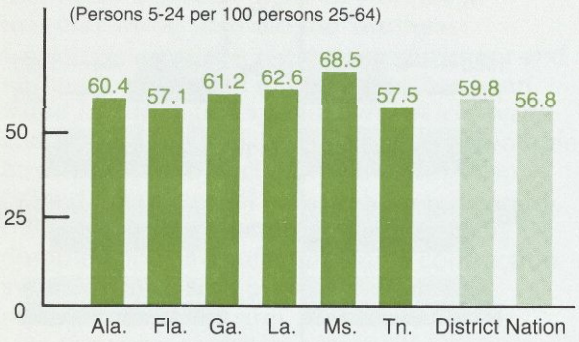
Baby boom moves into 25-44 bracket.



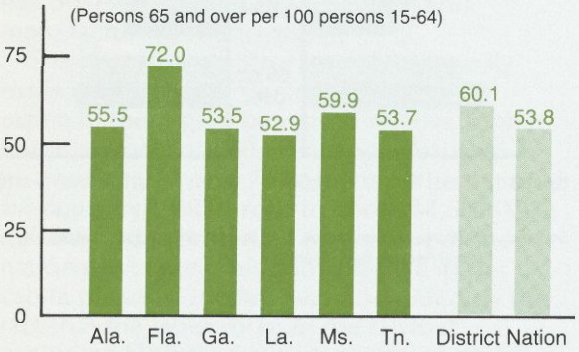
Sources: U.S. Bureau of the Census, U.S. Bureau of Economic Analysis and Federal Reserve Bank-Atlanta.

Chart 2
1990 Age Dependency Ratios

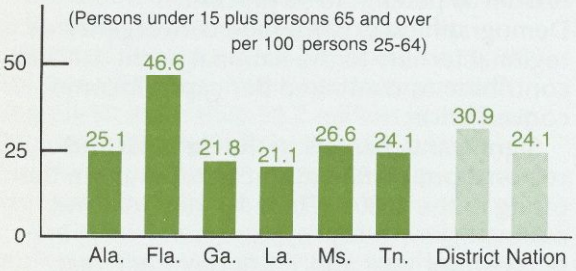
Mississippi will have highest school age dependency rate in District.



Florida will have extremely high elderly dependency rate.



Louisiana's overall dependency rate (school age plus elderly) will be lowest in District.



Sources: U.S. Bureau of Census, U.S. Bureau of Economic Analysis and Federal Reserve Bank-Atlanta.

region is due to the region's growing population base and the relative decline in the national age pool of likely migrants who add so much to the region's growth.[3]

The national trend toward a more stable, mature, and productive labor force as a consequence of the aging of baby boomers will be less pronounced in the Southeast relative to the nation. Past and expected migration and natural increase trends are likely to cause significant differences in southeastern growth rates by age from the nation; except for the age group 45-64, growth rates by age are higher for the Southeast in the decade of the 1980s. As a consequence, the District will likely show an overall increase in the age dependency ratio, with a particularly sharp increase in the elderly dependency ratio (Charts 2 & 3).[4]

Issues of Growing Importance in the 1980s

The broad strokes of economic and demographic changes outlined in the preceding section should, of course, be viewed with extreme caution. As baseline projections dependent upon historical tendencies, they are subject to change as the underlying assumptions regarding fertility, mortality, migration, labor force participation, marriage and divorce rates undergo transformation and as consumer and government preferences change and interact with constantly changing technology — here and abroad. In fact, there are many developing transformations which could significantly affect the scenario presented in addition to the already inherent uncertainties of the projections.

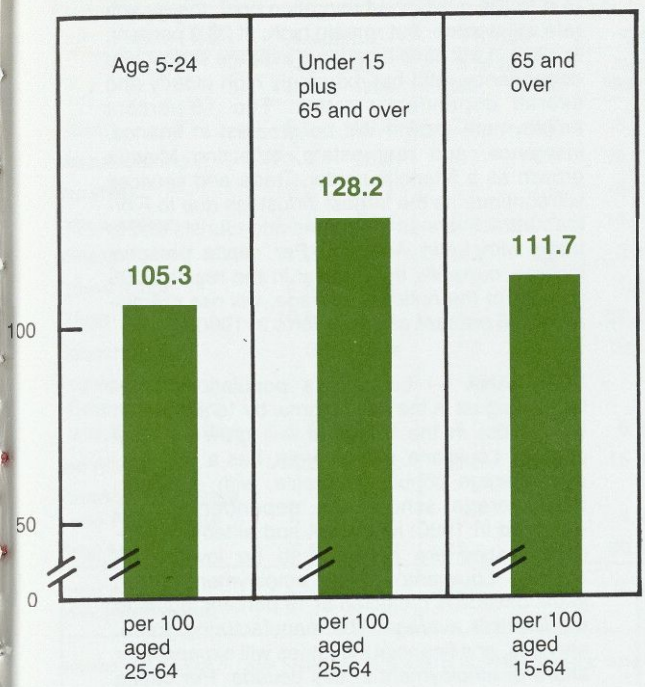
International political and economic developments will impact importantly on the Southeast — on Florida, in particular. Market and migration changes — of capital and people — will significantly influence the population and business of District states. Will legal (and illegal) migration, on balance, add

[3]The improved 1980 Census enumertion of Blacks and Hispanics who live disproportionately in the Southeast also has caused the 1970s growth rates to be somewhat overstated.

[4]The age dependency ratio takes into account joint changes in the proportions of children, "workers," and elderly in the population. Age dependency ratios thus summarize the age structure of a population.

Chart 3
1990 District Age Dependency Ratio
(District Relative to Nation)

Southeast's school age and elderly dependency rates will exceed nation's.



to or subtract from the region's stock of human and financial capital? Will immigrants be welcomed as potential labor shortages arise due to expanding markets in Latin America and declining labor force growth at home, or will they add ethnic to already apparent racial tensions?

Nationally, federal government tax, spending, and regulatory policy changes will have complex and conflicting effects on the region's well-being. Will deregulation of energy prices offset or diminish the region's current energy advantage by improving the comparative advantage of northern states which have suffered from government-imposed rigidities vis-a-vis the Southeast? What will be the effects of deregulation of transportation and financial markets? Will the end of subsidies to borrowers adversely affect housing and plant and equipment construction in the Southeast? How will pending reallocations of spending and transfers (more defense, less welfare and Social Security benefits) affect the region? Typically, there are positive and negative implications for the region for each of these questions.

Interregionally, will the slowdown of national population growth and the maturing of the population cause savings and productivity to rise, leading to more investment and capital per worker, income, and sales, especially of luxury goods, or will stagnation in the North lead to internal beggar-thy-neighbor policies? What, if anything, will be the impact of a slowing and aging population on the structure of demand and flexibility in the flow of resources? What will be the impact of increased southeastern representation in the Congress? How quickly will low wage rate, land, tax, and unionization advantages in the Southeast erode?

Within the region and individual states of the region, growing infrastructure needs are apparent. More schools and other investment in human capital are needed to prepare the young for work in an increasingly sophisticated technological society, and an aging population requires increased health care facilities. Will continued growth provide the needed funds, or will continued growth induce resistance and a halt to further growth due to growing potential environmental threats, congestion, and pollution?

Ultimately, of course, the answers to these and other questions depend upon the individual and collective choices made by baby boomers and their relatives. These choices, while not known with precision today, are perhaps sufficiently known to permit a cautious optimism regarding the future population and employment structure of the Southeast. The Southeast should continue to advance toward a rising national level of well-being — and at an above-average pace.

— William J. Kahley

INDIVIDUAL STATE EMPLOYMENT, INCOME, AND POPULATION CHANGES, 1980-90

Additional insight into the changing economic and population structure in the Southeast in this decade can be gained by examining movements within individual states. In fact, the changes and structure vary widely by state. Furthermore, important changes are projected for each of the Sixth District states (Tables 2 and 3).

ALABAMA — The population of Alabama, twenty-second largest in the nation, grew by only 13 percent in the 1970s. In the 1980s, growth will slow to 6.9 percent as it becomes the only state in the District to grow more slowly than the nation. By 1990, it will have more burdensome school age, elderly, and overall dependency ratios than the nation. Overall employment growth, projected at 19.3 percent in the 1980s, exceeds District and national growth rates.* Employment projections show marginal declines in the shares of farming and government, offset by increases in manufacturing, largely in the primary and fabricated metals industries. Per capita personal income will increase from 78 percent of the national average currently to 86 percent in 1990.

GEORGIA — Georgia, currently the thirteenth most populous state, had a population gain of 19 percent in the 1970s. In the 1980s, growth will slow to 10.2 percent. Georgia has a younger-than-average population and in 1990 will have higher-than-average school age and overall dependency ratios but a lower-than-average elderly dependency ratio. Employment growth is projected to be the lowest in the region, and, at 11.7 percent, it is the only regional state below the national average growth figure. Finance, insurance, and real estate and construction employment will be the fastest growing employment industries due largely to continued growth of Atlanta as the major regional business center. Per capita personal income is projected to rise from 85 percent of the national level currently to 89 percent in 1990.

*Employment growth figures for the states in the 1980s are probably somewhat distorted by the fact that 1980 is a recession year. Thus, states such as Alabama, Mississippi, and Tennessee, which are perhaps more vulnerable to recession than Florida, Georgia, or Louisiana, start the decade from a temporarily low relative employment base.

FLORIDA — With a 43-percent population gain in the 1970s, Florida was the third fastest growing state in the nation and now ranks seventh in size. Due to the diminished migration pool, the growth rate will decline, but remain high, at 23.9 percent. In 1990, it will have a national average school age dependency ratio but extremely high elderly and overall dependency ratios. The 16-percent employment growth will be greatest in finance, insurance, and real estate, reflecting Miami's growth as a financial center. Trade and services will continue as the largest industries due to Florida's attractiveness to retirees and tourists and to trade with Latin America. Per capita personal income, currently the highest in the region at 95 percent of the national average, will rise marginally to 96 percent of the nation's in 1990.

LOUISIANA — Louisiana's population, nineteenth largest in the nation, grew by 15 percent in the 1970s; in the 1980s, it will grow by 11.9 percent. Louisiana, like Georgia, has a younger-than-average population profile, with a higher-than-average school age dependency ratio expected in 1990; its overall and elderly dependency ratios are expected to be lower-than-average. Louisiana's overall employment growth in the decade is projected at 18 percent, equal to the District's average. The manufacturing, trade, services, and financial industries will expand their share of employment in this decade. Per capita personal income will increase from 88 percent of the nation's currently to 91 percent in 1990.

MISSISSIPPI — Mississippi, which ranks thirty-first in the nation in population size, grew by 14 percent in the 1970s; in the 1980s, population growth will be 10.4 percent. Mississippi is projected to have a significantly higher school age dependency ratio in 1990 than other states in the District and compared to the nation. And, while its 1990 elderly dependency ratio is very low, it will have a relatively high overall dependency ratio. Employment growth in the decade is a relatively high 23 percent. The bulk of the employment growth will be in durables manufacture. Per capita personal income will rise from 69 percent of the nation currently to 76 percent in 1990.

TENNESSEE — Tennessee is the nation's seventeenth most populous state. Its increase in population in the 1970s was 17 percent; in the 1980s, it is projected to increase by 14.2 percent. Tennessee's population profile in 1990 is expected to be very similar to the nation's, although the school age dependency ratio is projected to be slightly higher than the nation's. Overall employment is projected to increase by 24 percent in this decade, with employment gains concentrated in durables manufacture. Per capita personal income, now 82 percent of the nation's, is projected to increase to 88 percent by 1990.

Table 2. Establishment Employment by State

	Alabama		Florida		Georgia		Louisiana		Mississippi		Tennessee	
	% of Total		% of Total		% of Total		% of Total		% of Total		% of Total	
	1980	1990	1980	1990	1980	1990	1980	1990	1980	1990	1980	1990
Farm	5.0	3.8	2.6	2.2	3.7	2.9	3.3	2.2	7.6	5.5	5.4	3.8
Manufacturing	25.3	26.3	12.2	12.9	23.2	23.8	13.2	15.8	24.7	28.8	27.5	28.2
Durables	12.2	13.7	6.9	7.5	8.2	8.4	6.3	7.8	13.6	17.8	12.1	13.9
Nondurables	13.1	12.4	5.3	5.5	15.1	15.4	7.0	8.0	11.1	11.1	15.4	14.3
Mining	1.2	1.6	0.3	0.2	0.3	0.3	5.0	4.3	1.1	0.9	0.5	0.6
Construction	4.8	5.5	7.5	6.6	4.4	4.9	8.5	7.1	4.9	5.1	4.6	4.7
Trade	19.5	19.8	26.1	25.6	22.6	23.4	22.8	23.5	18.2	19.1	20.4	21.8
Government	21.0	19.0	17.0	16.6	19.1	17.7	18.9	17.0	21.7	18.8	17.0	15.9
Transportation, Communication, and Public Utilities	5.1	5.0	6.0	5.7	6.3	6.2	7.2	7.0	4.7	4.4	4.6	4.6
Services	14.2	14.3	21.6	22.3	15.3	15.1	16.2	17.5	13.4	13.1	15.9	15.6
Finance, Insurance, and Real Estate	4.1	4.7	6.7	7.9	4.9	5.7	4.7	5.5	3.7	4.3	4.1	4.8
Total Nonfarm	95.0	96.2	97.4	97.8	96.3	97.1	96.7	97.8	92.4	94.5	94.6	96.2
Total (In '000, 1972 bench marks)	1,421	1,695	3,625	4,207	2,221	2,480	1,593	1,876	896	1,103	1,872	2,329

Sources: U.S. Bureau of Labor Statistics U.S. Bureau of Economic Analysis, State Departments of Labor, and Federal Reserve Bank — Atlanta.

Table 3. Population and Age Structure of District States

	Alabama		Florida		Georgia		Louisiana		Mississippi		Tennessee	
	% of Total		% of Total		% of Total		% of Total		% of Total		% of Total	
	1980	1990	1980	1990	1980	1990	1980	1990	1980	1990	1980	1990
Under 5 years	7.6	7.9	6.3	7.2	8.0	8.4	8.1	8.3	8.5	8.6	7.2	7.9
5 to 14	16.0	15.3	13.5	13.5	16.7	15.4	17.1	15.8	17.6	16.4	15.3	14.8
15-24	18.4	14.6	16.9	12.6	19.0	15.0	19.7	15.5	19.1	15.7	18.0	14.4
25-34	16.1	16.5	14.2	15.2	17.1	16.5	16.3	17.5	15.2	16.6	16.3	16.9
35-44	11.3	14.6	10.4	13.4	12.0	14.9	11.0	14.8	10.5	13.6	12.0	15.0
45-54	10.1	10.1	10.4	8.9	9.7	10.4	9.6	9.8	9.2	9.2	10.4	10.4
55-64	9.2	8.4	10.9	8.1	8.3	7.9	8.4	7.8	9.1	7.4	9.4	8.3
65 or over	11.4	12.5	17.4	21.2	9.3	10.9	9.8	10.6	11.5	12.4	11.4	12.2
All Races												
Both Sexes (in '000)	3,890	4,160	9,740	12,068	5,464	6,024	4,204	4,704	2,521	2,784	4,591	5,243

Sources: U.S. Bureau of Census, U.S. Bureau of Economic Analysis and Federal Reserve Bank-Atlanta.

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Southeastern Agriculture in the 80s

Changes in factors affecting the supply of farm products will be the dominant forces in southeastern agriculture in the 80s. Since farmers in the region use more energy-related products than their national counterparts, cropping patterns in the Southeast may be changed by increasing energy costs. Farm credit volume will grow, but business will shift away from traditional lenders. The region is in good position to share in the growing agricultural export markets.

Southeastern agriculture seems likely to change dramatically during the decade of the 1980s. A number of economic forces have already set some of those changes in motion. Undoubtedly, other factors, as yet unrecognized, will also have important impacts.

The changes that appear most prominent from this vantage point are developments that will influence the future supply of farm products.

Energy

At the top of the list is the rapidly rising cost of energy. Energy affects not only the fuels required to operate machinery but also the whole complex of agricultural inputs of chemical origin, including fertilizers, insecticides, fungicides, and herbicides.

In the spring of 1980 when farmers were probably negotiating for most of their inputs for the year's crops, diesel fuel prices were nearly double the level of a year earlier. Prices of fertilizers and agricultural chemicals were also up substantially (20 percent or more), but the rate of increase was lagging behind that for fuels. Agricultural chemical prices are likely to increase more rapidly as accumulated inventories are worked off and manufacturing capacities become more fully utilized.

This escalation in energy prices will have a proportionately greater impact on southeastern agriculture than in the country as a whole because agricultural production in the Southeast is more energy-intensive than in most other parts of the country. Estimates of 1980 production costs show that in the Southeast 47 percent of variable production costs for cotton are made up of energy-sensitive items as opposed to an average of 28 percent for the U. S. The numbers for corn are 58 percent versus 53 percent and for soybeans, 45 percent versus 30 percent. Thus, the Southeast's disadvantage is substantial when energy costs are rising, largely because more fertilizer is required on relatively less fertile soils and more insecticides, fungicides, and herbicides are required for most crops because of the longer growing season. In addition, frequent rainfall (in normal years) requires repeated applications of chemicals to control insects, diseases, and competing vegetation.

The rapid rise in energy costs tends to make crop production more costly in southeastern states than in the rest of the U. S., affecting producers' comparative advantage. If energy costs should double from 1980 to 1982, comparative positions for producers of cotton, corn, soybeans, and rice would significantly deteriorate. Although crop production will not cease, producers would have an

incentive to shift to crops that use relatively less energy and in which their comparative disadvantage is least. Rice, soybeans, and wheat appear to be crops that producers will expand in the coming decade, while acreage of feed grains and cotton would probably decline unless price relationships among these crops undergo major changes.

Energy from Crops

Considerable experimentation is now under way on the feasibility of producing ethanol from agricultural products as a partial substitute for oil-based fuels. Should vegetable sources of energy become economically competitive, the Southeast is in good position to produce large tonnages of vegetable products for alcohol production. The long growing season, with relatively abundant rainfall, gives this area massive potential for increased forage production. Should specialty crops, such as sweet potatoes and sweet sorghum, in fact become efficient crops for alcohol generation, commercial crop production would take on a new dimension in this area. A livestock system to utilize the byproducts from alcohol production could significantly alter traditional animal production patterns.

Irrigation

The drought in 1980 reminded southerners of the value of our relatively abundant water supply, both surface and subsurface. The potential for irrigation could make a significant difference in crops grown in this area. For example, with adequate moisture, producers could have quickly started a crop of soybeans following 1980's winter wheat harvest. Without water, much acreage either did not get planted or did not emerge to an even stand following planting. Irrigation could have made a difference between obtaining two substantial crops from the same acreage in 1980 or obtaining only one crop. As more irrigation systems are installed and utilized more intensively in the Southeast, double and triple cropping (in the case of some vegetables) may become the rule rather than the exception in the years ahead. The effect would be to substantially increase the revenue from an acre of land while spreading production costs over a much larger output volume.

With increased irrigation will come new concerns involving water rights, allocations, and governmental jurisdictions. Actions to regulate and police water usage will result in additional costs that are also likely to influence crop choices.

Pollution

Related to water regulation is the broad area of environmental regulation. Agriculture will unquestionably experience greater future impacts from governmental regulations in this area. The direct effects on farmers themselves will involve cost-increasing practices that will be required to abate environmental pollution in all forms. The abundance of surface and subsurface water makes southeastern farmers more vulnerable to restrictive regulations on a broad spectrum of farm operations. For example, crops that require frequent applications of potent toxic materials are candidates for sharp alterations in cost structures as a result of additional restrictions nearly certain to be forthcoming. Livestock farmers are likely to be required to make substantial expenditures to adequately treat and dispose of animal waste products.

Farm Structure

The rapid growth in farm size has enabled producers to reduce average production costs by expanding their volume of output. The trend is likely to continue, resulting in fewer farmers and farm workers, while at the same time spurring the use of larger machines and the adoption of output-increasing technology.

Growth in farm size has resulted in a renewed expansion of tenancy as part-owner farm operators attempt to gain control of larger acreages without buying land outright. In most cases, land prices have escalated to the point where purchasers can no longer hope to generate sufficient cash flow from agricultural production to service indebtedness for farmland. The result? Landownership rests increasingly with those looking to farmland as an investment opportunity. They see farmland as protection against inflation because it appreciates more rapidly than the general price level. Since this environment increases tenant farm operators' uncertainty, they are likely to respond by reducing land improvements that pay off over the long

term. Eventually, the productivity of farmland is likely to decline as tenancy becomes more prominent. Absentee owners also will have different concerns from farm operators, which may affect the unity of support for future farm legislation.

Another product of fewer farms and larger operations is the organization of producers into larger cooperatives or grower associations. This trend is nothing new in itself. It has now spread from poultry and vegetable production to other enterprises, and some of its consequences *are* new or not yet fully recognized.

These enlarged organizations of producers, whether cooperatives, corporations, or just commodity associations, affect the competitive environment. In most cases, they reduce competition among members while enabling the membership to bargain more effectively with opposing forces in the marketing system. Large farmer cooperatives become the marketplace for both farmers' products and farm inputs. They perform research and educational functions for their members, and they substitute for many services traditionally provided by the Land Grant Colleges and the U. S. Department of Agriculture.

Credit

Large farm units have large credit demands—demands so large, in fact, they often surpass the lending expertise, if not the lending limits, of local credit institutions. Many lenders who have not specialized in agricultural finance find themselves ill-equipped to make and manage loans of the size and complexity required by large farming operations. Farmers in the South have looked more and more to the specialized financial institutions for credit needs. In cases where farmers are linked to other businesses through integration, credit needs are often supplied through large urban financial institutions. In the future, loans will increasingly flow through corporate headquarters to the producer level and will probably escape detection as agricultural credit altogether.

New banking legislation enacted in 1980 seems likely to affect the cost and availability of agricultural credit. It requires uniform reserve requirements on all banks after an initial adjustment period. Reserve requirements are, in an important sense, a cost of doing business for a bank. Banks that have not been members of the Federal Reserve System have had lower requirements than member banks. Thus, nonmember banks were able to place a higher proportion of their deposits in earning assets and to realize a higher return (or a lower cost) from their business operations.

Another important legislative change is that all banks can now pay interest on demand deposits or checking accounts. If competition forces most banks to pay interest at somewhere near 5 percent on most checking deposits, the cost of funds to banks will rise sharply. Profits from lending those funds will be squeezed, unless average lending charges (interest on loans) move up a comparable amount. The latter is a very likely outcome after an initial adjustment period. Farmers borrowing from such banks will likely find that the interest they are asked to pay for credit will be at a permanently higher rate in the future. If other lenders, such as the Farm Credit System agencies, do not experience a comparable rise in costs of funds acquired in national money markets, their competitive position *vis-a-vis* commercial banks will be enhanced.

To some extent, however, banks will pass along these higher interest rates to money market rates and users of credit in general. Bankers are important participants in national money markets through their exchanges of bonds, bills, and certificates of deposit. Bankers will not bid as eagerly for market instruments unless they offer returns high enough to offset the rising costs of deposits. The absence of bankers' participation in markets when rates drop below acceptable levels will probably cause users of funds to have to pay higher rates to attract investors back to the market. Thus, costs of funds to farm credit agencies will probably rise also.

The end result will be to tie interest rates on agricultural loans much more closely to national money market rates than they have been in the past. The cost of credit seems likely to rise in most localities, and interest charges will display an increased volatility. With the large and growing use of credit in farm operations, future success in farming may depend as much on the judicious acquisition and use of borrowed capital as on technical agricultural expertise.

Input Costs

Inflation has not only occurred in land and energy prices but has been running rampant in practically all items farmers buy. As farmers further expand output, the brisk demand for tractors, machinery, and other farm inputs will continue to support rising price levels of all major inputs. The rising general cost level will probably keep farm operating margins squeezed to the point that there will be little room for income declines (such as we experienced in 1980) without threatening the viability of many highly leveraged farming operations.

Risks

Efforts to protect against these increased economic risks will increase demands for insurance in a variety of forms. Lenders are likely to play a major role in inducing farmers to install irrigations systems, purchase crop insurance, engage in some form of forward pricing of products, and campaign for strengthened government programs to provide price and income support to farmers. However, serious efforts to combat inflation at the national level will cause Congress to press hard for reducing federal expenditures. The dwindling rural population and the consequent reduced political strength of the agricultural sector will render agricultural programs increasingly vulnerable to fiscal budget-cutting efforts. Future farm sector demands for price and income supports that involve government-imposed restrictions on output seem certain to be countered by strong demands to expand rather than restrain supply. Pressures will grow to reduce subsidies for crops such as tobacco and peanuts that do not have strong nationwide support.

Livestock Profits

Many factors affecting crop production will also impact the Southeast's livestock sector. Cattle and calf production, the largest single income-earning enterprise across the Southeast, will continue to be pushed off land that can be used for crops. The beef cattle enterprise is simply unable to provide a competitive return under existing levels of prices and technology. Although some practices may increase the productivity of grazing land, considerable escalation in cattle prices will be necessary to produce the future growth in beef output that once seemed likely for the Southeast. It is clear that the increased returns to crop production in the Midwest have all but stamped out the use of land for livestock grazing in most of that region. The same trend has already been observed in the more productive soil areas in the Southeast.

Feed Costs

Elevated energy costs further penalize the importation of feed grains to the Southeast, and the growing comparative disadvantage of feed grain crops in this region will not allow increased indigenous production. Livestock-feeding industries that depend heavily on harvested grains are thus unlikely to experience much growth. The poultry industry, however, which makes heavier use of soybean meal than do cattle or hogs, will receive offsetting benefits from the increased local supplies of soybeans and soybean meal. In the Southeast, then, feed costs are not likely to rise as much for poultry producers as for cattle and hog producers. That, combined with the lower winter requirements for auxilliary heat, may give southeastern poultry producers a considerable cost advantage over colder regions.

Exports

On the demand side, the biggest boost to the region, as well as to the country as a whole, has been the massive increase in export markets for agricultural commodities. The growing demand for feed grains and soybeans has been a particular boon for the Southeast because of the relatively large area of land in marginal uses that is adaptable to soybean production. The superior returns available from grain production in other regions have allowed a growing share of the soybean market to be filled by southern producers.

Part of the increase in export demand has been attributable to a decline in the value of the dollar against other currencies. This has given U. S. agricultural products a price advantage in world markets. More importantly, rapidly growing purchasing power in other

countries has fueled the demand for food and feed products. Thus, even if the dollar holds its own or regains some ground in foreign exchange markets in the years ahead, growth in export demand should continue strong because purchasing power is now strengthening in countries like Mexico with its newfound oil wealth. Another example is the People's Republic of China where virtually unlimited needs set the stage for prospective rapid growth in demand for most southeastern farm products.

The potential to respond to increased foreign demand is large and growing. Agricultural producers have easy access to ports all along the southern and eastern boundaries of our region. Inland waterways through the Southeast provide a transportation advantage of growing consequence as fuel costs continue to rise.

Growing demand and its impact on profitability will spur agronomic developments that could easily double yields of crops like soybeans. The Southeast has an abundance of land in marginal uses. Its producers have the capability to utilize technological innovations and expand production rapidly. The region is also developing facilities for handling large volumes of agricultural production. All these features place the Southeast in a strong position to respond to the massive growth in export demand that seems highly likely to occur in the 1980s.

Domestic Consumption

Although domestic population growth is likely to be limited during the upcoming decade, changing tastes and preferences stemming from rising incomes will enhance demand for superior food products. Consumers will demand more fruits, fresh vegetables, and exotic food preparations. Producers of fruits and fresh vegetables, especially those adjacent to large and growing population centers, may encounter growing local demand that could offset rising shipping charges that tend to shrink more distant markets. Producers of bulky products like melons, for example, are finding that a doubling of fuel costs since 1978 has necessitated such high prices in distant markets that the quantity demanded has declined.

On the positive side, the maintenance of food assistance programs will assure southeastern food crop producers of more stable demand than in the past. Specifically, during economic hardships, eligible consumers need not curtail their food purchases as long as the government's food stamp program continues to operate.

Highlights

Rapidly escalating farm input prices will markedly raise production costs of southeastern farmers. Enterprises using large proportions of energy-related inputs will be particularly hurt, and most southeastern crop producers use higher proportions of energy than do their national counterparts. Shifts in southeastern cropping patterns are likely to occur as energy costs rise.

Credit use will expand dramatically, but borrowing costs will move up to a permanently higher plane, and business will shift away from some traditional lenders.

Demand for food products will expand rapidly, with vigorous growth in effective demand in foreign markets. Southeastern producers have the advantage of a strategic location to share in the growing export markets for agricultural products. The growth in demand will raise prices sufficiently to offset cost increases for major enterprises, so that farmers will continue to bring marginal land into production and hold down their expansion of grazing livestock enterprises. On balance, total agricultural output will expand but shifts in competitive positions will cause traditional enterprises to diminish in importance.

The structure of southeastern agriculture will continue to change rapidly in the decade ahead. Commercial agriculture of the 1980s will differ remarkably from its predecessor of a short two decades ago.

—Gene D. Sullivan

Faulty Diagnosis: The GNP Revisions

Revisions to the GNP figures announced in December depict a stronger economy, especially for the last four years. Investment, productivity, saving, and output were all higher than previously reported. While some changes resulted from redefinitions of categories, many of the revisions were substantial enough to suggest that expansionist economic policies may have been overstimulative.

A patient being treated for severe anemia has been told that a new red cell counting procedure adopted in his physician's clinic has found him to be only mildly anemic and was so all along. The patient is immediately torn between the emotions of joy at learning he isn't terribly ill and of being irate over the side effects he has developed from his medication that wasn't necessary.

All the while, the patient had been feeling better than he was supposed to, considering his diagnosis. He couldn't convince the physician of what good shape he was in, even though he exercised and enjoyed life when he wasn't being told by the doctor how sick he was. Although recently the medication he was taking was making him nervous and somewhat hyperactive, the doctor had taken these developments as unfortunate but necessary consequences of trying to get the patient well.

Now that the mistake has been found, what will the correct course of action be? Unless the patient has become addicted to the medication, the obvious first step would be to stop or reduce sharply the medication. Maybe a valuable lesson was learned by the physician — trust your judgment about the patient's well-being if it runs counter to suspicious lab results.

Of course, this episode of erroneous diagnosis closely parallels governmental policy and the economy. Official statistics regarding output in the economy are the lab results; the government, as the doctor, prescribes economic remedies.

For several years, especially since 1975, statistics portrayed an economy apparently suffering from anemic growth, poor productivity, a steeply declining saving rate, and inadequate investment spending — and therefore slowly growing potential. Because of this supposed weak growth, fiscal and monetary policies were kept strongly stimulative. Meanwhile, officials argued that output was far below potential and stimulus was necessary to reduce unemployment and move closer to potential output. Further, they argued that all this could be achieved without making inflation worse. These arguments held sway despite evidence that noninflationary potential had been reached, probably in mid-1978.[1]

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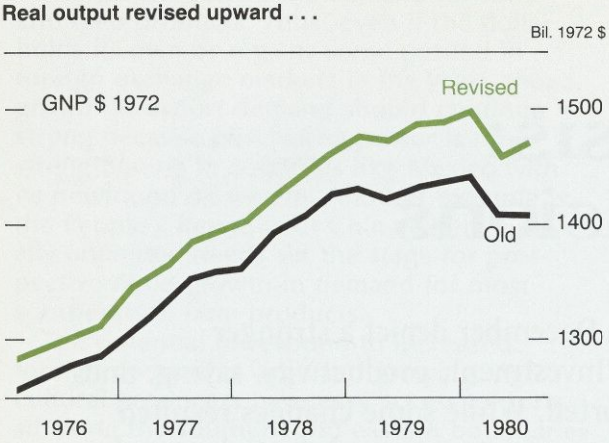
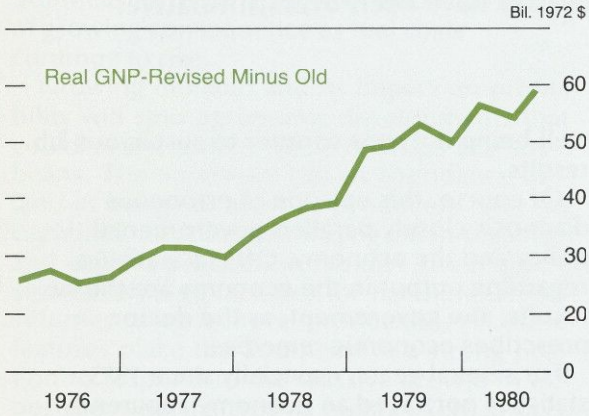
[1]See Haulk and Goudreau, "Potential GNP," **Economic Review**, Federal Reserve Bank of Atlanta, July/August 1979.

CHART 1
Real output revised upward . . .



and revisions increased since 1977.



Recently, the Commerce Department concluded what many suspected all along. Revisions to the GNP figures announced in December paint a much brighter picture than did previously reported numbers, especially for the last three or four years. For example, from first quarter 1978 to third quarter 1980, real output measured in 1972 dollars rose by $69 billion as opposed to the earlier reported $44 billion, a difference of over 50 percent. There were other important differences as well, including a higher saving rate, stronger investment, and higher profits. What were the changes that have so altered the nation's economic vital statistics?

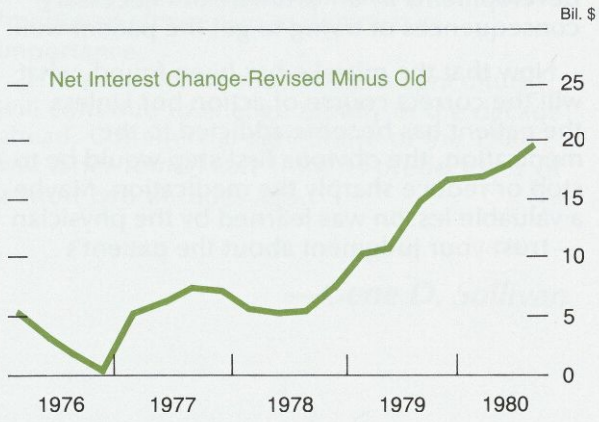
Corporate Profits Redefined

The Commerce Department's upward revision in corporate profits was largely due to a definitional change. Reinvested earnings of foreign subsidiaries of U.S. companies were previously not counted as corporate earnings; henceforth, they will be. In addition, errors were found in the way nonmerchandise international transactions were handled. Foreign income on corporate tax returns had previously been subtracted. Royalty payments are now included in corporate profits. The corrected procedure results in higher earnings for U.S. firms. More recent tax return data indicate profits were actually higher than earlier data predicted. Finally, the timing of depreciation of utility plants was changed to coincide with plant start-up rather than construction completion. All these changes raised corporate profits (after inventory valuation and capital consumption allowance adjustments) by nearly 10 percent above levels previously reported (see table). After adjusting for inflation, profits were 25 to 30 percent higher.

Interest Income Recalculated; Saving Rate Up

The 10-percent gain in net interest income (a component of personal income) was also the result of finding a sizable error in the way interest paid to businesses was calculated: businesses were being credited with more than they actually receive. In addition to the interest income revisions, the last couple of years saw a combination of changes in the rental, proprietor, and employee compensation components, totaling $10 billion.

CHART 2
Interest income revised up $10 billion for last two years.

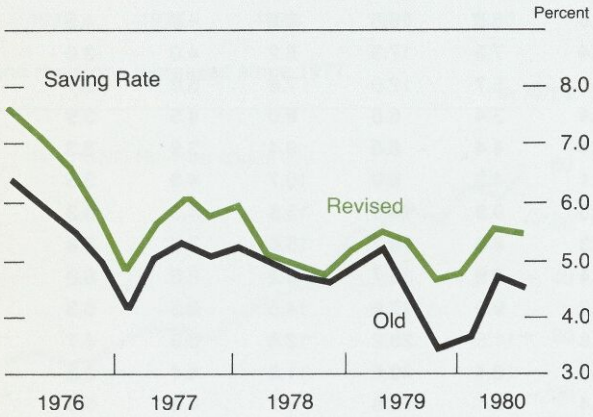


MAJOR REVISIONS IN GNP ACCOUNTS
(Differences and Percent Changes)

	GNP		Real GNP		Saving Rate	Corporate Profits After-Tax and IVA and CCA adj.		Net Interest	Nonresidential Fixed Investment	
	Billions of Dollars	Percent Increase	Billions of 1972 Dollars	Percent Increase	Percent Increase	Billions of Dollars	Percent Increase	Percent Increase	Billions of 1972 Dollars	Percent Increase
1970:1	7.8	0.8	7.8	0.7	13.1	2.7	7.9	11.3	3.8	3.4
1970:2	9.8	1.0	8.9	0.8	10.7	4.9	14.3	10.6	3.3	2.9
1970:3	11.0	1.1	11.3	1.0	9.0	3.8	11.2	10.0	3.9	3.5
1970:4	12.7	1.3	13.3	1.2	3.8	3.8	12.2	9.7	4.3	4.0
1971:1	15.3	1.5	16.2	1.5	5.0	6.6	17.9	8.9	3.0	2.8
1971:2	12.7	1.2	13.6	1.2	6.2	4.2	10.7	8.7	5.0	4.7
1971:3	14.2	1.3	14.7	1.3	6.6	6.6	16.6	8.8	4.8	4.5
1971:4	14.6	1.3	14.9	1.3	1.4	7.3	17.3	8.2	4.0	3.6
1972:1	15.4	1.4	16.0	1.4	1.5	5.7	12.0	7.6	5.8	5.1
1972:2	15.0	1.3	15.5	1.3	5.4	3.4	6.8	8.0	4.5	3.9
1972:3	14.7	1.2	15.1	1.3	5.1	4.4	8.6	9.4	3.9	3.3
1972:4	14.1	1.2	12.6	1.0	6.1	4.3	8.0	10.7	4.3	3.5
1973:1	18.2	1.4	17.3	1.4	11.8	9.9	19.0	13.5	4.3	3.3
1973:2	19.2	1.5	17.9	1.5	10.3	8.8	18.2	15.6	7.6	5.8
1973:3	20.2	1.5	20.5	1.7	11.4	7.9	15.7	16.2	8.0	6.0
1973:4	21.6	1.6	24.4	2.0	9.2	9.0	17.8	14.5	8.3	6.3
1974:1	18.7	1.4	24.5	2.0	15.6	11.5	28.2	12.8	6.3	4.7
1974:2	23.7	1.7	31.8	2.6	17.8	13.4	39.6	11.6	4.4	3.3
1974:3	21.5	1.5	31.7	2.6	19.4	12.1	52.8	8.7	4.6	3.5
1974:4	21.4	1.5	32.7	2.7	14.7	11.6	42.6	8.5	5.0	4.0
1975:1	25.1	1.7	34.7	3.0	12.5	12.3	36.6	8.4	3.0	2.5
1975:2	18.1	1.2	31.1	2.6	10.3	12.5	29.0	8.0	4.9	4.3
1975:3	14.5	0.9	28.4	2.3	10.7	11.4	21.0	7.0	7.2	6.4
1975:4	23.8	1.5	31.8	2.6	14.1	18.9	35.4	6.5	7.8	7.0
1976:1	18.3	1.1	27.7	2.2	20.3	11.4	17.2	6.5	6.7	5.8
1976:2	15.5	0.9	28.4	2.2	19.7	11.8	19.3	4.6	6.5	5.5
1976:3	13.2	0.8	26.2	2.1	23.2	10.6	16.8	2.3	6.7	5.6
1976:4	16.4	0.9	27.3	2.1	13.5	11.2	18.2	0.7	6.4	5.2
1977:1	18.9	1.0	30.2	2.3	16.7	14.1	20.8	6.5	8.2	6.5
1977:2	17.9	0.9	32.2	2.4	11.8	14.5	19.0	7.1	11.5	9.0
1977:3	19.9	1.0	31.9	2.4	14.8	15.4	17.7	8.1	10.8	8.3
1977:4	17.3	0.9	30.2	2.2	13.7	15.5	19.9	7.5	14.6	11.1
1978:1	21.1	1.0	34.5	2.5	15.1	22.0	31.3	5.7	12.6	9.5
1978:2	25.4	1.2	37.6	2.7	2.0	17.2	20.3	5.1	13.2	9.4
1978:3	31.3	1.4	39.4	2.8	0	17.7	20.2	5.3	13.4	9.5
1978:4	36.7	1.6	39.2	2.7	12.8	20.7	23.1	6.9	13.9	9.6
1979:1	48.5	2.1	49.3	3.4	6.0	25.7	29.3	8.8	14.2	9.6
1979:2	44.8	1.9	51.1	3.6	3.7	22.3	25.4	9.0	14.4	9.8
1979:3	47.6	2.0	54.9	3.8	25.6	24.3	28.0	11.6	15.7	10.4
1979:4	39.4	1.6	50.3	3.5	34.3	21.9	27.3	12.4	13.6	9.0
1980:1	50.9	2.0	57.2	4.0	32.4	33.4	46.0	11.7	13.8	9.1
1980:2	43.5	1.7	54.7	3.9	26.5	22.6	30.0	11.8	10.8	7.4
1980:3	50.8	2.0	60.2	4.3	29.8	26.4	36.1	12.1	12.0	8.4

Virtually all of the increase in disposable personal income resulting from these net interest revisions was allocated to savings. For example, in third quarter 1980, there was a $30-billion revision in disposable income, and savings were raised by $25 billion in that quarter; the revisions in consumption spending were insignificantly small. What this has done is to raise the personal saving rate.

CHART 3
Saving rate healthier than originally reported.



The table shows the saving rate changes over the period 1970 to 1980. The largest upward revisions in the saving rate were for the five quarters 1979:3 through 1980:3, although fairly large revisions were in evidence from 1973 through 1978:2 when they suddenly diminished, probably due to the lower interest rate effect on net interest income. During the last one and a half years or so, the saving rate was about 25 to 30 percent higher than originally reported. The long-term trend still declined during the seventies, but for the last two years when we heard so much about our deplorably low saving rate, it was actually just under its post-World War II average.

Changes in GNP

On the expenditure side, there were two major changes. First, net exports were raised by including net reinvested foreign earnings. Second, rebenchmarking (revisions of sampling using more recent information) discovered that producers' durable equipment was being underestimated. With a newer model in place, gross business investment outlays were calculated to be about 8 percent greater in real terms than previously reported.

Fixed Investment Figures Revised Upward

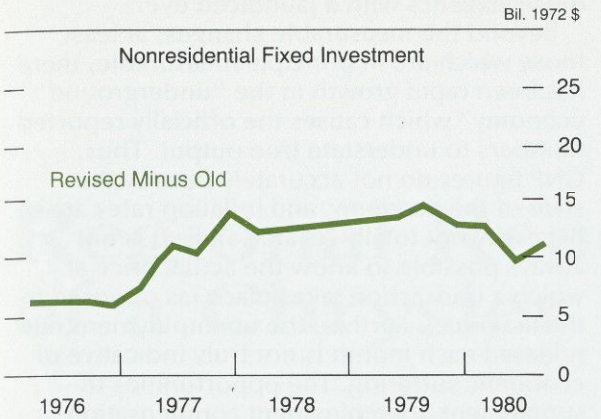
Since the revisions were concentrated in the producer durables component, fixed nonresidential investment was raised substantially both nominally and in constant dollars. Producer durables accounted for 60 to 70 percent of the revisions in nonresidential investment in the early 1970s and 100 percent by 1979. The size of the revisions in both absolute and percentage terms jumped in late 1973, fell back in 1974, and grew again in late 1975. Then in 1977, the revisions really swelled, going to 11 percent higher than the originally reported figure. After reaching as high as 14 percent, they appear to have leveled off. In addition to nonresidential investment revisions, residential investment was boosted by 2 billion 1972 dollars.

The share of nonresidential fixed investment in total GNP was raised by 8 to 10 percent for the past three years, less for earlier years. The share of GNP going to domestic investment has been higher in recent years than in any time in the post-WW II period. Furthermore, the fact that part of the increase in revised GNP was due to inclusion of unrepatriated earnings means that the share of gross domestic product going to investment was much higher than the post-WW II average.

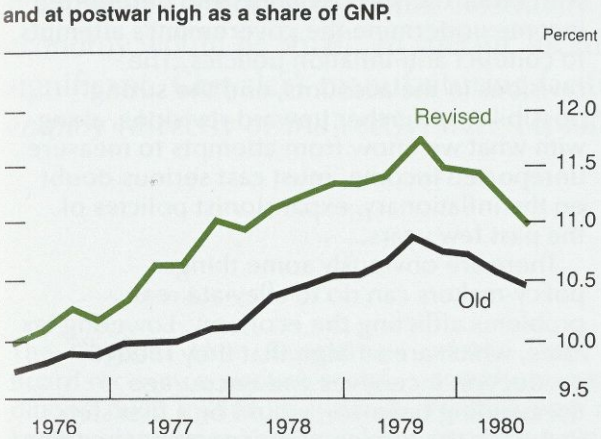
To the extent that producer durables have a shorter life than structures, the increase of producer durables relative to structures could slow the total growth of capital, since net investment would be lower. This may or may not be a problem, depending on whether the shift is a true reflection of rates of return on the different capital stock components. The Commerce Department's Bureau of Economic Analysis says that the revisions raised net growth of capital from 3.5 to 3.9 percent per year for 1969-79.[2] That is an 11 percent faster

[2]**Survey of Current Business,** December 1980, p. 23.

CHART 4
Nonresidential Fixed Investment over ten percent higher since 1977 . . .



and at postwar high as a share of GNP.



rate. As a matter of interest, the annual net growth rate of capital was 3.4 percent from 1949 to 1959 and 3.8 percent from 1959 to 1969. Given the big changes for 1977-79, we probably had a record rate of capital accumulation. These results indicate that much of the concern over the supposed weakness of investment in the U.S. has been unduly alarmist. It is important to remember that these revisions to producer durables are based in part on data already several years old. Additional upward revisions may come when later data are available.

Other Changes

Total consumption spending was negligibly affected by the revisions. However, measured in constant dollars, consumption was found to be about one percent higher than earlier reports indicated. Almost all the revision was accounted for by outlays on nondurable goods. Service outlays in nominal terms were lowered while constant dollar expenditures remained level, meaning that the deflator for services was revised downward. For durables, there was no significant change in nominal or real outlays.

Federal government spending was revised upward both nominally and in real terms. The largest revisions in real federal spending were for 1979 and 1980. For the third quarter 1980, the new figure is $3 billion, or 3 percent above the originally reported number. Nineteen-eighty state and local government spending, while 4 percent higher in real terms after revisions (lower in nominal terms), reflected a downward change in the government spending deflator.

Finally, alterations in the deflation procedure for nonmerchandise exports and imports plus a lowered estimate for the cost of items purchased by the federal government significantly reduced the growth rate of the GNP deflator, particularly for the last two years.

How Important Are the Revisions?

Even though the inflation rate for the past few years has been revised downward, it is still uncomfortably high. It is still a serious problem because, as it persists, the economy tries to cope by developing inflation-protection schemes which make it more difficult to control inflation. The GNP revisions did not reduce the growing tax burden felt by the middle-class, who must struggle against both inflation and the decreasing share of their gross income left in their pay envelopes.

Revisions in productivity figures indicate that productivity grew about 16 percent faster over the period 1972-79 than was earlier thought. That still leaves a very slow rate of increase of 0.92 percent per year. The productivity slowdown is a complex phenomenon and could be overstated for reasons discussed in the final section of this article.

The revisions are particularly disturbing because so much has been written to try to

explain the growing American capital shortage and poor productivity performance of recent years. The revisions are very generous to the producer durables component of investment. That makes sense in view of the upward revisions in profits and personal savings. It also makes sense in light of the very low, even negative, real after-tax interest rates prevailing for much of the period since the late 1960s, even taking into account problems created by the effect of historical cost depreciation on cash flow.

Some leading economists, including Otto Eckstein, have made light of the revisions, arguing that they are not of great importance. For example, the changes in definition to include unrepatriated earnings are of no consequence except to recognize the claims on foreigners that these profits represent. Likewise, the changing of depreciation for utilities was not overly significant. However, recalculating the GNP deflator, discovery that corporate profits were higher than estimated and finding substantial errors in investment estimates, personal income, and the saving rates cannot be waved off lightly as unimportant.

The discovery that investment as a share of GNP has been at a post-WW II high for the last three years is very important. Finding that the saving rate, while having fallen, is not inordinately low relative to post-WW II levels is quite a piece of news — especially in view of all that has been written and said about our lack of savings and investment.

More importantly, these revisions, many of them based on data several years old, should caution against over dependence or reliance on statistics based on extrapolations from sample data when the structure of the economy is rapidly changing. The changes in the economy over the last ten years (massive increases in government transfer payments, increasing tax burden, financial market developments, inflation, changes in industrial output mix, oil price hikes, and invasion of the U.S. markets by imports) should cause those who use national statistics derived from samples and historical relationships to view those statistics with a jaundiced eye.

Beyond the measurable changes, at least those which are in principle measurable, there has been rapid growth in the "underground economy" which causes the officially reported numbers to understate true output. Thus, GNP figures do not accurately portray the state of the economy, and inflation rates are of necessity not totally reliable since it is not always possible to know the actual price at which a transaction takes place (as opposed to the list price). Further, the unemployment rate released each month is not truly indicative of economic suffering. The opportunities to supplement unemployment compensation with other transfer payments and unreported income undermine the government's attempts to conduct anti-inflation policies. The revisions in the accounts, and the strong possibility of further upward revisions, along with what we know from attempts to measure unreported income, must cast serious doubt on the inflationary, expansionist policies of the past few years.

There are obviously some things policy-makers can do to alleviate real problems afflicting the economy. Lowering tax rates, which are so high that they reduce production incentives and encourage tax-avoiding behavior, would be a first step. Reducing the growth of government spending to eliminate perpetual deficits and their effects on interest rates and money creation would be a welcome move. The policymaker, like the wise physician, must act to produce overall good health rather than try to eradicate every ache and discomfort in the patient whether real or imaginary. Too much treatment could lead to a weakening of the patient's ability to cope with truly serious ailments. ER

—Charles J. Haulk

Regional Repercussions of a Chrysler Failure

If Chrysler Corporation should eventually fail, the effects on the region's economy would be small. In specific locations, however, the effects could be significant. Chrysler's manufacturing facilities, dealers, and parts suppliers employ (directly or indirectly) over 14,400 workers in the Southeast.

The Chrysler Loan Guarantee Board recently approved an additional $400 million in federal loan guarantees to the Chrysler Corporation. The approval was conditional upon: employees agreeing to forego wage and benefit concessions (for UAW workers this amounted to $622 million over the life of the current contract, which expires in September 1982); banks and other institutional lenders agreeing to convert some debt to equity, and to forgive other debt altogether in exchange for partial cash payments; and suppliers agreeing to price freezes and rollbacks, and to more generous credit terms. Despite the approval, Chrysler's future remains uncertain.

Where are the Chrysler facilities and their secondary suppliers located in the Sixth District? What would be the likely repercussions on income and employment in the Sixth District if Chrysler were to fail? The direct influence on income and employment in the Sixth District would be small. However, the indirect effects, which take into account the effects on area dealers and parts suppliers in addition to Chrysler plants, would be considerable. This preliminary study is designed only to provide a rough estimate, not an in-depth analysis.

Currently, the Chrysler Corporation has three primary facilities located in the Southeast, with a total work force of about 1,700. The facilities are located at Cape Canaveral, Florida (a wire products plant);

Facility	Location	Employment*
Huntsville Electrical Division	Huntsville, Alabama	1,460—January 1981
Chrysler Corporation Wire Products Plant	Cape Canaveral, Florida	33, but will be 0 by July 1981 or sooner
Chrysler Michoud Defense-Space (Engineering Facility)	Slidell, Louisiana	About 200
Dealership Employment:	Alabama	1,250
	Florida	3,130
	Georgia	2,230
	Louisiana	1,510
	Mississippi	1,340
	Tennessee	2,120
		11,580
Regional Headquarters and Parts Depots	Atlanta, Georgia, and Orlando, Florida	350
Total Direct Employment		13,623

*Estimates of workers are from officials at the area facilities; estimates of dealership workers are from Chrysler officials at the Detroit headquarters.

in Huntsville, Alabama (an electrical division); and in Slidell, Louisiana (a defense and space facility). Therefore, direct employment loss would be about 1,700— mainly in Huntsville.[1]

The Economic Stabilization Subcommittee of the House Banking Committee uses a multiplier of 1.7 to determine direct and indirect employment effects. For each 100 Chrysler manufacturing workers laid off, another 70 workers would be laid off at secondary suppliers. These 70 exclude those employees affected by dealership closings. If we assume that all secondary suppliers to the Cape Canaveral and Huntsville facilities are localized, the multiplier effect suggests that about 2,500[2] District *manufacturing* workers would lose their jobs or be laid off in the event of a Chrysler failure.

There are obviously many Chrysler dealerships that would also be affected by a failure. As of July 1, 1980, there were 4,006 Chrysler dealerships throughout the U. S. By January 1, 1981, that number had declined to 3,823. There are at least 11,930 workers at Chrysler dealerships, parts depots, and regional headquarters in the District. When the direct and indirect employment effects of Chrysler's manufacturing facilities are combined with the influence on dealerships, the total comes to at least 14,468 workers.[3] Although this estimate is small relative to the overall level of employment (11.2 million), it would have significant effects in some communities.

Income Loss

The income loss would be even less than the employment loss. Since these facilities could argue that they have been adversely affected by imports, they might qualify for trade assistance--up to 70 percent of gross weekly wages.[4] Moreover, when taxes are taken into consideration, net disposable income losses would be negligible. ER

—Charlie Carter

[1]Assuming that none of the plants would be purchased and run by another company.

[2]Estimates exclude the Chrysler workers at Slidell, Louisiana's defense-space facility. These workers would likely continue in the event of a Chrysler failure.

[3]Assuming that none of these workers would be hired by other dealers, repair shops, etc.

[4]President Reagan has proposed the elimination of the trade assistance program. Congressional approval is uncertain at this time.

The U.S. Economic Outlook: No Instant Miracles

—by Robert F. Lanzillotti

Robert F. Lanzillotti, Professor of Economics and Dean, Graduate School of Business, University of Florida, recently addressed the Board of Directors of the Federal Reserve Bank of Atlanta on the current economic outlook. Dr. Lanzillotti is optimistic about the Reagan policies and is convinced the American public will accept the necessary austerity accompanying this transition period.

For some weeks following the November elections many commentators viewed Stockman and Company's proposals for drastic budget cuts and major tax reductions as more post-election bravado than serious economic argument. The President's February 5 general economic message removed all doubt about his economic program: He intends to bring the country to terms with the problems of chronic high inflation, low productivity growth, slack production, and vulnerability to supply disruptions and OPEC price shocks.

What kind of costs are likely to result from the bold approach President Reagan is advocating? Put differently, how large are the costs our country is willing to bear to guarantee the benefits of lower inflation? Are there alternative policies which can both lower these costs and also reduce inflation as quickly?

Sources of Inflation

Since the mid-1960s, the U.S. has experienced a series of major economic shocks, which have increased the underlying ("embedded") inflation rate by almost tenfold (from about 1 percent per year in the first half of the 1960s to 9-10 percent currently).

The most traumatic shocks were triggered by the OPEC oil prices hikes, especially in 1973-74 and 1979. The 1973-74 hikes added about $18 billion to our imported oil bill (about 1.5 percent of GNP,) but the 1979 hike (from $15 to $35 per barrel) added another $50 billion to the cost of imported oil (roughly 2 percent of GNP).

The U.S. economy, indeed the world economy, was ill-prepared to meet these developments. What is truly remarkable is that the various economies, including the U.S., withstood these shocks so well, which is a kind of tribute to the resiliency of our economy.

But not all of the inflation shocks of the 1960s and 1970s were exogenous in nature. Many of our recent economic wounds were self-inflicted.

The military adventure in Vietnam and the mounting of the Great Society programs were financed for several years without a tax increase, leading to a very large federal deficit and a classic demand-pull jump in the underlying inflation rate by 4 or 5 percent. This was followed by the economic adventure in price and wage controls in 1971-73, producing various economic distortions and inequities.

At the same time, the 1970s gave birth to new adventures in regulation (worker and product safety, air and water standards, and other "mandated costs" to business). These new regulations were enacted in the face of extensive economic analysis urging the wisdom of deregulation. It is now clear that these federal regulations have failed to reflect a sensible

balancing of national priorities, and have largely disregarded the costs, benefits and least-cost solutions to proposed regulations.

I am convinced we will continue to give government regulations a "fresh look" to determine whether they should be modified or discarded altogether in the light of new economic and technical knowledge or new conditions. I expect this process to extend beyond railroads, trucking, airlines, energy, telecommunications, and banking to the new regulatory agencies (EPA, NHTSA, CEQ, OSHA, CPSC, etc.), as well as other government interventions, including unwarranted subsidies to business.

In short, while it is clear that business wants to get the federal government off its back, in the course of events I suspect it will become clear that some businessmen mean "just the government, not its subsidies."

The United States faces the same economic dilemma in the 1980s as in the 1970s: that is, are we willing to manage our economic affairs to correct the devastating inflation that fosters a kind of economic warfare among our citizens?

In forging a policy to correct the inflation, it is essential to understand inflation's sources and why it has increasingly developed a "ratchet-like" character. In addition to supply shocks, the 1960s and 1970s suffered from excess aggregate demand, declining productivity growth, and a refusal of wages and prices to decline in response to slack in the economy.

This downward insensitivity of both wages and prices has some rather deepseated structural origins, including multiyear wage contracts with cost-of-living clauses, noncompetitive influences in the operations of various markets, and government interventions in individual markets to fix wages, prices, quality, and production conditions.

Moreover, unions, business, and the public have welcomed the periodic validation by the Congress that economic policy will continue to be expansionary, and that Congress will continue to provide "special" relief and assistance when high prices and wages generate competitive difficulties.

Most of all, I believe the inflation of the past 15 years has been a monetary and financial phenomenon, created by excess liquidity, excessive credit expansion, and ultimately, excessive money-supply expansion.

There is ample empirical evidence that budget deficits have contributed to recent surges in inflation both by contributing to higher aggregate demand and by justifying expectations about levels of future aggregate demand. As we all know only too well, fiscal policy oriented toward stimulating aggregate demand to drive down unemployment requires monetary authorities to monetize the public debt.

The real challenge for economic policy is whether we can arrest and reverse the inflation without inflicting equally devastating side effects on output and employment. A corollary to this is whether our economic theory and econometric models are adequate to provide guidance and support to the supply-side strategy as the centerpiece of the new economic policy.

The Way Out: Tax Cuts, Monetary Restraint

Many things fall under the rubric of "supply-side economics." Essentially, it deals with the economics of production (as contrasted with the economics of consumption and aggregate demand). It includes anything that influences cost, efficiency, productivity, and the level and composition of GNP.

Principal attention is focused on incentives, and whether sharp tax cuts will "generate more supply than demand," by creating incentives to work, save, invest, and produce.

In this connection, it is argued that tax cuts can pay for themselves in 1982 and 1983. The answer depends, of course, on the type of tax cuts adopted.

Personal tax cuts will tend to increase aggregate demand by more than the tax cut, by virtue of the multiplier process. Hence, to the extent the supply response to such actions is *less than* the additional aggregate demand created, any such tax reductions are likely to add to inflationary pressures from the demand side, at least in the short run.

Recent studies demonstrate conclusively that one of the principal causes of the decline in productivity growth during the 1970s was the decline in the growth of capital stock relative to the labor force. In order to restore the growth of our capital stock per worker to the growth rate of the 1960s, real business fixed investment as a percentage of real GNP must rise by at least one-to-two percentage points (above the recent average of around 10 percent).

Hence, tax cuts in the form of accelerated depreciation allowances, larger investment tax

credit, or lower corporate income tax rates are likely to generate the required increases in business fixed investment, a significant increase in our capital stock and a significant increase in the level of productivity.

It goes without saying that demand-side and supply-side economic policies must be harmonized in a framework of fiscal restraint if we are to realize additional saving, investment, faster productivity growth, and reduction in the inflation rate.

My analysis of the probable macro-economic effects of alternative tax reductions leads me to the conclusion that investment-and productivity-oriented tax cuts for business are likely to increase saving, investment, and productivity by much more than cuts in personal income taxes. Moreover, since the supply response requires time to produce the intended effects, any personal tax cuts should be timed to be consistent with the degree of demand restraint needed to reduce inflation.

Tax reductions accompanied by reductions in federal spending of roughly the same magnitude will not change aggregate demand. But a very large tax cut not linked to spending cuts probably would lead to both an increase in inflation and a sharp rise in interest rates. Moreover, some of the stimulus to investment spending from the targeted tax cuts thus might be weakened by higher interest rates, generating new uncertainties.

In my opinion, the desired policy-mix is one emphasizing tax cuts for business, coupled with monetary restraint. If personal tax cuts are also included, it would be prudent to delay the effective date to July 1, or preferably October 1, 1981. This strategy offers the best prospect for significant reduction in the inflation rate within a span of two-to-three years.

I am optimistic about the economic policies of the Reagan administration because it is clear they will be tilted in the direction of measures oriented toward long-term policy goals, rather than short-run economic crises.

Accepting the Costs

This will mean accepting slower economic growth in order to stimulate investment in plant and equipment, new technology, and higher productivity, even if it means in the short run there will continue to be some relatively high levels of unemployment, lower profits and slower rates of growth in total personal income.

I am convinced that the American public as well as the American business community is prepared to accept the necessary austerity that must accompany this period of transition from "an economy in distress" to an economy capable of maintaining viable growth and stability. The prospects for the U.S. economy for 1981 and beyond thus depend principally upon our success in bringing down the rate of inflation.

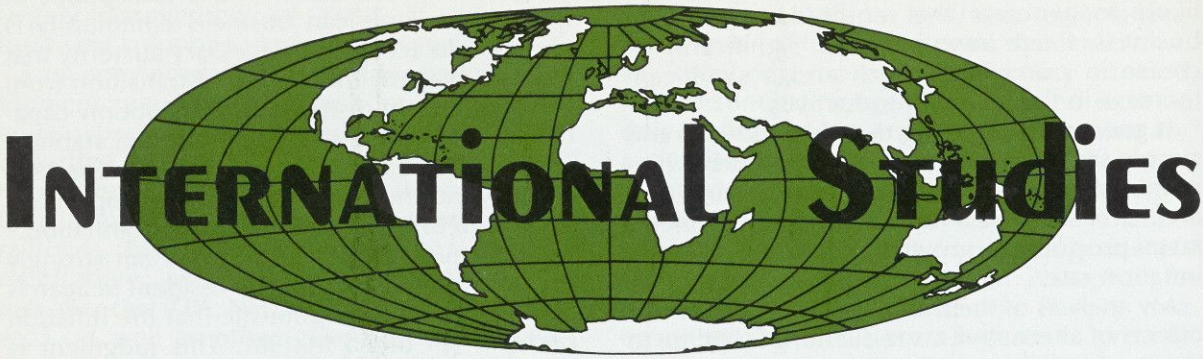
At this juncture, even though I am strongly supportive of the approach President Reagan is planning, I am not optimistic that the inflation rate will fall much in 1981. This judgment is based on my earlier comments about the pervasive institutionalizing of the inflation through wage escalators, indexed transfer and pension payments, and other contractual arrangements which are not likely to be altered in the short run. Accordingly, wage costs will accelerate in 1981 for both "catch up" and "keep up" reasons in the face of rather dim prospects for productivity gains.

While there still are no clear indicators of the widely predicted recession for early 1981, the outlook is not strong for much real growth in GNP. The wide swings we witnessed in 1980 are not likely to recur this year.

It is important also to ensure that the high volatility of interest rates in 1980 is not repeated. I look for some reduction in the growth of monetary aggregates and shall be both surprised and disappointed if the Fed's recently announced reductions in target growth rates for 1981 are not implemented.

What does all this signify with respect to the economic outlook for the U.S.? The President's program is bold, and the proposed changes in economic policy should produce a quantum improvement in the long-run economic outlook. The character of the program undoubtedly already has favorably affected producer and consumer expectations.

The real test, however, must be measured in terms of the *actual* effects on economic performance, particularly the rate of inflation, national income, output, and productivity. Economic processes are complex and often slow; hence, several years will be required to correct cumulative errors in economic policy and to unwind the tangles and imbalances generated. In short, even assuming the program, with all of its strengths, is adoped intact by the Congress, history and prudence caution us that in the economic world there are "no instant miracles." ER



International Deposits In Miami — A Profile

The surge in international banking activity in Miami is led by deposits from Latin American individuals and nonfinancial firms. Interviews with Miami commercial banks, Edge Act corporations and foreign bank agencies suggest that foreign depositors come to Miami primarily for portfolio diversification, political stability, and personal, bilingual service.

International banking transacted by Miami commercial banks, Edge Act corporations, and foreign bank agencies is surging. Four years ago, Miami had no foreign bank agencies and only 10 Edge Act corporations. As of late March, 1981, 27 foreign bank agencies or representative offices and 36 Edge Act corporations have Miami banking offices open or pending. These include 25 of the world's largest 100 banks.[1] Additionally, Miami has over 20 commercial banks with active international departments — that's over 75 banking entities in Miami with an active international orientation.[2]

A significant flow of international deposits is placed in these Miami international banking institutions. As of June 1980, aggregated international liabilities of Miami banking entities (commercial banks, Edges, and foreign agencies), excluding liabilities to the banks' own foreign offices, approached $2.5 billion. By far, the bulk of these international deposits (90 percent) was placed in Miami by individuals and nonfinancial firms. A large part of these accounts are in time deposits; most (over 90 percent) are from Latin America.

On top of those deposits directly placed on Miami books is a significant Miami-generated deposit base (perhaps another third) placed directly on a bank's Eurocurrency branch in the Bahamas, Cayman Islands, and London.

In order to provide a profile of the character of international deposits placed in Miami, this author carried on a series of interviews during February 1981 with 14 Miami commercial banks, Edge Act corporations, and foreign bank agencies, which account for four-fifths of Miami's foreign liability base. The interviews concentrated on those factors affecting individual and nonfinancial international deposits in Miami.

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[1] **American Banker,** July 25, 1980.

[2] For a detailed list of the international banking participants in Miami, see **"Behind Miami's Surge in International Banking"** in the **Economic Review**, April 1981.

Table 1. Miami Banking Entities' International Deposits* (June 1980)

To	Percent of Total	Percent in Time Deposits	Percent Latin American
Foreign official institutions	2.8	13.3	99.0
Unaffiliated foreign banks	6.7	0.5	88.6
All other foreigners	90.5	80.4	93.5
Total	100.0	73.2	93.3

*Excludes foreign liabilities to own branches and affiliates.
Source: U.S. Treasury.

The average international deposit account is large compared to its domestic counterpart. Some Edge Act corporations and foreign bank agencies have a strictly wholesale orientation and are hesitant to accept retail international deposit accounts. An average time account in these entities surpasses $100,000, and the number of international deposit accounts may be 500 or less. Other edges and foreign bank agencies, as well as the Miami-based commercial banks, accept smaller accounts — still, an average time account ranges from $50,000-$100,000 or more.

Time deposits are the principal deposit instrument, although most international depositors (and the banks themselves) prefer that the depositor also open a demand deposit account; this facilitates the banking relationship. The Miami banking entities are principally interested in these full banking relationships. Most request bank references and prefer depositors referred to them rather than relying on walk-in business. Some Miami banking entities travel abroad selling their personal deposit services; others do not travel at all and only passively accept international deposits which may be generated by the bank's Miami or world reputation. Few of the Edges and agencies advertise locally for international deposits.

WHY ARE INTERNATIONAL DEPOSITS PLACED IN MIAMI?

Are Interest Rates a Major Factor? — Yes, but.

Question 1. How responsive are foreigners' Miami bank deposits to interest rate differentials between the U.S. and the foreigners' home country?

	Responses
a. very responsive	3
b. moderately responsive	7
c. not very responsive	4

Question 2. How significant is interest rate competition on CDs in the Miami banking market?

	Responses
a. significantly competitive	9
b. moderately competitive	3
c. very limited competition	2

Nearly three-quarters of the interviewed bankers perceive Miami international deposits as somewhat to very responsive to rate differentials between U.S. and Eurodollar rates and what a large depositor could earn in his home country. But none of the bankers perceived interest rate differentials as the prime explanation for Miami's international deposit growth. They view international depositors as increasingly sophisticated and aware of the differences between home country and international deposit interest rates.

In response, an increasing number of Latin American economies are allowing their domestic time deposit rates to fluctuate with international rates — sometimes with a marginally favorable difference in favor of the home country. Mexico has been particularly alert to maintaining its deposit rates marginally above comparable U.S. and Eurodollar rates. Costa Rica and Venezuela also have permitted their rates to vary with international rates, although sometimes with a lag. In contrast, Guatemalan maximum deposit rates, for instance, remained constant throughout the extremely volatile 1980 international interest rate scenario and likely induced a deposit outflow.

Several bankers mentioned the fact that though some deposits do enter the Miami and Eurodollar international deposit place due to favorable interest rates, once placed abroad, a significant proportion of these deposits stay, even if the favorable rate differential disappears. Therefore, it is likely that international deposits are placed in Miami also for portfolio diversification and political stability purposes.

Table 2. Typical Interest Rates on Large Time Deposits (percent)

1980	Costa Rica[1]	Guatemala[2]	Mexico[3]	Venezuela[4]	United States[5]	Eurodollar Deposits[6]
January	15.0	9.0	17.35	15.00	13.39	14.33
February	17.5	9.0	18.15	15.00	14.30	15.33
March	16.1	9.0	20.71	17.00	17.57	18.72
April	10.8	9.0	22.03	17.00	16.14	17.81
May	10.9	9.0	21.11	13.00	9.79	11.20
June	11.8	9.0	19.13	12.00	8.49	9.41
July	12.2	9.0	18.20	12.00	8.65	9.33
August	13.3	9.0	18.98	12.00	9.91	10.82
September	13.7	9.0	20.74	12.00	11.29	12.07
October	15.4	9.0	21.74	12.00	12.94	13.55
November	17.9	9.0	23.25	16.00	15.36	16.46

[1]Six-month foreign currency deposit.
[2]Maximum interest rate permissible on deposit liabilities.
[3]Large three-month certificates of deposit.
[4]Large six-month certificates of deposit.
[5]Three-month certificates of deposit, secondary markets (average of five dealers).
[6]Three-month rate.

Most of the bankers interviewed regarded Miami as a moderate to significantly competitive banking market for large international deposits — significantly more competitive than it was even a few years ago due to the influx of the new internationally oriented banks. Still, Miami rates are typically below New York levels because of demand factors — the bankers simply do not have New York's loan demand. But competitive factors in Miami's banking market are closing the gap between Miami and New York rates.

The sensitivity of large CD deposits to a particular bank's rates has been heightened by the 1980 volatile rate scene. Large depositors earned over 17 percent on three-month certificates of deposit in March 1980, but the renewal rate in June 1980 was at half that level. This induced a greater number of depositors to "shop around" for rates. It also may have induced greater deposit placements in Eurodollar markets, since banks can quote marginally higher Eurocurrency rates to such interest-sensitive large depositors.

Some Miami banking entities resisted paying the peak March/April 1980 CD rates, assuming that the cost of funds would soon fall and that the bulk of their depositors would stay due to longstanding banking relationships and personal attention given to their clientele. Some banks, then, differentiate their product (deposit services) through such personal service.

Large depositors are dealt with personally by the bilingual senior official staff of Miami's banking entities — this is often in contrast to treatment afforded the same depositor in the same bank's head office in money centers. The smaller scale operations out of Miami make such treatment possible. These accounts also get significant attention because the personal international accounts are the bulk of Miami's international deposit base. It is this service and personal attention — so important to Latin American clients — that permit Miami banking entities to compete against New York and Eurodollar rates. The competition is in nonprice (noninterest rate) factors.

Is Economic and Political Stability a Factor? — Yes!

Question 3. How responsive are foreign deposits in Miami to fears of home country devaluation or exchange control establishment?

a. very responsive	8
b. moderately responsive	6
c. unresponsive	0

Question 4. How important a role does the political stability of the U.S. play in attracting foreign deposits in Miami?

a. very important	13
b. moderately important	1
c. relatively unimportant	0

Question 5. How responsive are foreign deposits in Miami to political instability in the foreign depositor's home country?

a. very responsive	13
b. moderately responsive	1
c. unresponsive	0

Political and economic stability is important to the placement of international deposits in the U.S. Miami international bankers see this factor, along with portfolio diversification, as the basic rationale behind international deposit placement by individuals and nonfinancial firms.

International depositors react to real and perceived factors. In countries which habitually have large current account deficits combined with high inflation and stable exchange rates, large depositors react to rumors of devaluation and exchange control implementation or tightening of existing controls. This occurred, for instance, in Mexico prior to the dramatic 1976 peso devaluation which caused a Mexican deposit overflow into dollar-denominated accounts in Mexico and abroad. In those countries which periodically adjust exchange rates, the deposit outflow due to anticipated changes is lessened. Where exchange controls are already in effect, the deposit outflow is likely reduced but not by any means eliminated.

Not surprisingly, bankers also agreed that political instability in the depositor's home country (or in a neighboring country) also caused deposit inflows into Miami. This factor, combined with the political and economic stability of the U.S., has been a prime element in attracting deposits.

Still, as one banker noted, other economies offer political stability. The reasons why deposits are placed in the U.S. go beyond political factors alone. The U.S. has commercial and cultural ties with Latin America. A large part of Latin American trade is conducted with the U.S.; many Latin Americans travel to the U.S. for business purposes. Further, a significiant number of Latin Americans study in U.S. colleges, spend their vacations in the U.S., and purchase retail goods here.

All of these factors have induced the placement of dollar deposits in the U.S. Miami is in an especially good position for housing such deposits — it is the U.S. arrival and departure point for a third of international air passengers destined to or arriving from Latin America. For many, Miami is increasingly the final U.S. destination point also, since business, banking, and tourism can be combined there.

Are Euromarkets and International Banking Facilities Important in Miami's International Deposit Base? — Yes.

Question 6. What proportion of your bank's Miami international deposit base is actually booked on your Eurocurrency branch?

a. less than 10 percent	5
b. 10 to 35 percent	4
c. over 35 percent	5

Question 7. How will the proposed IBFs affect Miami's international banking activities (assuming a $500,000 minimum transaction)?

a. very significant, positive effect	3
b. moderate, positive effect	9
c. no effect	1
d. detrimental effect	1

Banks are able to offer Eurocurrency deposit rates through placing international deposits on Eurocurrency branch books. The Edge Act corporations and foreign banks in Miami have Eurocurrency branches, as do several Miami commercial banks. Generally, bankers are not anxious to offer Eurocurrency rates on small transactions due to the paper work involved in matching maturities of the deposit liability

with a similarly maturing income earning asset. Still, competition in Miami is reducing the minimum in which bankers will quote Eurocurrency rates. Some Miami banking entities apparently quote Eurocurrency rates on deposits as low as $25,000, although most require a $100,000 or higher deposit minimum.

The Eurocurrency markets typically offer higher deposit interest rates than comparable U.S. rates. For instance, for the week ending January 2, 1981, U.S. three-month certificates of deposit yielded, on average, 16.99 percent[3] while comparable Eurodollar deposits yielded 17.79 percent. Such Eurocurrency deposits operate without reserve requirements, so long as the funds are not transferred back to the U.S. — this enables the yield differential compared to U.S. booked deposits. Still, many international depositors prefer to have their deposits placed on U.S. rather than Eurocurrency books, since the "safekeeping" aspect of placing deposits in the U.S. is foremost in mind.

The proportion of international deposits generated by banking entities in Miami but actually placed on Eurocurency branch books is difficult to estimate. The proportion, however, has been growing because more Miami-based commercial banks have Eurocurrency branches and because the 1980 interest rate volatility caused international depositors to be more rate conscious.

Five of the 14 interviewed banks responded that less than 10 percent of their international deposit base is placed in Eurocurrency markets — partly because some of these banks do not have direct Eurocurrency facilities. On the other hand, another five of the interviewed banks estimated that over 35 percent of their Miami deposits were actually placed on Eurocurrency branches. A rough estimate is that approximately one-third of deposits generated by Miami banking entities are actually booked in Euromarkets.

A recent Board of Governors' proposal would permit banks operating in the U.S. to offer International Banking Facilities (IBFs). This proposal would eliminate reserve requirements and interest rate ceilings on international deposits placed in such IBFs by non-U.S. residents. In 1978 New York state passed legislation that would exempt IBFs, if approved by the Board of Governors, from state and local taxes. Other states are now considering accompanying legislation to exempt IBFs from state and local taxes. Florida has already largely exempted foreign source income from state and local taxes, although some relatively minor alterations to fully exempt IBFs are being presented to the Florida legislature this spring.

The Board of Governors' proposal permits IBF establishment by all U.S. depository institutions, by Edge Act corporations, and by branches and agencies of foreign banks in this country. Only non-U.S. residents, other IBFs, and the parent institutions of IBFs would be eligible to place funds with IBFs. IBF deposits of foreign nonbank customers would be subject to a two-day minimum maturity to minimize use of such deposits for transaction purposes. To maintain a wholesale orientation, the Board proposed a $500,000 minimum transaction but at the same time requested comment on an alternative proposal that would require a $500,000 daily average balance for the reserve computation period, with a minimum amount of $100,000 for deposit or withdrawal transactions.

The proposal would, therefore, permit banks to offer Eurocurrency-type large time deposits through an IBF instead of resorting to booking the deposit on a Eurocurrency branch. This issue is important to Miami's international banking development. It offers a Eurocurrency dimension to Miami commercial banks without offshore branches. It may induce formation of Miami Edge Act corporations by regional banks anxious to offer IBFs but operating in states which have not exempted such IBFs from state and local taxation. At the same time, however, it may induce placement of some funds into IBFs which otherwise would have been placed on a Miami banking entity's own books and made available for local lending. Generally, IBF funds would be destined abroad or to other IBFs, since the only domestic lending permitted is to U.S. offices of the IBF's parent depository institution — and these latter transactions are to be subjected to the Eurocurrency reserve requirement (3 percent).

Twelve of the 14 interviewed Miami international banking entities perceived the

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[3]Five-day average of rate quotes by five dealers for three-month certificates of deposit in secondary markets. Source of interest rate quotes: Board of Governors of the Federal Reserve System, **Federal Reserve Bulletin,** Washington, D.C., January 1981.

IBF proposal as having positive effects on Miami's international banking, although only three perceived the facilities, as proposed, as having *very significant* effects. Many felt that the $500,000 minimum transaction (or minimum $500,000 daily average balance for the reserve computation period) was too high; average certificate of deposit accounts, although large, were well below these minimums. Still, all banks had some accounts which would be eligible for IBF placement. Several of the bankers perceived the need for Florida to offer fully tax-exempted IBFs for defensive purposes, since New York — Miami's principal U.S. competitor for international deposits — has already exempted IBFs from state and local taxation.

International Deposits in Miami — A Perspective

Miami's international deposit base is primarily generated from nonfinancial firms and individuals. Only a limited amount of official and unaffiliated bank-to-bank foreign liability activity is conducted from Miami. The potential for expansion of these latter foreign liability functions pends development in Miami of an efficient bank clearings system which can rival other competing banking centers.

International deposits — principally time deposit accounts — are in Miami to take advantage of asset diversification, economic and political stability, and favorable deposit returns due to interest rate differentials between the U.S. and Euromarkets and the depositor's home country-controlled rates.

A significant proportion of Miami international deposits are actually booked in Euromarkets due to the marginally higher deposit interest rates available there. The proposed IBFs, even with $500,000 minimum balances, will bring Eurocurrency deposits onto Miami books. IBFs will also induce additional Edge Act corporations into Miami to take advantage of Florida's anticipated full exemption of IBF activity from state and local taxation. At the same time, however, IBFs may affect the amount of international deposits available for local and U.S. lending. ER

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