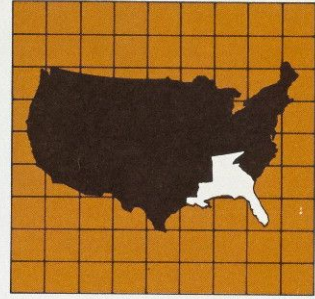


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HOUSING How Safe is Creative Financing?

BUDGET A Fundamental Redirection

ADAM SMITH Capitalism's Moral Base

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Economic Review



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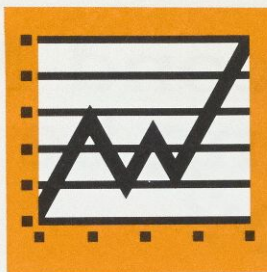
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Will Second-Mortgage Financing be the REITs of Today?

In 1969, the emerging Real Estate Investment Trust (REIT) industry had only a few bank sponsored tax-free trusts and about \$1 billion in total assets. By 1974, five years later, the industry had grown to 208 trusts with total assets over \$21 billion.¹ The process of growth was simple: offer individual investors high rates of return on construction loans to builders and developers for apartments, motels, condominiums, shopping centers, and commercial rental property. The property managers found aggressive ways to lend funds since their salaries were based on the number of transactions they closed, rather than the creditworthiness of the project. They were not required to judge whether the project could financially survive in a difficult economic environment. Only two years later, in 1976, foreclosed property represented a third of invested assets, dividends were less than one-fifth of what they had been in 1973, and

many REITs failed to pay dividends for a 48-month period. The industry was crumbling. But many of the REITs' key characteristics survived in another mode of financing.

Today, the phenomenon of creative financing, where sellers and buyers meet, encouraged by the real estate agent, has three principal points in common with the REITs of yesterday:

1. Both the REITs of a half decade ago and today's creative second mortgage financing involve an individual whose salary is derived from consummating a transaction rather than from examining the creditworthiness of the borrower and his ability to pay the obligation from his current income.
2. Both are predicated on the notion that the asset's underlying value is likely to continue to rise and that appreciation is critical to fulfilling the financial commitment.

History of REITs

The Real Estate Investment Trust was a financial intermediary created by 1960 tax legislation. The trusts were exempt from federal corporate income tax provided they met certain requirements concerning ownership and income distribution to shareholders. The government's purpose in establishing the trusts was to allow individuals to invest in real estate in the same way they buy stocks through mutual funds. The REIT was managed by an adviser who belonged to a completely distinct entity from the trust. However, the adviser could own up to 35% of the REIT stock. The adviser was generally a

commercial bank, mortgage banker, financial conglomerate or life insurance company, whose function was to decide upon the types of investments to be made and arrange the financing between the REIT and the borrower. For this service the adviser received a fee based on the loan amount. Typical investments were construction loans for single-family homes, apartments, condominiums, or commercial structures; development loans for site improvement and road construction; and long-term mortgage loans.

The REITs did not become important financial intermediaries in the real estate market until interest rates surged in 1969 and funds for construction and mortgage loans became scarce. As market rates climbed above the legally allowed rates paid by savings and loans,

The boom in creative financing is helping the real estate industry cope with high interest rates. But similarities between creative financing techniques and the ill-fated Real Estate Investment Trust (REIT) industry raise questions about what will happen in three to five years when balloon payments are due.

3. Both sacrifice scrutiny and critical credit analysis by the institution most fit and qualified to examine the risk of the underlying asset, and both assume that conventional measures of real estate financing are too archaic and conservative for today's market conditions.

Today's Real Estate Market

The current real estate market offers many similarities to the environment which prompted the proliferation of REITs in the early 1970s. Today, savings and loan associations are not constrained by interest rate ceilings. Mortgage funds are available for those who can afford them. However, with mortgage rates ranging from 16% to 18%, few families can afford to purchase a home. Various forms of floating rate mortgages are

being offered at savings and loans, but buyers are less willing to take the risk of increasing loan payments. The National Association of Home Builders estimates that only 7% of the families in the United States can qualify for a 15%, 30-year conventional mortgage on \$60,000, compared to 18% who can afford the same mortgage at a 10% rate.² The squeeze in the current market is taking place through the price mechanism; in the REIT market, funds were squeezed by the artificial constraints of government regulations.

In an effort to cope with the current mortgage market, another form of financial intermediation has grown popular — creative financing. The National Association of Realtors estimates that over 50% of existing home sales currently employ some means of seller financing.³ The reasons for the trend are clear. Sharp inflation in housing prices has left many homeowners with substantial equity in their

deposits flowed out of these institutions. Builders and developers were forced to look elsewhere for funds. Real Estate Investment Trusts were the link between borrowers who were willing to pay a high rate of interest and lenders who were looking for high rates of return. Where government regulations restricted the natural flow of money, REITs helped to fill the gap.

The tight money period in 1969-70 gave the real estate industry a taste of the profitability of REITs. In the two-year period 1969-70, REIT industry assets increased five-fold from \$1 billion to almost \$5 billion. At the beginning of 1969, only 8 REITs existed, but by the end of 1970, 53 new trusts had been formed.¹⁰ Interest rates subsided, but real estate values continued to climb. REITs flourished throughout the early

seventies, as investments were made based on the expected appreciation of real estate. The advisers earned profits amounting to 60-80% of the fees they collected.¹¹ These profits, which attracted many firms into the industry, increased competition and tempted advisers to make risky loans. Another cyclical rise in interest rates in 1973 and 1974 drew funds away from the savings and loan associations and into the REITs where yields were higher. Of the 208 trusts at the end of 1974, 39 were advised by commercial banks which held 32% of industry assets.¹² The banks made ideal advisers since they needed a mechanism for real estate lending in place of their own constrained services. The banks could benefit from the new deposits brought in by the REITs, and in return the REITs had easy access to bank credit lines.

homes. High interest rates and housing prices have raised the monthly payments on mortgages, making qualifying by potential borrowers more difficult. Present levels of interest rates are also well above those of the recent past, giving home buyers incentive to assume existing mortgages when that is possible. In addition, demand for homes is being buoyed by the movement of a large segment of the population into the home-buying age group, the general view that homes are a good hedge against inflation, and the inflation-induced rise in the tax-incentive for home ownership.

These motivating factors call for financing techniques that allow secondary financing, loan assumptions and other methods to ease the purchasing of a home. Such techniques primarily involve several variations on the second mortgage, but they may also involve special terms for first mortgages. The creative techniques are perceived in the marketplace as ways of easing housing transfers for both buyer and seller. Realtors see them as ways of assuring sales in a slow market, and lenders see profit potential in creative financing.

Seller-financing is being encouraged by real estate agents whose traditional role in the marketplace has been to match buyers with sellers. In order to close sales in the current mortgage market, however, realtors are becoming financial innovators as well. They often encourage creative techniques in order to satisfy both the buyer's and the seller's

demands — and preserve their commissions in a troubled market as well.

One common technique that realtors are encouraging is the use of second mortgage financing. The seller's loan may be assumable, but the buyer may not have enough cash to fulfill the seller's equity needs. A typical example is a \$100,000 home financed with an assumable first mortgage of \$50,000, a second mortgage of \$40,000, and a down payment of \$10,000. Commercial lending institutions, especially mortgage bankers and finance companies, have jumped into the second mortgage market to meet this demand. However, the rates they require (generally 18% or higher) may be just as prohibitive to the buyer as taking a new mortgage. Instead, realtors have encouraged sellers to finance the second mortgage at a below-market rate of interest.

Balloon payments are common in creative financing. Lenders seek to avoid long-term commitments of funds, while borrowers seek to limit monthly payments. The remaining portion of the buyer's second mortgage will be payable to the seller in 3-5 years (whenever the "balloon" is due). Borrowers in such cases will be faced with the need to finance their balloon at some future date. Many borrowers and lenders seem to be depending on continued inflation to raise incomes and home values enough to ease refinancing requirements when the balloon comes due. Balloon repayments are consistent with

Why REITs Failed

REIT loans were decided upon by the adviser who was paid a commission on the dollar amount of investments he made rather than on the long-term profitability of the firm. The profits from these ventures were extremely rewarding, and as long as the market held up, no one objected to the high degree of risk. Many advisers were lending (1) without long-term takeouts (loans broken into increments with conditions for approval), (2) without assessing the supply of and demand for the projects, (3) based on unrealistic appraisals of

properties which often caused the loan-to-value ratios to be greater than 100%, and (4) in concentrated markets to one developer, in one type of loan, or to one geographic market. These lending practices put assets on the books which were overvalued or for which only a distress market existed once the economy declined.

The adviser could lend REIT funds to his own firm at more favorable terms than could be obtained elsewhere. Shareholders could not easily detect this conflict of interest, since the favorable terms were often in non-price forms such as overstated appraisal values. Advisers also had the incentive to borrow as much as

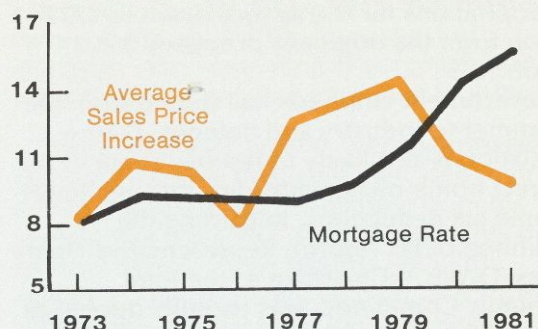
transient markets. Buyers finance a 5-year balloon note expecting to sell their homes before the note is due. The proceeds of such a sale would repay the balloon and leave the borrower with some extra money if inflation of housing prices persists.

Similarities to REITs

These seller-financed second mortgages are based on the belief that inflation will continue and the mortgage market will improve. Similarly, the REITs made risky loans with the expectation that demand would continue to be strong and inflation would push up real estate values. Today's sellers are trusting that buyers will be able to make the balloon payment.

Just as with the REITs, assumptions are being made that rule out the possibility of a real estate downturn. However, a new tide has turned in government policy which is likely to trim back the special considerations given to the housing industry in the past. The current deregulation of financial institutions allows the money markets to control the level of interest rates as a balance between demand and supply. In the past, Americans have essentially paid a negative rate of interest to borrow money for home purchases. This funding subsidy increased the incentive to invest in real estate for individual use and for speculation. But with new mortgage rates now tied to the fluctuations of the money markets,

Chart 1. Existing Home Sales



Sources: Federal Home Loan Bank Board and National Association of Realtors

the costs of financing real estate may soon override the benefits of appreciation. For example, from June, 1980, through June, 1981, the average mortgage rate on resale of existing homes was almost 15%. Over the same time span, the average sales price of existing homes rose only 10% (Chart 1).

The current administration's desire to reduce government intervention in the economy has not only been evident in deregulation but also in cutbacks on direct subsidies for housing. The 1982 level of new subsidized housing units has been reduced to 153,000 from the previous administration's proposed 260,000 units. This action decreased the budget authority by nearly \$10 billion. Other cuts in the budget of the Department of

possible to increase loanable funds. A highly leveraged position was often not in the best interest of the shareholders, although it increased the income of the adviser.

Advisers were not the only ones at fault in encouraging REITs to take on risky assets. Investment bankers profited from underwriting the REIT shares and encouraged formation of new trusts. Underwriters were approached not only by those knowledgeable in the real estate market, but also by people with no background who wanted to raise millions of dollars to start a trust. As early as 1969, *Barron's* quoted an investment banker who said in regard to the neophyte trustees, "I asked them what they

knew about the field. They replied that they didn't need to know anything; they could always hire a mortgage man from a bank."¹³

And the banks lending to the REITs tended to ignore the warning signals of overleveraged trusts. Had they required the REITs to provide documented evidence of market demand for projects, more equity from developers, more realistic cost estimates and budgets, and firmer takeouts from lenders, much of the precarious position of the industry would have been eliminated. Through REITs, bankers indirectly financed projects which would never have withstood a rigorous credit analysis within their own institutions.

Urban Development brought total appropriations for the agency down to \$25.6 billion from the originally proposed \$38.2 billion.⁴

Government emphasis has shifted from the consumer to industry and defense. Future legislation is also likely to remove some of the indirect home-owner subsidies through fewer income tax deductions. Regarding the likelihood of tax reform, Representative Henry Reuss (D.Wis.), Chairman of the Joint Economic Committee, was recently quoted as saying, "Second- and third-home deductions will be out."⁵

With investment interest in housing waning, home values may begin to advance more slowly. Owners who hold low-interest fixed-rate mortgages will be less willing to sell, and the turnover of existing homes should gradually slow down.

The negative prospects for the housing market intensify the concern over the increased popularity of seller-financing. As in the REIT experience, financing is being arranged by people who have not developed an expertise in that area. Realtors are being forced to sell financing techniques to their clients in order to sell homes. Their incentive is based on the sales price of the home, not the soundness and profitability of the financing arrangement.

The seller-held second mortgage is a relatively illiquid asset. The mortgage can be

sold on the secondary market. However, most seller-financed mortgages are at a lower-than-market rate and can be sold on the secondary market only at a very substantial discount. By lowering the sales price, the seller may be able to avoid holding a second mortgage. The profit could be close to the same as it would be by financing and selling the mortgage. With the proliferation of seller-financing, perhaps sales price reductions have been overlooked.

Survey

Recently we surveyed realtors in the Southeast to determine the extent of creative financing during the first quarter of 1981. We contacted realtors in each of the following cities: Atlanta, Birmingham, Jackson, Jacksonville, Orlando, Nashville, New Orleans, and St. Petersburg. The survey, based on over 200 telephone interviews with realtors during the first two weeks of April, 1981, also provided insight about their attitudes toward creative financing. The purpose of the questions was to determine first, the percentage of total closings that involved seller-financing, and second, the extent and terms of balloon payment financing. The following questions were asked:

1. What was your total number of transactions during the first quarter of 1981?

Why REITs Failed *(continued)*

The REIT industry, with its shaky foundation, began to crumble as the recession hit in 1974 and 1975. While REITs had seemed the answer to the real estate market's prayers, they only exacerbated the normal cyclical downturn. This violation of prudent lending principles may have gone undetected had the real estate market continued to appreciate rapidly and had the U.S. economy marched upward and onward. But risky ventures were not able to withstand the blows of a declining economy that left many

REITs unable to collect on their loans.

When the recession hit, unexpectedly high rates of inflation boosted building costs far above the projections made for loan commitments. Rather than foreclose, or leave a structure standing unfinished, REITs lent additional funds. Some developers gambled that interest rates would improve by the time of the project's completion and began construction without firm takeouts. Rather than improving, the interest rate outlook worsened and funds were impossible to obtain. The recession left the nation immobile, and speculative construction found no demand. Even when foreclosures became necessary, the recourse was an effort to minimize loss. The market for foreclosed

2. How many transactions involved second mortgages held by the seller?
3. What was the average maturity of the second mortgages?
4. How many of the second mortgages were 2-3 years long?
5. How many of the second mortgages could be prepaid without penalty?
6. How many of the second mortgages were financed with balloon notes?

The results indicated that 43% of single-family homes sold in the first quarter of the year involved seller-financing with a second mortgage (Chart 2 next page). (Statistical application of a "t-distribution" indicated that we may be 99% confident that the population mean truly lies somewhere between 31% and 55%.)

Most realtors indicated that sellers are charging below-market rates on their loans. While institutions are charging 18% on second mortgages, sellers are financing them for 10-15%. This low rate encourages the proliferation of seller-held debt. Where loans cannot be obtained through financial institutions, sellers are slashing finance charges to make the purchase affordable. This discounting of market rates is similar to the REIT lending practices where funds were advanced by the trusts for projects which could not have passed the scrutiny of institutional lenders.

Realtors found that creative financing techniques became increasingly popular as

mortgage rates climbed above 12% and almost a necessity as rates topped 14% and fixed-rate money dried up. With the prospect of mortgage rates remaining at very high levels, seller-financing will only continue to grow.

Those respondents who were aggressively pursuing creative financing indicated their sellers depend upon the income from the second-mortgage to make the payments on another home. Those realtors with little activity in creative financing said only those sellers who did not need the cash were extending loans.

The survey showed the average length of the second mortgages to be 8.3 years, but that figure is biased upward by several responses of 20-25 years. The frequency distribution indicates that the average length of most second mortgages is five years or less (Chart 3 next page). The balloon payments varied in maturity from 2 to 5 years. This time period is critical. In the next several years, the demand for mortgage financing should leap upward as balloon payments become due, in addition to the normal needs for financing. Depending on the financial environment at that time, defaults may rise and heavy losses could be incurred.

Not all seller-held second mortgages are being financed with balloon payments. The responses to the question regarding balloon financing fell into three general categories:

property remained stagnant for months and even years in the case of many condominiums. The taxes, interest carrying charges, and maintenance costs on foreclosures eroded any retrievable equity.

As the situation worsened, investment analysts began to shun the trusts. The NAREIT stock price index (1966 = 100) for mortgage trusts fell from over 400 in 1972 to less than 100 in mid-1974.¹⁴ However, there was still confidence in the survival of the industry. Investors were quoted in the spring of 1974 as saying that the industry would survive. The failure of a large bank-managed REIT was deemed impossible since the bank's name was at stake. Investors believed the REITs would have easy access to

funds from their sponsoring bank. *Business Week* wrote as late as March, 1975 that, "it is hard to imagine the world's third-largest bank letting an REIT that shares its name go down the drain."¹⁵ But the losses drained so heavily on the banks' earnings that they were finally left with no other choice but to admit their mistakes.

As the industry folded, many REITs were abolished and commercial banks took severe losses to rid their books of the overvalued assets. Dividends distributed by the REIT industry fell from a high of \$155 million in the fourth quarter of 1973 to \$30 million in the third quarter of 1976.¹⁶ Today, trusts hold assets of only \$10.3 billion in current dollars compared to the high of \$21 billion in 1974.¹⁷

1. **Aggressive** — Almost all second-mortgages have been financed with balloon payments. The realtors believe "balloons" are a good tool for closing sales.
2. **Diversified** — Some of the second mortgages have been financed with balloon payments. The realtors believe "balloons" are a useful tool, but they are using many and varied financing techniques to aid in closing sales.
3. **Wary** — Very few second mortgages have been financed with balloon payments. The realtors perceive the risks and are wary of using this form of creative financing.

The frequency distribution of second mortgages financed with balloon payments showed the responses clustered heavily on either end of the distribution (Chart 4). Over 50% of the respondents replied that either virtually all their second mortgages were financed with balloons or that very few were financed with balloons. The risk is not spread evenly across the real estate industry. The mean of the sample indicates 40% of seller-held second mortgages are financed with balloon notes, and 16% of all transactions involved balloon financing (Chart 5).

When asked if there is any risk to the seller in taking back a second mortgage, realtors emphatically responded, "No." They defended seller-financing for basically three reasons: (1)

If sellers demand a sufficient downpayment, generally 50% of the equity, then a default would not cause a serious cash loss. (2) If the buyer defaults, the home value will have appreciated and can be sold for a substantial profit. (3) The seller can only benefit from a default since he has the opportunity to sell the house again for a sizable profit.

Realtors are educating themselves on ways to implement financing techniques and enlightening their clients to its advantages. Wary sellers must be sold on the idea of taking back a second mortgage. Many realtors said that their sellers had made no attempt to qualify buyers. If a large enough downpayment is made, the seller feels that the buyer is going to protect his equity by making every effort to fulfill the obligation. Yet some are worried. As one realtor put it, "seller financing involves little risk, but if the mortgage markets are as tight as they are now in three years when balloon payments come due, we will all be in hot water."

Enforcement Problems of Balloons

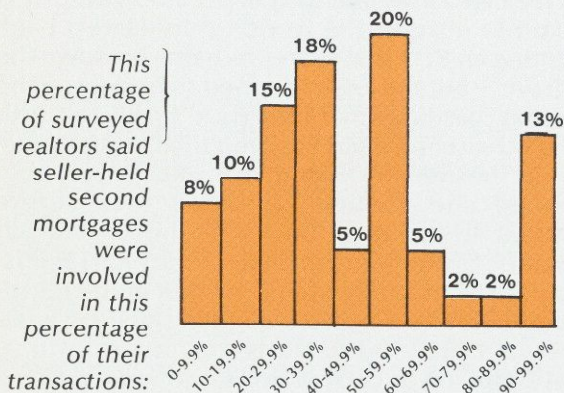
When balloon payments are due, three to five years from now, the financial market may be just as tight as it is today. The problem could be exacerbated in the courts. Although federal courts have upheld the "due-on-sale" clauses, a few state courts have ruled that they are unenforceable.⁶ In many California cases,

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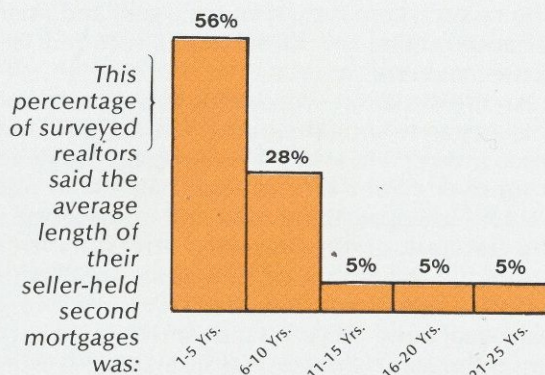
SELLER-HELD SECOND MORTGAGES

3

Percent of Total Transactions



Average Length



Similarities Between Second Mortgage Financing and REIT Lending

Second Mortgage	REITs
The realtor acts as an agent between the borrower and the lender.	The adviser was essentially an agent who brought borrowers and lenders together.
The realtor profits from volume and value of sales.	The adviser was paid based on the volume and value of sales.
Lenders (sellers) are often not qualifying buyers.	Strict credit analysis was often bypassed.
Realtors would rather see a high sales price with second mortgage financing than encourage the seller to drop his price.	Loans were often made for over 100% of the value of the property because of unrealistic appraisals.
Buyers and sellers are counting on equity appreciation to shelter them from risk.	Lenders used little caution about investments, assuming inflated equity would cover losses from any poor choices.

the court determined that the enforceability of "due-on" clauses, whether it be sale, encumbrance, or a certain date, was justified only if legitimate lender interest is threatened. Lender justifications were the preservation of security from waste or depreciation and

avoiding the risk of an uncreditworthy borrower.⁷

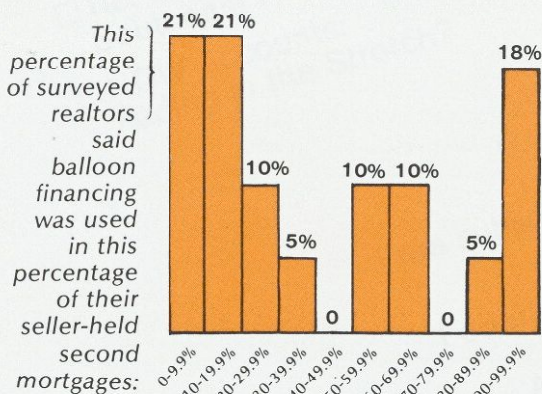
A 1979 California case⁸ ruled that an institution could not require a balloon payment to be made if the borrower had made timely and full payments leading up to

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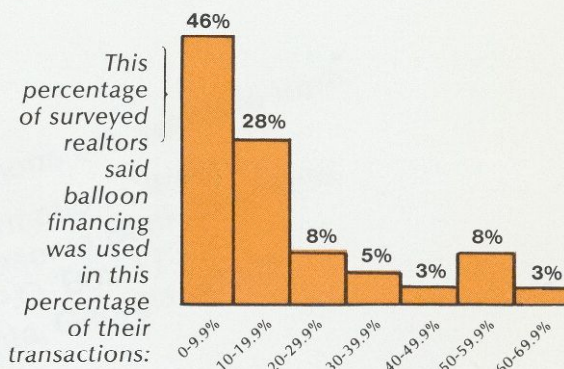
BALLOON FINANCING

5

Percent Used in Seller-Held Second Mortgages



Percent Used in Total Transactions



the "due-on-date." Lender demands for payment were considered to be unconscionable conduct since the funds, once collected, would just be lent to someone else. Additionally, a 1978 California case⁹ found that a private individual could enforce a balloon payment only if the property was damaged or if the borrower's ability to pay had declined. The payment could not be demanded if the lender's only justification was that he "expected the property to be sold before the note went full term and . . . wanted the cash to put into other investments." Sellers may find collecting balloon payments to be more difficult than they perceived at the time of sale.

Summary

The similarities between seller second-mortgage financing and REIT lending are striking (see table, p. 11).

There is a potential for loss to sellers and financial institutions who hold claims on these assets. Those involved are trusting that real estate values will continue to escalate and that the mortgage market will improve. As we have witnessed with the REIT experience, euphoria in real estate investment often provides the incentive to take great risks. Highly leveraged financial positions result in profits on the upside, but work just as hard against earnings on the downside. Sellers who take back second mortgages now are ecstatic about the sale of their homes plus the potential to earn a hefty return on the equity they must finance. But a depressed real estate market could spell serious trouble for the players involved in "creative financing."

— Donald L. Koch
and Delores W. Steinhauser

¹1975 REIT Fact Book, National Association of Real Estate Investment Trusts, pp. 136, 143

²Robert Shehan, National Association of Home Builders, April 28, 1981.

³Ken Kerin, *The Real Estate Status Report*, National Association of Realtors, May 1980.

⁴"Reagan Housing Plans Generally Approved," *Congressional Quarterly Weekly Report*, Aug. 15, 1981, p. 1471.

⁵Nossiter, Daniel D., "Structural Change — Costly Mortgages Put Crimp in Housing Values," *Barron's*, April 27, 1981, p. 9.

⁶John Gunther, Deputy Director of Litigation, Federal Home Loan Bank Board, May 14, 1981.

⁷Smolker, Gary S., "Legal Corner," *Real Estate Review*, Winter 1981, p. 12.

⁸Larwin — S. Cal Inc. vs. JGB Inv. Co., 101 Cal. App. 3d 626, 640 (1979).

⁹87 Cal. App. 3d 521, 530 (1978).

¹⁰Schulkin, Peter, A., "Real Estate Investment Trusts: A New Financial Intermediary," *New England Economic Review*, Federal Reserve Bank of Boston, November/December 1970.

¹¹Robertson, Wyndham, "How the Bankers Got Trapped in the REIT Disaster," *Fortune*, March, 1975, p. 168.

¹²1975 REIT Fact Book, page 136.

¹³Thomas, Dana L., "Misplaced Trust? Tight Money, Footloose Expansion Plague the Mortgage Funds," *Barron's*, July 7, 1969.

¹⁴Robertson, Wyndham, p. 115.

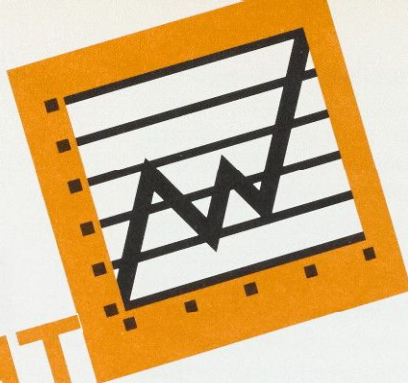
¹⁵"The Damage REITs Have Done to Bank Lending," *Business Week*, March 31, 1975, p. 68.

¹⁶1977 REIT Fact Book, p. 15.

¹⁷National Association of Real Estate Investment Trusts.

Perspectives on the Southeast's Economy

INSIGHT



(an economic newsletter from
the Federal Reserve Bank of Atlanta)

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The Reagan Program for Economic Recovery: An Historical Perspective

Comparison with policies over the last 30 years shows that the Reagan program is in fact a redirection of the federal government's role in the U.S. economy. The Reagan administration's determination to stick with its program is exemplified by the second round of proposed budget cuts under consideration as this issue went to press.

On February 18, 1981, President Reagan presented to a Joint Session of the Congress a program for economic recovery from high inflation and sluggish growth. The program called for a "fundamental redirection" in the role of the federal government by proposing reductions in personal tax rates and business taxes, spending cuts, reductions in the burden and the intrusion of federal regulations, and a commitment to slow and steady money growth¹.

In August Congress approved in essence the tax part and the spending part (for fiscal

1982) of the President's economic program. This action does indeed represent a fundamental redirection in the federal budget. For this reason it is important to fully understand what it is about the Reagan economic program that represents a new and different role for the federal government in the U.S. economy. This article will examine the new role for government spending and tax revenues. A subsequent article will examine the new role for money growth and regulatory policy.

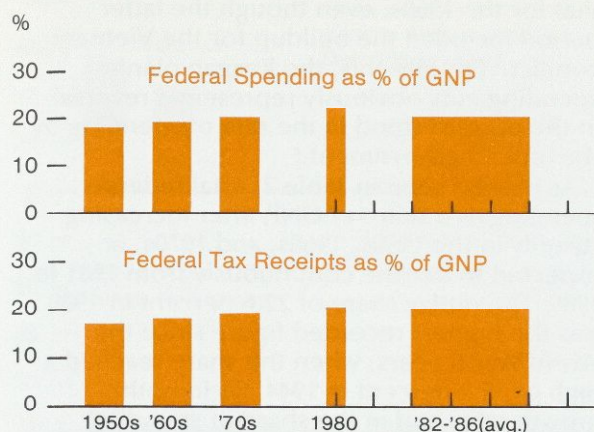
An Overview

Above all, the Reagan plan embodies a significantly reduced role for the federal government in the U.S. economy. Charts 1a and 1b (as well as Table 1) demonstrate this clearly,

¹See Summary Fact Sheet, the President's Economic Program, Office of the Press Secretary, the White House, February 18, 1981. For a more detailed discussion of the economic rationale underlying the Reagan program's four parts, see James R. Barth, "The Reagan Program for Economic Recovery: Economic Rationale (A Primer on Supply-Side Economics)," this Review, September 1981.

Editor's Note: All the numbers in this article are based on the Reagan economic plan as originally formulated in March 1981. As economic events unfold, however, the administration may respond by modifying its original plan. These modifications, as demonstrated by the President's Sept. 24 announcement of additional spending cuts, will depend on the degree to which economic events depart from the expected scenario. This article's figures are significant in that, when compared to the Sept. 24 cuts and any additional changes, they reflect the extent to which the administration's original plan has been modified.

Chart 1. Reagan Plan Reduces Government's Role in the Economy.



showing federal spending and tax receipts as shares of gross national product. For the budgets that would have resulted under existing law, the share would have exceeded 23 percent in fiscal 1981 and 1982, then would have declined to about 21 percent by 1986.² Under the Reagan plan, the decline in the share of outlays is significantly sharper and deeper. The figures for 1980 are the same, of course, and nearly so for 1981, but after that the share under the Reagan program drops below 20 percent by 1984, falling further to 19 percent by 1986. (The existing law budget shows what outlays and receipts would be if no policy changes were made, thus providing a base with which the administration's budget proposals may be compared. In other words, existing law estimates reflect what would happen if all federal programs and activities were carried on during ensuing fiscal years at the same level as the fiscal year in progress and without presidential policy changes in such programs and activities.)

The distinction on the tax receipts side is even more significant. Under the existing law budget, the share of receipts would actually have risen, from a little over 21 percent in 1981 to 24 percent in 1986. In contrast, under the Reagan plan, federal receipts as a share of GNP fall from 21 percent to 19½ percent during the same period. The reason for this sharp divergence, of course, is the substantial tax

rate cuts in the Reagan program. Without these tax cuts, inflation would continue to push taxpayers into higher and higher tax brackets, and the federal government's tax take would rise disproportionately to income. The tax cuts, however, plus the hoped-for resurgence of the economy in response to tax cuts, combine to raise the share of receipts in 1985 and 1986 under the Reagan plan.³

The difference between these two budgets with respect to future movements of outlays and receipts also changes the resulting movements of federal budget deficits. Compared to existing law, the Reagan plan delays the projected balance in spending and revenue from 1983 to 1984 and generally includes higher deficits (or lower surpluses).⁴

There is reason to be skeptical, however, about the likelihood that these deficit forecasts will materialize — almost every administration has projected a balanced budget during its tenure, but the budget has been in surplus only once in the past 20 years. The point to be emphasized is that there is obviously considerable debate and uncertainty about the Reagan plan. The economic environment will change almost constantly. Congress may or may not pass additional legislation consistent with the plan. As a result, the plan will doubtless change. But the plan is important, first because it points toward such a significant redirection of budget policy, and second because the recently signed legislation conforms so closely to the plan.

The size and duration of the deficit is an extremely important part of the Reagan plan, and we shall return to it in a moment. Before we do, let's look more closely at the extent to which there is redirection of spending and taxation in the Reagan plan.

Spending Cuts

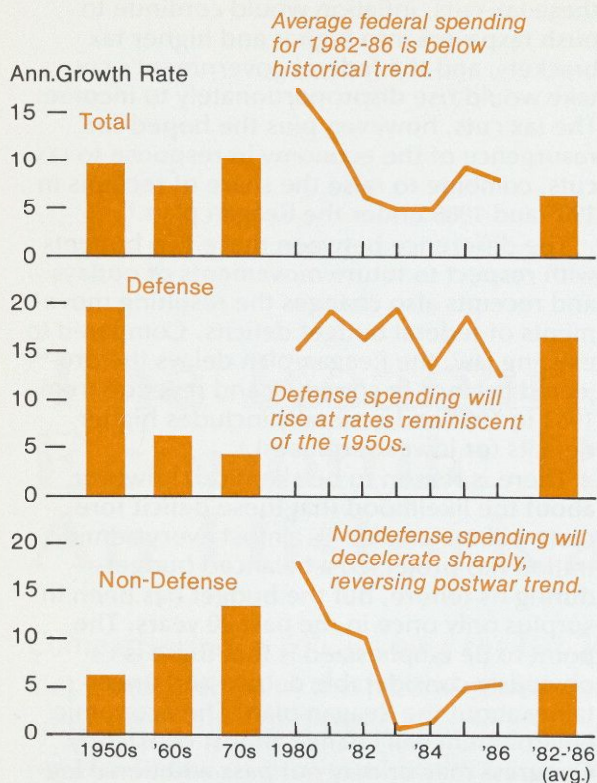
On the spending side, the Reagan plan involves both a sharp deceleration in federal

²When the President transmits the budget to the Congress in January for the coming fiscal year (which begins on October 1), budget estimates for the four subsequent fiscal years are simultaneously transmitted. (All the figures in this article refer to the unified budget.)

³Recently signed legislation included indexation of tax rates beginning in 1985, which will lessen the rise in receipts.

⁴It should be pointed out that substantial areas of government spending remain completely outside the budgetary process. As the result of legislation, important federal programs have been removed from the budget, resulting in incomplete budget coverage and totals that understate the actual level of federal activities. "Off-budget" activities include expenditures by the Board of Governors of the Federal Reserve System, Postal Service Fund, Federal Financing Bank, and the Synthetic Fuels Corporation. Outlays of all off-budget agencies amounted to about \$14 billion in 1980. The administration estimates that this amount will decline to \$9.5 billion in 1984 and then decline even further to \$6.5 billion in 1986.

Chart 2. Growth in Federal Spending



spending growth and a distinct shift in the composition of spending from "human resources" programs to defense. From all the discussion of federal spending cuts, many people probably expect to see actual reductions in the dollar level of total spending. The Reagan plan, however, calls for deceleration, not shrinkage in the level. Actual reductions have been quite rare. During the past fifty years reductions in the dollar level of federal spending have occurred only 10 times, most recently in 1964.

The deceleration, moreover, is not uniform. Actual spending grew by more than 17 percent in 1980 and will decelerate to 13 percent in 1981. This, under the Reagan plan, is followed by a sharp reduction to 6 percent in 1982, more moderate reductions to about 5 percent in 1983 and 1984, and then by a reversal as the growth in federal spending accelerates again to more than 9 percent in 1985 and 8 percent in 1986.

Even so, the average annual growth rate in total federal spending under the administration's plan is about 6½ percent for the 1982-

86 period (Chart 2). However, the growth rate for the 1982-86 period is only slightly below that for the 1960s, even though the latter period included the buildup for the Vietnam conflict.⁵ Despite this, the Reagan plan's spending cuts obviously represent a reversal in the upward trend in the rate of spending by the federal government.⁶

As may be seen in Table 2, total federal spending as a share of GNP, after increasing steadily in the 1950s, 1960s, and 1970s, is expected to decline continuously from 1981 to 1986. The outlay share of 22.6 percent in 1980 was the highest recorded figure since the World War II years, when the share reached a high of 45.2 percent in 1944. So in both growth rates and in the share of spending relative to GNP, the Reagan plan reverses a steady upward trend in federal spending during the post-World II period.

Table 2 also documents the shift from defense to nondefense spending. The Reagan plan shows an average growth in defense spending of 16.7 percent during 1981-86 as compared to average growth of only 5.6 percent in nondefense spending.

Both of these figures represent sharp breaks with the past. Growth in defense spending fell from a rate of about 19 percent in the 1950s to about 4 percent in the 1970s. Growth in non-defense spending, on the other hand, rose steadily from the 1950s to the 1970s. The Reagan plan's average growth in defense spending during 1981-86 of about 17 percent is only exceeded in the post-World War II period by growth rates of 87 and 18 percent for the Korean and Vietnam war years, respectively.⁷

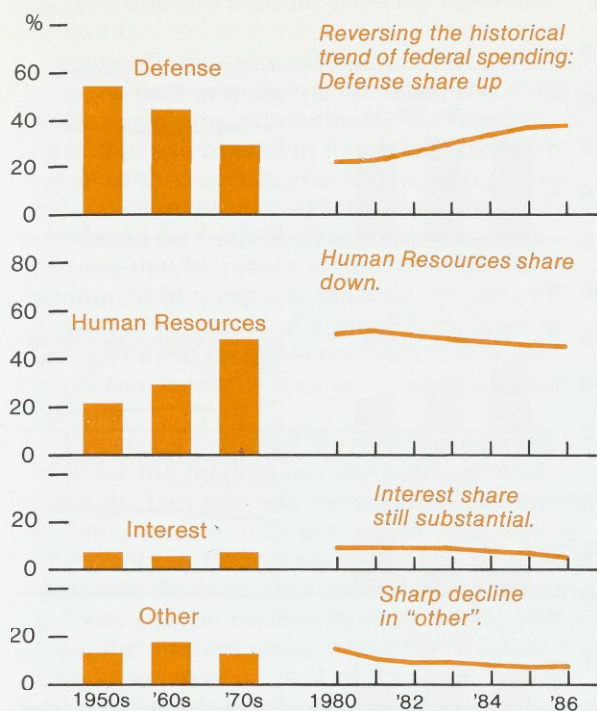
As a share of GNP, defense spending steadily increases from 1980 to 1986. The average for the 1981-86 period is 6.4 percent. During the past thirty years the share has been below 6.4 percent only 8 times, all of which occurred from 1973 through 1981. Thus, the administra-

⁵Federal government spending grew at rates of 13.7, 17.5, and 13.0 percent in 1966, 1967, and 1968, respectively.

⁶In constant 1972 prices, the growth rates for total federal spending are 6.5, 4.0, 0.2, and 0.6 percent for the periods 1950-59, 1960-69, 1970-79, and 1982-86, respectively. For 1982-84, however, the real growth rate is a negative 1.7 percent.

⁷In constant 1972 prices, the average annual growth rate in defense spending during the 1981-86 period is 9.1 percent as compared to a growth rate of 9.9 percent during the 1966-68 period. The defense buildup being proposed by the administration thus does not exceed that which occurred during the Vietnam conflict, at least when measured in real growth rates rather than actual dollar amounts. The current concern is that a rapid military buildup will encounter bottlenecks and thus add to inflationary pressures.

Chart 3. Composition of Federal Spending



tion's defense spending proposals do represent a reversal in the declining portion of GNP being used for defense purposes.

While defense spending is increasing as a share of GNP, nondefense spending is decreasing. As Table 2 shows, the nondefense share of GNP was at a record peace-time high of 17.3 percent in 1980, and had risen steadily since 1950. This figure is slated to decline throughout the 1981-86 period, representing a clear reversal in the share of overall economic activity devoted to nondefense purposes.

To better understand the implications of the administration's budget for the mix of federal spending, the various percentages of total federal spending devoted to each of the major spending categories (national defense, human services and net interest) are presented in Table 3 (and Chart 3). Starting from an actual figure of 23.4 percent in 1980, the administration proposes increasing the defense portion of the federal budget year-in and year-out through 1986, when it is expected to be 37.6 percent. In contrast, during the previous three decades the defense share of the budget fell — from about 54 percent in the 1950s to 29 percent in the 1970s.⁸

The shares of federal spending devoted to human resources and net interest (mainly interest payments on the national debt), on the other hand, are expected to decline. From a share of about 52 percent in 1980, human resources will account for 5 percentage points less of total federal spending by 1986. Notice, however, that the average share of the budget devoted to human resources for the 1981-86 period is 49.7 percent, which is still higher than the 48.5 percent figure for the 1950s.⁹ The net interest share declines more sharply from 9.8 percent in 1981 to 6.9 percent in 1986. Until recently, this figure showed no real upward or downward trend, instead fluctuating around 7 percent.

Tax Cuts

The administration's economic program includes reductions in both personal income tax rates and business taxes. These reductions will affect federal government revenue or receipts. As Table 4 shows, the actual growth in federal receipts was 11.6 percent in 1980, and is expected to rise further to 15.4 percent in 1981 and then decline steadily to 8.7 percent in 1984. However, the growth rate is expected to jump to 10.3 percent in 1985, and then rise further to 10.6 percent in 1986. For the entire 1981-86 period, the average rate of growth is expected to be 10.4 percent (or 9.4 percent if one excludes the extremely high growth rate year of 1981). By slowing down the rate of growth in receipts, the administration would be bringing the growth rate more into line with those prevailing in the 1960s (9.2 percent) and the 1970s (9.7 percent). Clearly, the administration's tax package is not expected to lead to a decline in the level of

⁸It should be noted that the federal outlays may be divided between those of an "investment" or capital nature and those devoted to "current" or operating purposes. Doing this, one finds that defense spending is more investment-intensive than nondefense spending. In 1980, for example, investment-type outlays accounted for 35 percent of total defense spending versus only 20 percent for total nondefense spending (see Special Analyses, Budget of the U.S. Government, 1982, pp. 87-105). This means that by changing the mix of total federal spending towards defense, the administration is increasing the proportion of total outlays devoted to investment.

⁹Since there is substantial interest in Social Security, it should be noted that Social Security expenditures accounted for 18.5 percent of total federal outlays in 1980 and it is estimated by the administration that this figure will rise to 22.0 percent in 1984 and then to 22.1 percent in 1986. The concern is that this growth will explode early in the next century when individuals born during the baby boom of the 1940s and 1950s reach retirement age. To control federal government spending in the longer-run, it is therefore argued that Social Security benefits must eventually be cut, despite the fact that there have been no major cuts in the program's 46-year history.

federal receipts (that is, a negative growth rate). Indeed, since 1950, receipts actually fell only 4 times — in 1955, 1958, 1959, and 1971.

As a percentage of GNP, federal receipts are expected to decline to 19.5 percent in 1986 from an actual figure of 20.3 percent in 1980 (see Table 4). The average annual receipts share of GNP expected during the period 1981-86 is about 20 percent, which represents a reduction from the actual 1980 figure, but still leaves it above the average figures for the past thirty years. It is interesting to note that during the 1950-79 period individual income taxes grew at a roughly constant rate of 9.6 percent.¹⁰ This rate then jumped to 12 percent in 1980. The administration expects the growth in individual income taxes to increase further to 13.7 percent in 1981 and then to drop abruptly to 3.7 percent in 1982. After that, however, the rate of growth is expected to rise steadily until 1986.

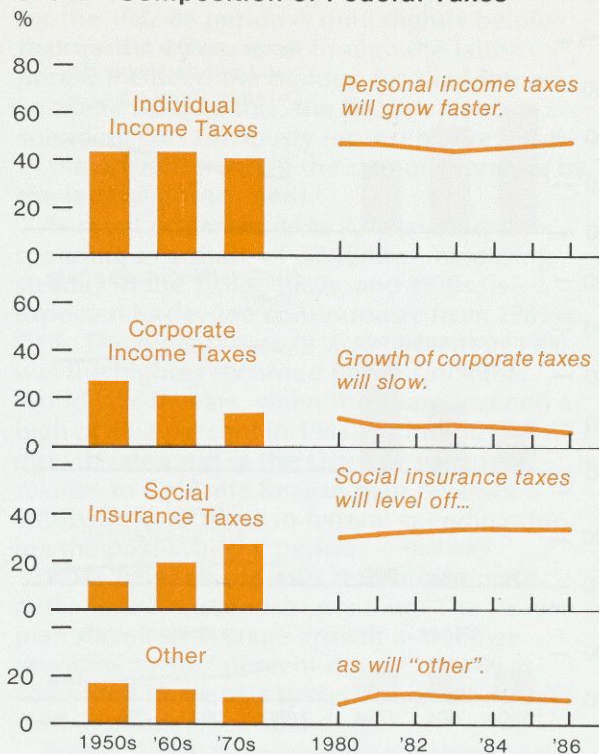
The average rate of growth in individual income taxes expected by the administration during the entire 1981-86 period is 10.4 percent, compared to actual average growth rates of about 9 percent during the 1950s, 1960s, and 1970s. It appears, therefore, that the administration is actually expecting not slower, but more rapid increases in the growth of individual income taxes than in earlier years.

In contrast, corporate income taxes are expected to grow at a rate of only 2 percent, well below the average annual growth rates of the last three decades.

Social insurance taxes and contributions are expected to grow at a rate of about 12 percent during the 1981-86 period, slightly below the average annual growth rate of 13 percent for the previous thirty years.

Table 4 also contains information on the various shares of GNP accounted for by the major sources of federal receipts. The trend throughout the 1950s, 1960s, and 1970s has been for the individual income tax and social security tax and contribution shares of GNP to increase, while the corporate tax share decreases. The administration's budget plan will continue this trend. As shares of GNP, individual income taxes are expected to aver-

Chart 4. Composition of Federal Taxes



age 9 percent (versus an average of 8.6 during the 1970s) and social security taxes and contributions are expected to average 6.7 percent (versus an average of 5.4 percent during the 1970s) during the period 1981-86. Corporate taxes as a share of GNP are expected to average only 1.9 percent during the same period (versus an average of 2.6 during the 1970s).

Table 5 presents more complete information on the composition of receipts. It is interesting to note that 1980 is an historic year during the 1940-80 period. In that year, as a percentage of total federal receipts, individual income taxes and social security taxes and contributions were at record highs, while corporate income taxes were at a record low. More generally, the administration expects individual income taxes, social security taxes, and corporate taxes to account for 45, 34 and 9 percent, respectively, of total federal receipts during the 1981-86 period. The comparable figures for the 1950-79 period were 43, 20 and 21 percent. Clearly, the administration expects to rely ever more heavily upon individual income taxes and social security taxes and

¹⁰It should be noted that of the approximately 14.7 million income tax returns filed by businesses during the 1977-78 period — corporations, partnerships, and sole proprietorships — 1.8 million were taxed at corporate rates and nearly 13 million businesses, the vast majority of which are small, were taxed at individual rates (IRS Statistics of Income, 1977).

contributions and increasingly less heavily upon corporate income taxes for revenues (Chart 4).

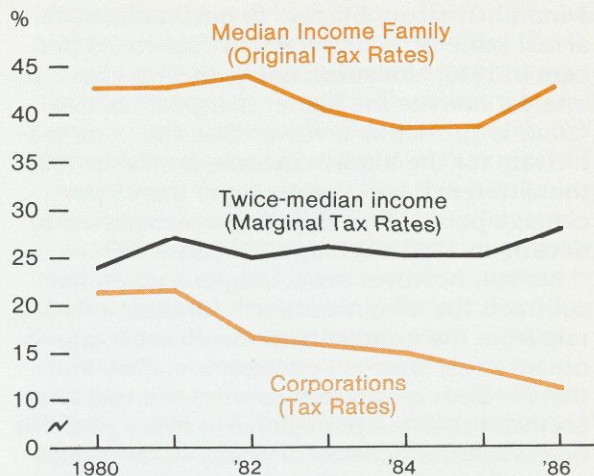
Given all the discussion about not just tax cuts but cuts in marginal tax rates, it is worthwhile examining more closely the marginal tax rates that will prevail in the near future as a result of the tax cuts enacted in August. The individual income marginal tax rates in Table 6 are based on a family of four with median income that increases at the same rate as the administration expects personal income to grow. For purposes of comparison, Table 6 also gives the marginal tax rates that would apply to a family of four with twice the median income.

The actual marginal tax rate prevailing in 1980 for the median income family was 24 percent. This rate will increase to 27 percent in 1981, decline to 25 percent in 1982, rise to 26 percent in 1983, drop back to 25 percent in 1984 and 1985 and then increase to 28 percent in 1986. For the median income family, therefore, the amount of each additional dollar it is able to retain as a result of the marginal tax rate cut ranges from a plus 2 cents to a negative 3 cents over the 1981-86 period. As compared to a marginal tax rate of 24 percent in 1980, this family finds itself facing a 28 percent marginal tax rate in 1986.¹¹ Thus, tax-bracket creep may more than offset the lower marginal tax rates, though the indexation of taxes beginning in 1985 eliminates the inflation-induced component, leaving just the real-income-induced component.

The situation is somewhat better for a family of four with twice the median income (Chart 5). The actual marginal tax rate for this family was 43 percent in 1980 and will fall to 38 percent in 1984 and 1985, and then rise to 42 percent in 1986. As a result, this family experiences only a 1 percentage point reduction in its marginal tax rate in 1986 as compared to 1980.

Finally, although not reported in Table 6, a family of four earning \$108,300 or more beginning in 1980 was subject to a marginal tax rate of 70 percent. For this family the marginal tax rate steadily decreases to 50 percent in 1984

Chart 5. Tax Rates



and remains at this level. Higher income families thus benefit more from the recently enacted tax cuts than do lower income families. Higher income families, in other words, are provided with more of a tax incentive to earn additional income than are lower income families.¹²

Table 6 also presents information on the administration's expected corporation income tax rates. Unfortunately, it was not possible to calculate the marginal tax rates for corporation income on the basis of available data. Only average tax rates could be calculated. As may be seen, the average tax rate was actually 27 percent in 1980. The administration expects this rate to decline steadily throughout the 1981-86 period, reaching a low of 16 percent in the last year.¹³

Before concluding this section, it may be useful to show the after-tax interest rates that are implied by the tax cuts. Table 7 presents the after-tax interest rates for a median income family of four and for a family of four subject to the highest marginal tax rate in effect. These after-tax rates are based upon the nominal 3-month U.S. Treasury bill rate expected by the administration during the 1981-86 period.

¹¹Although the concern here is federal tax changes, it should be pointed out that, according to the National Governors Association, 18 states enacted tax increases in 1980. Even more states have been considering tax increases in 1981. This means that federal tax cuts may be offset, at least partially, by state tax increases.

¹²By taking into account the scheduled increases in the social security tax rate and in the taxable earnings base, this point is reinforced. Families of 4 with twice the median income or higher will face no scheduled social security tax increases on each additional dollar earned. Families of 4 with the median income, however, paid a marginal tax rate of 30.1 percent in 1980 when one includes social security taxes and this marginal tax rate will rise to 34.2 percent in 1986, because for these families their income always remains below the maximum taxable earnings base.

¹³Recall from the previous footnote that nearly 90 percent of all businesses, mainly the small ones, are taxed at individual, not corporate, rates.

The administration expects the nominal 3-month Treasury bill rate to decline from its actual value of 11.5 percent in 1980 to 5.5 percent in 1986. Not surprisingly, the after-tax interest rate for the higher marginal tax rate family is substantially lower than the comparable rate for the median income family. In 1980 the difference was slightly more than 5 percentage points. This difference is expected to decline to 1.2 percentage points by 1986.

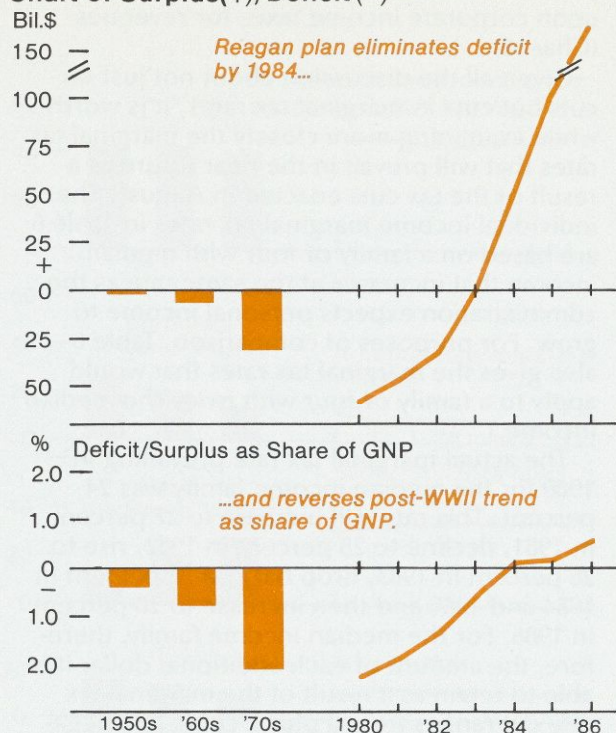
Notice, however, what happens when one subtracts the administration's forecast inflation rate from the nominal after-tax interest rate to obtain a real after-tax interest rate. One finds that for both tax bracket families the real after-tax interest rates are negative in every year but one. Whereas nominal after-tax interest rates generally decline during the 1981-86 period, real after-tax interest rates generally increase, at least for the median low income.¹⁴

Budgetary Deficits

There is substantial concern, if not alarm, over the continual federal deficits. Already, thirty-one state legislatures have approved resolutions petitioning for a constitutional convention that would require a balanced federal budget on a fiscal year basis. Similar resolutions are being considered by other state legislatures.¹⁵ At the same time, a growing number of members of Congress are urging the federal legislature to follow suit. The Senate Judiciary Committee has already approved a proposed amendment that would permit a budget deficit only in wartime or when authorized by a three-fifths majority of the House and Senate. Given all this concern over budgetary deficits, it is important to put the administration's proposed budgetary position into perspective.

Table 8 presents information about federal budgetary deficits during the 1950-86 period. As may be seen, the administration plans to reduce the deficit from an actual figure of roughly \$60 billion in 1980 to nearly zero by 1984. It should be pointed out, however, that the recent spending cuts are insufficient to

Chart 6. Surplus(+)/Deficit (-)



reach a balanced budget by 1984. The administration therefore plans to ask the Congress for additional federal spending cuts of at least \$74 billion in fiscal years 1983 and 1984. Once the budget is brought into balance in 1984, the estimates indicate surpluses in the two subsequent years. In view of the fact that there have been deficits in 42 of the past fifty years, the administration's program to eliminate federal deficits in only three years is a definite reversal in trend (Chart 6).¹⁶

Table 8 also shows that the federal deficits have been increasing in size, both absolutely and relative to GNP, during the past 30 years. Starting with an average annual deficit of \$1.8 billion during the 1950s, the average increased to \$5.7 billion during the 1960s and then to \$31.5 billion. In 1980 the deficit was a huge \$59.6 billion, only exceeded once since 1789 and then just four years ago in 1976.

As a share of GNP, the situation is quite similar. During the 1950s average deficits accounted for only 0.4 percent of GNP. This figure doubled during the 1960s and then

¹⁴It should be noted that for a nominal rate of interest of 12 percent and a 10 percent inflation rate, a 50 percent tax rate is effectively a 300 percent tax on the real return. This is due to the fact that the U.S. tax system is based upon nominal rather than real values, though this will change beginning in 1985.

¹⁵Action by only three additional states is all that is required to force Congress to organize a constitutional convention to consider a balanced-budget amendment.

¹⁶In the past 20 years, there have been 19 deficits, the only surplus occurring in 1969.

jumped even further to 2.1 percent during the 1970s. In 1980 the figure was slightly higher at 2.3 percent. The administration plans to reduce this figure in each of the next three years so that it is nearly zero by 1984. It then is expected that the federal budget will turn a surplus each year thereafter through 1986, when the surplus will represent about 0.6 percent of GNP. Thus it is clear that the administration expects to reverse the trend towards persistent and growing federal deficits during the entire post-World War II period.¹⁷

Conclusion

President Reagan announced last February a new economic policy to reduce inflation and stimulate economic growth. Since then, considerable momentum has built toward the successful implementation of this policy, as

evidenced by recent Congressional enactment of spending tax cut legislation. This article has examined two key elements — limiting the growth of federal expenditures and creating new tax incentives — of the President's four part economic program. Comparing each of these elements to its post-WW II historical counterpart, it was shown that this new policy does indeed represent a "fundamental redirection" in the role of the federal government in the U.S. economy. A subsequent article will examine the extent to which the other two parts of the economic program — slow and steady money growth and regulatory reform — also contribute to this redirection. Whether this redirected role of the federal government, if fully approved by the Congress, will achieve the stated goals of lower inflation and improved economic growth, however, remains to be seen.

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The author wishes to acknowledge the helpful comments of Neela Manage, Michael Marlow, Gary Tapp, and especially William Cox.

¹⁷It should be noted that inflation complicates the measure of a deficit. This may be shown as follows. The nominal federal government deficit may be written as: (1) $D = G + iB - T = dB + dM$, where D is the nominal deficit, G is nominal government spending, i is the nominal interest rate on government bonds, B is the nominal amount of government bonds outstanding, T is nominal tax revenues, M is federal government monetary liabilities outstanding or currency held by the public plus reserves held by financial institutions at the Federal Reserve, dB is the change in government bonds outstanding, and dM is the change in monetary liabilities outstanding. In words, equation (1) says that government purchases of goods and services plus transfer payments plus interest payments on the federal debt minus taxes (when positive) represent a deficit that must be financed through the sale of bonds to the public or by "printing money." Of course, the government does own gold, foreign exchange, land, buildings and equipment which could conceivably be depleted to meet current expenditures, but since this is rarely done, a reduction in assets rather than simply an increase in liabilities does not enter equation (1).

In the presence of inflation, equation (1) may be written as: (2) $D/P = G/P + iB/P - TP - (dP/P)B/P - (dP/P)M/P = d(B/P) + d(M/P)$ where P is the price level and dP/P is the inflation rate (see James R. Barth and Joseph J. Cordes, "Substitutability, Complementarity, and the Impact of Government Spending on Economic Activity," *Journal of Economics and Business*, Spring/Summer 1980, pp. 235-242.) This expression demonstrates that with inflation the real deficit is lower than in the absence of inflation (when dP/P equals zero). In other words, inflation acts as a tax by reducing the value of government bonds and liabilities outstanding. If the nominal interest rate, i , increases with the inflation rate, then this effect may be offset to some degree. Given that B was equal to \$594 billion and M was equal to \$157 billion in 1980 and that the inflation rate in that year was 9 percent, one would have to subtract about \$68 billion from the nominal deficit to obtain the inflation adjusted measure given by equation (2). As Table 8 shows, when one does this, the result is that the deficit becomes a surplus.

Table 1. Budget Totals
(dollar amounts in billions)

	<i>Actual</i>	<i>Administration Program</i>					
	1980	1981	1982	1983	1984	1985	1986
<i>Budget Under Existing Law</i>							
<i>Totals</i>							
Outlays	579.6	658.0	736.5	806.5	866.7	928.5	992.6
Receipts	520.0	608.8	701.6	806.2	915.5	1028.1	1153.9
Surplus or Deficit (–)	–59.6	–49.2	–34.9	–.3	48.8	99.6	161.3
<i>Percent of GNP</i>							
Outlays	22.6	23.1	23.1	22.4	21.7	21.1	20.6
Receipts	20.3	21.4	22.0	22.4	22.9	23.4	24.0
Surplus or Deficit (–)	–2.3	–1.7	–1.1	0	1.2	2.3	3.4
<i>Administration's Proposed Budget Totals</i>							
Outlays	579.6	655.2	695.3	732.0	770.2	844.0	912.0
Receipts	520.0	600.3	650.3	709.1	770.7	849.9	940.2
Surplus or Deficit (–)	–59.6	–54.9	–45.0	–22.8	0.5	5.8	28.2
<i>Percent of GNP</i>							
Outlays	22.6	23.0	21.8	20.3	19.3	19.2	19.0
Receipts	20.3	21.1	20.4	19.7	19.3	19.3	19.5
Surplus or Deficit (–)	–2.3	–1.9	–1.4	–.63	.01	.13	.59

Source: **Federal Government Finances**, March 1981 edition, U.S. Office of Management and Budget.

Table 2. Growth in Federal Spending
(1950-1980)

	<i>1940-1980</i>		<i>Actual</i>				<i>Administration Program</i>					
	High Year	Low Year	1950-59	1960-69	1970-79	1980	1981	1982	1983	1984	1985	1986
<i>Annual Rate of Growth (%)</i>												
National Defense	312.5 (1942)	–72.1 (1947)	19.8	6.3	4.1	15.4	19.3	16.5	19.7	13.1	18.9	12.8
Nondefense	68.2 (1947)	–21.6 (1951)	6.2	8.6	13.7	18.0	11.7	10.3	.09*	1.5*	5.0*	5.4*
Total	157.5 (1947)	–40.5 (1946)	9.8	7.3	10.4	17.4	13.0	6.1	5.3	5.3	9.6	8.1
<i>Outlay Share of GNP (%)</i>												
National Defense	38.7 (1944)	1.6 (1940)	10.0	8.6	6.0	5.3	5.7	5.9	6.3	6.4	6.9	7.1
Nondefense	17.3 (1980)	5.0 (1945)	8.2	10.8	14.9	17.3	17.3	15.9	14.1*	12.9*	12.3*	11.8*
Total	45.2 (1944)	10.0 (1940)	18.2	19.4	20.9	22.6	23.0	21.8	20.3	19.3	19.2	19.0

*Assumes that savings to be presented subsequently by the administration will be from the nondefense programs. These savings are included in the administration's outlay estimates but have not yet been allocated by program.

Source: **Federal Government Finances**, March 1981 edition, U.S. Office of Management and Budget.



FINANCE

STATISTICAL SUPPLEMENT

	AUG 1981	JUL (R) 1981	DEC (R) 1980	ANN. RATE OF CHG.		AUG 1981	JUL (R) 1981	DEC (R) 1980	ANN. RATE OF CHG.
\$ millions									
UNITED STATES									
Commercial Bank Deposits	1,043,046	1,026,278	1,017,230	+ 4	Savings & Loans				
Demand	295,915	293,884	331,626	- 18	Total Deposits	508,952	511,242	500,985	+ 2
NOW	44,859	42,146	0		NOW	6,538	5,910	0	
Savings	153,496	155,078	166,274	- 13	Savings	96,566	98,331	104,240	- 12
Time	579,392	564,614	526,103	+ 17	Time	405,812	406,221	394,288	+ 5
Credit Union Deposits	37,454	37,297	34,870	+ 12		JUN	MAY	DEC	
Share Drafts	2,297	2,045	1,641	+ 67	Mortgages Outstanding	505,819	503,036	494,179	+ 5
Savings & Time	32,961	33,016	30,093	+ 16	Mortgage Commitments	18,113	18,635	16,021	+ 26
SOUTHEAST									
Commercial Bank Deposits	111,524	109,692	107,549	+ 6	Savings & Loans				
Demand	33,806	33,454	39,157	- 23	Total Deposits	74,818	75,041	72,600	+ 5
NOW	5,724	5,333	0		NOW	1,022	916	0	
Savings	15,117	15,156	16,578	- 15	Savings	12,138	12,306	13,165	- 13
Time	60,143	58,531	53,704	+ 20	Time	61,508	61,604	58,912	+ 7
Credit Union Deposits	3,558	3,444	3,209	+ 18		JUN	MAY	DEC	
Share Drafts	256	231	192	+ 56	Mortgages Outstanding	73,798	73,372	71,065	+ 8
Savings & Time	3,069	2,969	2,797	+ 16	Mortgage Commitments	3,724	4,058	3,652	+ 4
ALABAMA									
Commercial Bank Deposits	12,856	12,603	12,280	+ 8	Savings & Loans				
Demand	3,449	3,311	3,972	- 22	Total Deposits	4,334	4,386	4,265	+ 3
NOW	510	475	0		NOW	54	49	0	
Savings	1,615	1,629	1,754	- 13	Savings	620	630	690	- 17
Time	7,683	7,460	6,746	+ 26	Time	3,679	3,715	3,575	+ 5
Credit Union Deposits	556	554	521	+ 11		JUN	MAY	DEC	
Share Drafts	52	49	41	+ 45	Mortgages Outstanding	4,008	4,002	3,947	+ 3
Savings & Time	496	496	479	+ 6	Mortgage Commitments	113	123	136	- 34
FLORIDA									
Commercial Bank Deposits	37,072	36,308	36,141	+ 4	Savings & Loans				
Demand	12,314	12,228	14,577	- 26	Total Deposits	45,405	45,533	43,996	+ 5
NOW	2,493	2,332	0		NOW	717	646	0	
Savings	6,474	6,436	7,333	- 20	Savings	8,057	8,165	8,774	- 14
Time	16,661	16,073	14,471	+ 25	Time	36,415	36,480	34,698	+ 8
Credit Union Deposits	1,608	1,588	1,491	+ 13		JUN	MAY	DEC	
Share Drafts	143	129	106	+ 59	Mortgages Outstanding	44,907	44,567	42,742	+ 10
Savings & Time	1,248	1,232	1,177	+ 10	Mortgage Commitments	3,095	3,369	2,984	+ 7
GEORGIA									
Commercial Bank Deposits	14,917	14,673	14,550	+ 4	Savings & Loans				
Demand	5,812	5,794	6,793	- 24	Total Deposits	9,528	9,542	9,237	+ 5
NOW	832	763	0		NOW	107	92	0	
Savings	1,610	1,614	1,683	- 7	Savings	1,275	1,290	1,398	- 15
Time	7,653	7,481	7,011	+ 15	Time	8,164	8,169	7,835	+ 7
Credit Union Deposits	689	608	543	+ 45		JUN	MAY	DEC	
Share Drafts	20	17	12	+112	Mortgages Outstanding	9,484	9,468	9,332	+ 3
Savings & Time	659	580	517	+ 46	Mortgage Commitments	152	170	183	- 34
LOUISIANA									
Commercial Bank Deposits	19,902	19,708	18,690	+ 11	Savings & Loans				
Demand	5,837	5,804	6,461	- 16	Total Deposits	7,112	7,121	6,865	+ 6
NOW	767	722	0		NOW	59	54	0	
Savings	2,445	2,478	2,529	- 6	Savings	1,222	1,240	1,257	- 5
Time	11,411	11,120	10,093	+ 22	Time	5,852	5,840	5,617	+ 7
Credit Union Deposits	98	84	57	+121		JUN	MAY	DEC	
Share Drafts	7	5	4	+126	Mortgages Outstanding	6,998	6,963	6,777	+ 7
Savings & Time	91	78	52	+126	Mortgage Commitments	245	256	221	+ 22
MISSISSIPPI									
Commercial Bank Deposits	9,270	9,148	8,759	+ 10	Savings & Loans				
Demand	2,304	2,258	2,639	- 21	Total Deposits	2,371	2,376	2,332	+ 3
NOW	422	396	0		NOW	26	22	0	
Savings	767	767	842	- 15	Savings	241	242	262	- 13
Time	6,034	5,920	5,451	+ 18	Time	2,109	2,114	2,067	+ 3
Credit Union Deposits	N.A.	N.A.	N.A.			JUN	MAY	DEC	
Share Drafts	N.A.	N.A.	N.A.		Mortgages Outstanding	2,205	2,201	2,182	+ 2
Savings & Time	N.A.	N.A.	N.A.		Mortgage Commitments	38	43	58	- 69
TENNESSEE									
Commercial Bank Deposits	17,507	17,252	17,128	+ 4	Savings & Loans				
Demand	4,090	4,059	4,716	- 22	Total Deposits	6,069	6,084	5,904	+ 5
NOW	700	645	0		NOW	59	53	0	
Savings	2,207	2,232	2,437	- 16	Savings	723	739	784	- 14
Time	10,700	10,477	9,931	+ 13	Time	5,289	5,285	5,120	+ 6
Credit Union Deposits	607	610	597	+ 3		JUN	MAY	DEC	
Share Drafts	34	31	29	+ 29	Mortgages Outstanding	6,196	6,171	6,085	+ 4
Savings & Time	575	583	572	+ 1	Mortgage Commitments	81	97	70	+ 31

Notes: All deposit data are extracted from the Federal Reserve Report of Transaction Accounts, other Deposits and Vault Cash (FR2900), and are reported for the average of the week ending the 1st Wednesday of the month. This data, reported by institutions with over \$15 million in deposits as of December 31, 1979, represents 95% of deposits in the six state area. The annual rate of change is based on most recent data over December 31, 1980 base, annualized. Savings and loan mortgage data are from the Federal Home Loan Bank Board Selected Balance Sheet Data. The Southeast data represent the total of the six states. Subcategories were chosen on a selective basis and do not add to total.

N.A. = fewer than four institutions reporting. R = revised.

EMPLOYMENT

	JUL 1981	JUN (R) 1981	JUL 1980	ANN. % CHG.		JUL 1981	JUN (R) 1981	JUL 1980	ANN. % CHG.
UNITED STATES									
Civilian Labor Force - thous.	108,408	107,621	107,000	+ 1	Nonfarm Employment- thous.	91,680	92,446	89,711	+ 2
Total Employed - thous.	100,474	99,341	98,590	+ 2	Manufacturing	20,330	20,525	19,702	+ 3
Total Unemployed - thous.	7,934	8,279	8,410	- 6	Construction	4,534	4,466	4,562	- 1
Unemployment Rate - % SA	7.0	7.3	7.6		Trade	20,737	20,781	20,300	+ 2
Insured Unemployment - thous.	2,759	2,592	3,803	-27	Government	15,488	16,194	15,611	- 1
Insured Unempl. Rate - %	3.2	3.0	4.4		Services	65,652	66,321	64,422	+ 2
Mfg. Avg. Wkly. Hours	39.6	40.2	38.8	+ 2	Fin., Ins., & Real Est.	5,408	5,383	5,234	+ 3
Mfg. Avg. Wkly. Earn. - \$	317	320	283	+12	Trans. Com. & Pub. Util.	5,161	5,191	5,132	+ 1
SOUTHEAST									
Civilian Labor Force - thous.	13,152	13,124	12,910	+ 2	Nonfarm Employment- thous.	11,346	11,435	11,064	+ 3
Total Employed - thous.	12,172	12,123	11,849	+ 3	Manufacturing	2,282	2,310	2,196	+ 4
Total Unemployed - thous.	984	1,001	1,061	- 7	Construction	729	722	715	+ 2
Unemployment Rate - % SA	7.0	7.2	7.9		Trade	2,622	2,622	2,571	+ 2
Insured Unemployment - thous.	295	262	387	-24	Government	2,096	2,165	2,099	- 0
Insured Unempl. Rate - %	3.1	2.4	4.2		Services	2,148	2,148	2,051	+ 5
Mfg. Avg. Wkly. Hours	40.0	40.6	39.3	+ 2	Fin., Ins., & Real Est.	630	629	612	+ 3
Mfg. Avg. Wkly. Earn. - \$	271	273	247	+10	Trans. Com. & Pub. Util.	687	688	681	+ 1
ALABAMA									
Civilian Labor Force - thous.	1,636	1,645	1,666	- 2	Nonfarm Employment- thous.	1,345	1,346	1,343	+ 0
Total Employed - thous.	1,483	1,484	1,487	- 0	Manufacturing	356	358	344	+ 3
Total Unemployed - thous.	153	161	179	-15	Construction	71	71	73	- 3
Unemployment Rate - % SA	8.5	9.3	9.8		Trade	270	271	272	- 1
Insured Unemployment - thous.	53	45	76	-30	Government	293	292	300	- 2
Insured Unempl. Rate - %	4.2	3.6	6.0		Services	207	207	205	+ 1
Mfg. Avg. Wkly. Hours	40.4	40.4	39.5	+ 2	Fin., Ins., & Real Est.	59	59	59	0
Mfg. Avg. Wkly. Earn. - \$	285	282	257	+11	Trans. Com. & Pub. Util.	72	71	72	0
FLORIDA									
Civilian Labor Force - thous.	4,201	4,145	4,019	+ 5	Nonfarm Employment- thous.	3,689	3,747	3,498	+ 5
Total Employed - thous.	3,929	3,882	3,710	+ 6	Manufacturing	466	472	441	+ 6
Total Unemployed - thous.	272	263	309	-12	Construction	287	286	267	+ 7
Unemployment Rate - % SA	5.9	6.0	7.2		Trade	968	970	914	+ 6
Insured Unemployment - thous.	67	53	74	- 9	Government	585	636	588	- 1
Insured Unempl. Rate - %	1.9	1.5	2.3		Services	878	879	812	+ 8
Mfg. Avg. Wkly. Hours	40.4	40.8	39.7	+ 2	Fin., Ins., & Real Est.	271	270	254	+ 7
Mfg. Avg. Wkly. Earn. - \$	268	266	240	+12	Trans. Com. & Pub. Util.	224	225	218	+ 3
GEORGIA									
Civilian Labor Force - thous.	2,443	2,442	2,413	+ 1	Nonfarm Employment- thous.	2,151	2,162	2,129	+ 1
Total Employed - thous.	2,291	2,289	2,227	+ 3	Manufacturing	518	523	503	+ 3
Total Unemployed - thous.	152	153	186	-18	Construction	100	99	105	- 5
Unemployment Rate - % SA	5.7	5.8	7.2		Trade	485	486	491	- 1
Insured Unemployment - thous.	51	42	66	-23	Government	426	433	424	+ 0
Insured Unempl. Rate - %	1.9	1.5	2.3		Services	360	358	346	+ 4
Mfg. Avg. Wkly. Hours	39.7	40.7	39.3	+ 1	Fin., Ins., & Real Est.	115	114	113	+ 2
Mfg. Avg. Wkly. Earn. - \$	251	257	226	+11	Trans. Com. & Pub. Util.	141	141	139	+ 1
LOUISIANA									
Civilian Labor Force - thous.	1,797	1,804	1,736	+ 4	Nonfarm Employment- thous.	1,638	1,633	1,572	+ 4
Total Employed - thous.	1,653	1,647	1,618	+ 2	Manufacturing	216	217	210	+ 3
Total Unemployed - thous.	147	157	118	+25	Construction	156	153	145	+ 8
Unemployment Rate - % SA	7.7	7.8	6.5		Trade	365	364	355	+ 3
Insured Unemployment - thous.	40	40	43	- 7	Government	318	318	299	+ 6
Insured Unempl. Rate - %	2.6	2.7	3.0		Services	284	283	273	+ 4
Mfg. Avg. Wkly. Hours	40.9	41.4	40.5	+ 1	Fin., Ins., & Real Est.	76	76	75	+ 1
Mfg. Avg. Wkly. Earn. - \$	348	351	317	+10	Trans. Com. & Pub. Util.	129	128	126	+ 2
MISSISSIPPI									
Civilian Labor Force - thous.	1,019	1,022	1,041	- 2	Nonfarm Employment- thous.	817	820	818	+ 0
Total Employed - thous.	935	934	949	- 1	Manufacturing	219	221	213	+ 3
Total Unemployed - thous.	84	88	92	- 9	Construction	42	42	46	- 9
Unemployment Rate - % SA	7.7	7.8	8.3		Trade	166	166	164	+ 1
Insured Unemployment - thous.	30	30	43	-30	Government	183	184	189	+ 3
Insured Unempl. Rate - %	3.8	3.8	5.5		Services	121	121	120	+ 1
Mfg. Avg. Wkly. Hours	38.9	39.8	38.1	+ 2	Fin., Ins., & Real Est.	33	33	33	+ 0
Mfg. Avg. Wkly. Earn. - \$	232	237	206	+13	Trans. Com. & Pub. Util.	41	41	41	+ 0
TENNESSEE									
Civilian Labor Force - thous.	2,057	2,067	2,034	+ 1	Nonfarm Employment- thous.	1,705	1,727	1,705	+ 0
Total Employed - thous.	1,880	1,888	1,857	+ 1	Manufacturing	508	519	484	+ 5
Total Unemployed - thous.	176	179	177	- 1	Construction	74	73	79	- 6
Unemployment Rate - % SA	8.1	8.6	8.3		Trade	368	365	375	- 2
Insured Unemployment - thous.	55	52	85	-35	Government	291	303	299	- 3
Insured Unempl. Rate - %	3.3	3.1	5.1		Services	298	299	295	+ 1
Mfg. Avg. Wkly. Hours	39.9	40.5	38.8	+ 3	Fin., Ins., & Real Est.	77	77	79	- 3
Mfg. Avg. Wkly. Earn. - \$	267	272	236	+13	Trans. Com. & Pub. Util.	80	82	85	- 6

Notes: All labor force data are from Bureau of Labor Statistics reports supplied by state agencies.
Only the unemployment rate data are seasonally adjusted.
The Southeast data represent the total of the six states.
The annual percent change calculation is based on the most recent data over prior year.
R = revised.



CONSTRUCTION

	JUL 1981	JUN 1981	JUL 1980	ANN. % CHG.		JUL 1981	JUN 1981	JUL 1980	ANN. % CHG.
12-Month Cumulative Rate									
UNITED STATES									
Total Construction Contracts					Residential Contracts				
Value - \$ mil.	156,879	156,290	144,915	+ 8	Value - \$ mil.	68,699	69,015	62,139	+ 11
Nonresidential Contracts					Number of Units - Thous.	1,359.3	1,378.1	1,368.3	- 1
Value - \$ mil.	56,852	56,235	50,668	+ 12	Residential Permits - Thous.				
Sq. Ft. - mil.	1,207.9	1,215.6	1,260.7	- 4	Number single-family	711.5	733.8	729.7	- 2
Nonbuilding Contracts					Number multi-family	492.6	498.9	483.0	+ 2
Value - \$ mil.	31,328	31,040	32,107	- 2					
SOUTHEAST									
Total Construction Contracts					Residential Contracts				
Value - \$ mil.	28,085	28,330	24,104	+ 17	Value - \$ mil.	14,111	14,191	12,112	+ 17
Nonresidential Contracts					Number of Units - Thous.	318.2	321.6	299.8	+ 6
Value - \$ mil.	8,396	8,338	7,119	+ 18	Residential Permits - Thous.				
Sq. Ft. - mil.	196.7	196.0	189.3	+ 4	Number single-family	155.7	159.7	149.1	+ 4
Nonbuilding Contracts					Number multi-family	127.8	128.7	106.7	+ 20
Value - \$ mil.	5,578	5,835	4,872	+ 14					
ALABAMA									
Total Construction Contracts					Residential Contracts				
Value - \$ mil.	1,867	1,955	1,789	+ 4	Value - \$ mil.	982	991	798	+ 23
Nonresidential Contracts					Number of Units - Thous.	26.3	26.6	23.3	+ 13
Value - \$ mil.	525	539	574	- 9	Residential Permits - Thous.				
Sq. Ft. - mil.	12.3	12.7	15.7	- 22	Number single-family	8.1	8.6	8.4	- 4
Nonbuilding Contracts					Number multi-family	7.1	7.4	6.0	+ 18
Value - \$ mil.	360	425	417	- 14					
FLORIDA									
Total Construction Contracts					Residential Contracts				
Value - \$ mil.	14,073	14,071	11,406	+ 23	Value - \$ mil.	7,985	7,967	6,862	+ 16
Nonresidential Contracts					Number of Units - Thous.	178.5	179.6	168.3	+ 6
Value - \$ mil.	3,591	3,552	2,809	+ 28	Residential Permits - Thous.				
Sq. Ft. - mil.	90.6	90.4	82.0	+ 10	Number single-family	93.8	94.7	84.8	+ 11
Nonbuilding Contracts					Number multi-family	90.1	90.4	75.4	+ 19
Value - \$ mil.	2,497	2,552	1,735	+ 44					
GEORGIA									
Total Construction Contracts					Residential Contracts				
Value - \$ mil.	3,895	3,925	3,761	+ 4	Value - \$ mil.	1,999	1,958	1,672	+ 20
Nonresidential Contracts					Number of Units - Thous.	45.3	46.3	42.1	+ 8
Value - \$ mil.	1,267	1,246	1,238	+ 2	Residential Permits - Thous.				
Sq. Ft. - mil.	35.9	35.5	36.5	- 2	Number single-family	26.4	27.5	26.5	- 0
Nonbuilding Contracts					Number multi-family	10.6	10.8	7.4	+ 43
Value - \$ mil.	629	720	851	- 26					
LOUISIANA									
Total Construction Contracts					Residential Contracts				
Value - \$ mil.	3,628	3,683	3,204	+ 13	Value - \$ mil.	1,353	1,383	1,084	+ 24
Nonresidential Contracts					Number of Units - Thous.	27.4	27.1	24.1	+ 14
Value - \$ mil.	1,272	1,255	1,240	+ 3	Residential Permits - Thous.				
Sq. Ft. - mil.	23.7	22.5	19.3	+ 23	Number single-family	11.7	12.2	11.9	- 2
Nonbuilding Contracts					Number multi-family	9.1	9.3	6.6	+ 38
Value - \$ mil.	1,003	1,045	879	+ 14					
MISSISSIPPI									
Total Construction Contracts					Residential Contracts				
Value - \$ mil.	1,809	1,786	1,188	+ 52	Value - \$ mil.	635	679	542	+ 17
Nonresidential Contracts					Number of Units - Thous.	15.0	15.4	14.1	+ 6
Value - \$ mil.	640	614	312	+105	Residential Permits - Thous.				
Sq. Ft. - mil.	8.6	8.4	9.0	- 4	Number single-family	4.8	4.9	4.6	+ 4
Nonbuilding Contracts					Number multi-family	3.9	4.0	4.2	- 7
Value - \$ mil.	534	528	333	+ 60					
TENNESSEE									
Total Construction Contracts					Residential Contracts				
Value - \$ mil.	2,813	2,909	2,756	+ 2	Value - \$ mil.	1,157	1,213	1,153	+ 0
Nonresidential Contracts					Number of Units - Thous.	25.6	26.7	28.0	- 9
Value - \$ mil.	1,101	1,131	946	+ 16	Residential Permits - Thous.				
Sq. Ft. - mil.	25.6	26.6	26.8	- 4	Number single-family	11.0	11.8	12.9	- 15
Nonbuilding Contracts					Number multi-family	6.9	6.9	7.0	- 1
Value - \$ mil.	555	565	657	- 16					

Notes: Contracts are calculated from the F. W. Dodge Construction Potentials. Permits are calculated from the Bureau of the Census, Housing Units Authorized By Building Permits and Public Contracts. The Southeast data represent the total of the six states. The annual percent change calculation is based on the most recent month over prior year.



GENERAL

	JUL 1981	JUN 1981	JUL 1980	ANN. % CHG.		JUL 1981	JUN 1981	JUL 1980	ANN. % CHG.
UNITED STATES									
Personal Income-\$ bil. SAAR (Dates: 1Q, 4Q, 1Q)	2,292.5	2,228.3	2,062.8	+11	Agriculture				
Retail Sales - \$ bil.- SA	88.0	86.9	79.9	+10	Prices Rec'd by Farmers Index (1977=100)	141.0	142.0	135.0	+ 4
Plane Passenger Arrivals (thous.)	N.A.	N.A.	N.A.		Broiler Placements (thous.)	80,019	84,702	78,622	+ 2
Petroleum Prod. (thous. bls.)	8,626.7	8,633.6	8,709.5	- 1	Calf Prices (\$ per cwt.)	64.80	66.20	75.60	-14
Consumer Price Index 1967=100	274.4	271.3	247.6	+11	Broiler Prices (\$ per lb.)	30.4	29.2	31.7	- 4
					Soybean Prices (\$ per bu.)	7.11	7.10	6.97	+ 2
					Broiler Feed Cost (\$ per ton)	233	234	192	+21
SOUTHEAST									
Personal Income-\$ bil. SAAR (Dates: 1Q, 4Q, 1Q)	266.8	258.6	235.0	+14	Agriculture				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		Prices Rec'd by Farmers Index (1977=100)	126.8	134.0	124.8	+ 2
Plane Passenger Arrivals (thous.)	4,314.7	4,093.0	4,547.9	- 5	Broiler Placements (thous.)	31,632	33,468	27,824	+14
Petroleum Prod. (thous. bls.)	1,427.8	1,444.9	1,543.4	- 7	Calf Prices (\$ per cwt.)	56.38	59.77	70.86	-20
Consumer Price Index 1967=100	N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	30.1	27.5	30.9	- 3
					Soybean Prices (\$ per bu.)	7.09	7.18	7.17	- 1
					Broiler Feed Cost (\$ per ton)	224	228	184	+22
ALABAMA									
Personal Income-\$ bil. SAAR (Dates: 1Q, 4Q, 1Q)	31.1	30.3	28.2	+10	Agriculture				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: JUN, JUN)	801		710	+13
Plane Passenger Arrivals (thous.)	125.4	119.6	132.3	- 5	Broiler Placements (thous.)	40,795	42,737	40,697	+ 0
Petroleum Prod. (thous. bls.)	60.0	63.0	60.0	0	Calf Prices (\$ per cwt.)	51.00	57.80	67.50	-24
Consumer Price Index 1967=100	N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	28.5	27.5	32.0	-11
					Soybean Prices (\$ per bu.)	6.83	6.91	7.45	- 8
					Broiler Feed Cost (\$ per ton)	245	250	179	+37
FLORIDA									
Personal Income-\$ bil. SAAR (Dates: 1Q, 4Q, 1Q)	95.3	92.2	82.0	+16	Agriculture				
Taxable Sales - \$ mil.	63,908	62,836	55,513	+15	Farm Cash Receipts - \$ mil. (Dates: JUN, JUN)	2,779		2,478	+12
Plane Passenger Arrivals (thous.)	1,961.3	1,751.8	2,085.9	- 6	Broiler Placements (thous.)	7,087	7,971	6,668	+ 6
Petroleum Prod. (thous. bls.)	101.0	114.4	115.4	-12	Calf Prices (\$ per cwt.)	62.00	65.20	76.10	-19
Consumer Price Index - Miami Nov. 1977 = 100	JUL 146.1	MAY 143.2	JUL 133.6	+ 9	Broiler Prices (\$ per lb.)	30.5	26.0	29.5	+ 3
					Soybean Prices (\$ per bu.)	6.83	6.91	7.45	- 8
					Broiler Feed Cost (\$ per ton)	240	240	200	+20
GEORGIA									
Personal Income-\$ bil. SAAR (Dates: 1Q, 4Q, 1Q)	46.8	45.4	41.7	+12	Agriculture				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: JUN, JUN)	1,145		1,028	+11
Plane Passenger Arrivals (thous.)	1,774.7	1,737.0	1,845.1	- 4	Broiler Placements (thous.)	49,461	52,161	46,413	+ 7
Petroleum Prod. (thous. bls.)	N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	51.60	56.60	65.00	-21
Consumer Price Index - Atlanta 1967 = 100	JUN 239.2	APR 265.9	JUN 242.2	+11	Broiler Prices (\$ per lb.)	29.0	26.5	30.0	- 3
					Soybean Prices (\$ per bu.)	7.09	7.17	6.90	+ 3
					Broiler Feed Cost (\$ per ton)	210	210	188	+12
LOUISIANA									
Personal Income-\$ bil. SAAR (Dates: 1Q, 4Q, 1Q)	38.1	36.7	33.2	+15	Agriculture				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: JUN, JUN)	595		542	+10
Plane Passenger Arrivals (thous.)	258.0	272.2	280.8	- 8	Broiler Placements (thous.)	N.A.	N.A.	N.A.	
Petroleum Prod. (thous. bls.)	1,171.5	1,172.5	1,266.0	- 7	Calf Prices (\$ per cwt.)	58.50	59.80	69.00	-15
Consumer Price Index 1967 = 100	N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	31.5	28.0	33.0	- 5
					Soybean Prices (\$ per bu.)	7.26	7.51	7.35	- 1
					Broiler Feed Cost (\$ per ton)	250	245	195	+28
MISSISSIPPI									
Personal Income-\$ bil. SAAR (Dates: 1Q, 4Q, 1Q)	17.4	17.0	15.9	+ 9	Agriculture				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: JUN, JUN)	788		785	+ 0
Plane Passenger Arrivals (thous.)	39.1	36.2	41.6	- 6	Broiler Placements (thous.)	24,127	25,712	22,469	+ 7
Petroleum Prod. (thous. bls.)	95.3	95.0	102.0	- 7	Calf Prices (\$ per cwt.)	57.10	60.70	72.70	-21
Consumer Price Index 1967 = 100	N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	34.5	29.5	31.0	+11
					Soybean Prices (\$ per bu.)	7.10	7.04	7.15	- 1
					Broiler Feed Cost (\$ per ton)	210	220	175	+20
TENNESSEE									
Personal Income-\$ bil. SAAR (Dates: 1Q, 4Q, 1Q)	38.1	37.0	34.0	+12	Agriculture				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		Farm Cash Receipts - \$ mil. (Dates: JUN, JUN)	699		647	+ 8
Plane Passenger Arrivals (thous.)	156.2	176.2	162.2	- 4	Broiler Placements (thous.)	5,057	5,291	5,310	- 5
Petroleum Prod. (thous. bls.)	N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	57.00	57.70	72.30	-21
Consumer Price Index 1967 = 100	N.A.	N.A.	N.A.		Broiler Prices (\$ per lb.)	29.0	29.5	30.0	- 3
					Soybean Prices (\$ per bu.)	7.12	7.23	6.91	+ 3
					Broiler Feed Cost (\$ per ton)	210	225	185	+14

Notes:

Personal Income data supplied by U. S. Department of Commerce. Taxable Sales are reported as a 12-month cumulative total. Plane Passenger Arrivals are collected from 26 airports. Petroleum Production data supplied by U. S. Bureau of Mines. Consumer Price Index data supplied by Bureau of Labor Statistics. Agriculture data supplied by U. S. Department of Agriculture. Farm Cash Receipts data are reported as cumulative for the calendar year through the month shown. Broiler placements are an average weekly rate. The Southeast data represent the total of the six states. N.A. = not available. The annual percent change calculation is based on most recent data over prior year.

Table 3. Composition of Federal Spending
(Percent of total spending)

Budget Category	1940-1980		Actual				Administration Program ¹					
	High Year	Low Year	1950-59	1960-69	1970-79	1980	1981	1982	1983	1984	1985	1986
National Defense	88.3 (1945)	15.8 (1940)	54.5	44.2	29.0	23.4	24.7	27.2	30.9	33.2	36.0	37.6
Human Resources ²	54.0 (1976)	1.9 (1945)	22.6	30.5	48.5	52.3	53.3	52.4	49.4	48.5	47.7	47.1
Net Interest	14.6 (1948)	1.9 (1943)	7.6	6.8	7.4	9.1	9.8	9.8	9.4	8.8	7.7	6.9
All Other	28.8 (1940)	6.4 (1945)	15.3	18.5	15.1	15.2	12.2	10.6	10.3	9.6	8.6	8.5

¹Assumes that savings to be presented subsequently by the administration will be from the human resources programs. These savings are included in the administration's outlay estimates but have not yet been allocated by program.

²Human resources is composed of the education, training, employment, and social services function; the health function; the income security function; and the veterans benefits and services function.

Source: **Federal Government Finances**, March 1981 Edition, U.S. Office of Management and Budget.

Table 4. Growth in Federal Receipts
(1950-1986)

	1940-1980		Actual				Administration Program						
	High Year	Low Year	1950-59	1960-69	1970-79	1980	1981	1982	1983	1984	1985	1986	
Annual Rate of Growth (%)													
Individual													
Income Taxes	211.7 (1944)	— 195 (1949)	9.7	9.3	9.8	12.0	13.7	3.9	7.9	9.2	12.9	14.6	
Corporation													
Income Taxes	156.4 (1942)	— 29.6 (1947)	6.2	8.6	6.9	— 1.6	— .1	— 3.5	9.8	4.1	.1	1.9	
Social Insurance													
Taxes and Contributions	30.4 (1967)	— 10.5 (1946)	12.1	13.4	13.6	13.5	15.9	15.1	11.9	9.9	12.2	10.6	
Other	41.9 (1981)	— 7.3 (1955)	4.4	6.1	5.6	24.0	41.9	18.7	5.2	7.0	3.1	1.5	
Total	87.2 (1944)	— 13.0 (1946)	7.9	9.2	9.7	11.6	15.4	8.3	9.0	8.7	10.3	10.6	
Receipts Share of GNP (%)													
Individual													
Income Taxes	10.0 (1944)	1.2 (1940)	7.6	8.1	8.6	9.5	9.8	9.0	8.6	8.5	8.7	9.1	
Corporation													
Income Taxes	7.6 (1944)	1.0 (1940)	4.6	4.0	2.6	2.5	2.3	2.0	1.9	1.8	1.6	1.5	
Social Insurance													
Taxes and Contributions	6.3 (1980)	1.5 (1946,79)	2.1	3.6	5.4	6.3	6.6	6.7	6.7	6.6	6.7	6.8	
Other	3.9 (1946)	1.7 (1979)	2.8	2.9	2.2	1.9	2.5	2.6	2.5	2.4	2.3	2.0	
Total	21.9 (1944)	6.7 (1940)	17.8	18.6	19.0	20.3	21.1	20.4	19.7	19.3	19.3	19.5	

Source: **Federal Government Finances**, March 1983 edition, U.S. Office of Management and Budget.

FEDERAL RESERVE BANK OF ATLANTA

Table 5. Composition of Federal Receipts
(percent of total receipts)

	<i>1940-1980</i>		<i>Actual</i>				<i>Administration Program</i>					
	High Year	Low Year	1950-59	1960-69	1970-79	1980	1981	1982	1983	1984	1985	1986
Individual												
Income Taxes	46.9(1980)	17.5(1940)	43.1	43.8	40.7	46.9	46.2	44.3	43.9	44.1	45.1	46.8
Corporation												
Income Taxes	40.5(1943)	12.4(1980)	27.6	21.3	14.9	12.4	10.8	9.6	9.7	9.3	8.4	7.7
Social Insurance												
Taxes and												
Contributions	30.9(1976,80)	7.6(1945)	11.8	19.3	28.5	30.9	31.0	33.0	33.8	34.2	34.8	34.8
Other*	40.2 (1940)	9.4(1978)	17.6	15.6	11.5	9.8	12.0	13.2	12.6	12.5	11.6	10.7

*Excise taxes, customs duties and miscellaneous receipts

Source: **Federal Government Finances**, March 1981 edition, U.S. Office of Management and Budget.

Table 6. Individual and Corporation Income Tax Rates

	<i>Family of 4 with Median Income</i>		<i>Family of 4 with Twice Median Income</i>		<i>Corporations</i>
	Income	Marginal Tax Rate	Income	Marginal Tax Rate	Average Tax Rate
1980	\$24,409	24%	\$48,818	43%	27%
1981	27,094	27	54,188	43	27
1982	30,210	25	60,420	44	22
1983	33,684	26	67,368	40	21
1984	37,019	25	74,038	38	20
1985	40,462	25	80,924	38	18
1986	44,185	28	88,370	42	16

Source: **America's New Beginning: A Program for Economic Recovery**, U.S. Office of Management and Budget, February 18, 1981, and Economic Recovery Tax Act of 1981, Conference Report, Aug. 1, 1981.

Table 7. Actual (1980) and Expected (1981-86) After-Tax Interest Rates for Families in Selected Income Tax Brackets*

	Administration's Expected Interest Rate (3-Month U.S. Treasury Bill Rate)	Nominal After-Tax Interest Rate		Real After-Tax Interest Rate	
		Median Income Family	Highest Marginal Tax Bracket Family	Median Income Family	Highest Marginal Tax Bracket Family
1980	11.5%	8.7%	3.4%	-0.3%	-5.6%
1981	13.6	9.9	4.2	+0.3	-5.4
1982	10.5	7.9	5.2	-0.1	-2.8
1983	7.5	5.6	3.8	-1.4	-3.2
1984	6.8	5.1	3.4	-0.9	-2.6
1985	6.0	4.5	3.0	-0.9	-2.4
1986	5.5	4.0	2.8	-0.9	-2.1

*Based on administration's expected interest rate, tax rates and inflation rates.

Table 8. Federal Budgetary Deficits (1950-1986)

	1940-1980		Actual				Administration Program					
	High Year	Low Year	1950-59	1960-69	1970-79	1980	1981	1982	1983	1984	1985	1986
Surplus or Deficit (–) (Billions)	12.0(1948)	– 66.4(1976)	– 1.8	– 5.7	– 31.5	– 59.6	– 54.9	– 45.0	– 22.8	0.5	5.8	28.2
Surplus or Deficit (–) as a Share of GNP (%)	4.9(1948)	– 31.0(1943)	– 0.4	– 0.8	– 2.1	– 2.3	– 1.9	– 1.4	– .63	.01	.13	.59

Source: **Federal Government Finances**, March 1981, Edition, U.S. Office of Management and Budget.

The Other Adam Smith



ADAM SMITH

From *Readings in the History of Economic Thought* by S. Howard Patterson, McGraw-Hill, 1932. By permission of McGraw-Hill Book Co.

There is much talk these days about supply side economics, which I take to mean the shift of attention from increasing consumption to encouraging production. In theory this is achieved by throwing off as many artificial constraints as possible, those regulations, controls, and excessive taxes which tend to impede investment leading to greater productivity. The aim, of course, is to return to a freer market in which productive capacity will increase and the pressures of inflation will abate.

Behind all of this thinking the name of Adam Smith looms prominently, for Adam Smith had indeed set forth much of the intellectual rationale for the free market in his *Wealth of Nations* published in 1776. He proposed to allow the market to function as the chief allocator of investment, thereby rewarding the diligent and the astute, and penalizing the tradition-bound and inefficient. Such a remedy has obvious attractions today for all who labor under the burden of excessive regulation, whether in business or in other institutions like universities.

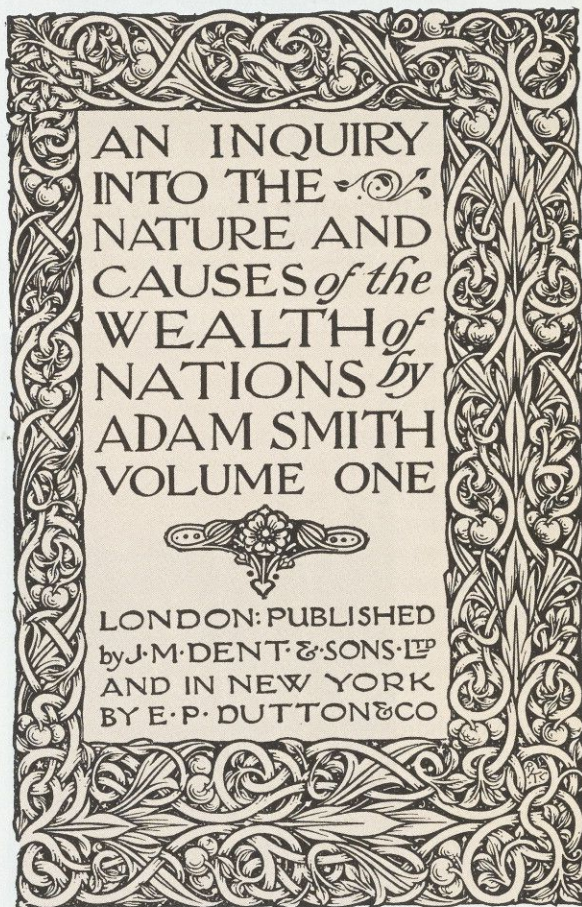
Adam Smith may have more to teach us than we have yet acknowledged. He was not simply an economist (indeed there was no such thing then), but was a political and moral philosopher, concerned primarily with the springs of human behavior and of social responsibility. His *Theory of Moral Sentiments* sought to explain men's actions, just as the *Wealth of Nations* explained the economic functioning of society. And as the market was the key to his *Wealth of Nations*, so the term, *sympathy*, is the key to his *Theory of Moral Sentiments*.

Capitalism, said Adam Smith, depends on disciplined, public-spirited citizens who are willing to postpone reward for the sake of future productivity. At a recent dinner for Atlanta Federal Reserve Bank directors and members of the business community, James T. Laney, President of Emory University (and former Dean of Emory's Candler School of Theology) argued that the shift toward consumption and immediate gratification undermines the moral and psychological foundations of capitalism.

Sympathy: The Moral Basis of Capitalism

Sympathy had a very specialized meaning for Smith, indicating that capacity to identify with others, to engage one's passions in the service of things larger than one's self. Sympathy could lead to a lively, accurate understanding of other people and thus enable one to become socially more useful. Sympathy was not a sentimental concept for Smith, rather it invested the idea of one's larger interests with the new dimension, for unless self-interest is intelligent it degenerates into pandering to the passions. To be intelligent means to know others and what they would like and aspire to become themselves. To pursue one's interests can lead to mutual advantage if the enterprising spirit can identify and meet a real need that exists beyond one's self.

It was in this way that Smith joined or saw the joining together of what had traditionally been separate, namely the passions on the one hand and interests on the other. In the centuries preceding the emergence of capitalism, the passions had been directed principally toward the achievement of glory, as with the codes of honor embodied by the nobility. Their highly refined sense of honor was for the most part socially useless and economically costly. To work for one's interests directly was despised and considered ignoble. But Smith was confident that the intelligent pursuit of one's true interests — one's advantage — would lead to a great advantage for all. He saw that it was possible for men's ambitions, which until then had been focused on vainglory, to be directed



From the Everyman's Library Edition. By permission of the publisher in the United States, E.P. Dutton.

instead toward the power and respect that could be gained through economic success. By coupling men's passions with men's interests in this new way, he saw that a new era of unprecedented energy and creativity might be unleashed.

This new understanding of passions and interests required a new set of virtues, a morally authorized code of behavior newly sanctioned and rewarded by society and the church. The identification of these new virtues has been amply documented by scholars in books such as *Religion and the Rise of Capitalism* by R. H. Tawney, and *The Protestant Ethic and the Spirit of Capitalism* by Max Weber. These books have shown us that it was the great Puritan contribution to economic life to identify a "calling" or vocation which requires enterprise, diligence, and thrift for its fulfillment.

Puritanism gave the pursuit of such interests divine sanction and showed that this working of divine will through an individual's daily work could be advantageous to society at

large. Within this Puritan ethic, to become a productive and useful member of society offered a measure of respect and honor, as well as the possibility of wealth.

Self-improvement was tied to virtues which led to a mastery of self, and thereby to a mastery of the world. It was because the Puritan, this new character or personality, was satisfied to postpone or delay his gratification, that capital accumulation was made possible and that investment leading to new kinds of productivity emerged.

It is interesting to trace how church and society began to honor this type of character, setting up the payment of debts — hence trustworthiness and solid work, hence integrity — as the principal ideal of individual life. This type of personality was promoted and approved through class meetings in the Protestant church, through the strict expectations and standards of Victorian morality, and through home life. It was believed that one did not have to take undue advantage of another to be in the pursuit of one's own interests.

We can readily see how these moral assumptions underlay the development of the modern ethos of capitalism. This kind of character was inner-directed, embodying disciplines and restraints which made possible the successful operation of the free market and free enterprise itself. It is important to us to recognize that the basic condition for the emergence of capitalism was the postponement of gratification for the sake of investment and enterprise, in other words, for the sake of future productivity. The free market of Adam Smith was in the service of this type of person and required this type of person for its operation. When one forgets that the *Wealth of Nations* is written by the man who also gave us the *Theory of Moral Sentiments*, it is easy to overlook that an adequate operation of the free market still requires the type of person who can be entrusted with this kind of freedom and power.



The Shift from Sympathy

It is evident that in the last half century or so there has been a profound shift in our basic ethos, a shift from an emphasis upon

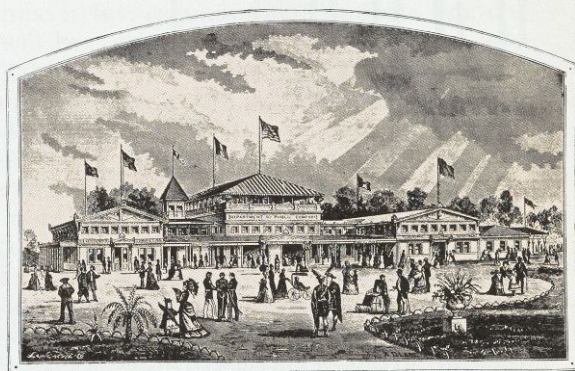
productivity and the postponement of gratification to consumption and immediate gratification. If the emphasis on production requires certain traits or virtues, it is similarly clear that an emphasis upon consumption will develop its own kind of personality. That personality is very much in evidence in our society today.

How has this come about? For one thing, we see that there has been a steady erosion of religious conviction concerning vocation. There is little talk today about the sense of doing the will of God in one's daily work, whether that work is in the marketplace or in a profession. The emphasis all about us is on the encouragement of enjoyment through various kinds of increasingly sophisticated consumption. The passions, instead of being directed toward the approval of God, are now in pursuit of their own ends.

Secondly, instead of seeing ourselves as participants in production, we understand ourselves as consumers. This means that getting our share of the fruit of labor is our principal end, and this leads to a pitting of self-interest against society rather than for the good of society as Adam Smith envisioned. One does not think of one's contribution to society as much as what one can get out of it.

And thirdly, the enormous increase in specialization, along with the increasing complexity of society and administration of all institutions, has led to a loss of personal identification with what one does in life. In other words, that remarkable fusion of the passions and interests that marked an earlier age is gone, and with it that type of character. We see in emerging young professionals, whether in business or in law or in medicine, a willingness to submit to the disciplines of the job or profession only if there are large compensations which are not too long delayed. In many cases, this means that their hearts are not in their work, which they are willing to endure only for the sake of the "private life" that it makes possible.

It follows that persons are less likely to embody those public virtues upon which society depends and are cultivating instead those private tastes which have little to contribute to the public good. Self-interest and public interest are now held together more by external rewards than by internal motives. We see a growing impatience with all

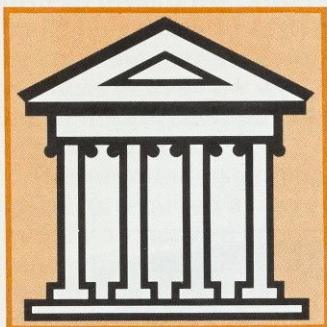


outside authority and with those moral expectations which in another age might have directed our behavior. The Moral Majority appreciates the nature of this contemporary problem but uses condemnation as its principal means of addressing it. This grows more out of a vague nostalgia for the past than out of any thoughtful assessment of or attention to the true nature of the problem.

To revert to our original understanding, it is true that many things can be accomplished by market mechanisms, but the deepest social and economic problems are harder to address unless there is also a kind of personality, a type of character, which can be counted upon to work for the common good while pursuing private ends.

What this all means is that capitalism has a stake in the moral climate of a society. Its leaders must embody those qualities and virtues which alone can ensure the well-being and total good of the society. And its individual citizens must share a sense of labor and professionalism and public life that embraces the now old-fashioned notion of the common good.

**— James T. Laney
President
Emory University**



The Future of the Financial Services Industry

Four hundred financial leaders gathered in Atlanta June 3-4 for what proved to be a lively discussion of future developments in financial services. In this issue we present brief summaries of the final three sessions: "Banking as a Separate Product Line," "The Likelihood of Legislative Change," and "Checks and Pricing: The Role of the Fed," as well as of the keynote addresses by Congressman Douglas Barnard (D-Ga) and Governor Nancy H. Teeters of the Federal Reserve Board of Governors. The full texts of these papers, as well as the papers from the first session, "The Changing Role of Financial Institutions," are available in *Proceedings* form. Ordering information is included in this issue.

Banks and Financial Services

Michael Laub
Director of Economic
and Policy Research
American Bankers Association

As director of economic research for the American Bankers Association and staff director for the ABA's Economic Advisory Committee, P. Michael Laub coordinates research and advises the Association on economic aspects of legislation and regulations that affect banks. He oversees staff contributions to the Government Borrowing Committee, which advises the Treasury on its financing plans prior to its mid-quarter refunding, and has worked at the staff level with the Association's Select Task Force on Inflation. Dr. Laub previously was an economist with the Board of Governors of the Federal Reserve System.

In the tradeoff between yield and nonprice considerations, Laub predicts that savers and investors will increasingly express a preference for yield. Interest rate restrictions will continue to cause institutions subject to them to lose business to less regulated competitors. Branching will become more burdensome and less profitable as a way of selling retail services.

Laub discusses some key interactions which are likely to shape the industry's future. Volatile inflation will produce more sophisticated tax planning. Flight from long-term investments will continue. At the same time, Laub says, concern about retirement planning will increase.

Laub also explains why he thinks these trends will continue even if we have a return to a more stable economy. Even if investors became convinced that a return to stability would be relatively permanent, Laub argues, the pressures which produced deregulation would be strong enough to prevent "reregulation."

Regulatory Issues

Robert A. Eisenbeis
Federal Reserve Board

Robert Eisenbeis is senior deputy director in the Division of Research and Statistics at the Federal Reserve Board. He is in charge of basic research on banking market structure and performance and analysis of proposed bank holding company acquisitions, mergers, and new holding company activities.

Eisenbeis explores the argument over whether commercial banking should be used as the "line of commerce" when regulators are evaluating the competitive effects of mergers and acquisitions. Although there is growing sentiment against the old definition, Eisenbeis suggests a cautious approach. In the context of the present Supreme Court criteria for defining the line of commerce, the recent changes in banking may not make much difference.

Changing the definition could precipitate a consolidation of the banking system. The basic question, Eisenbeis says, then becomes "what type of consolidations do we want to promote and how do we want that process to proceed?"

We need to be careful, Eisenbeis suggests, that a broader definition does not result in consolidations favoring one segment of the industry over another.

Empirical Evidence on Sources of Business Finance

Peter Eisemann
Georgia State University

Peter Eisemann, associate professor of finance at Georgia State University, has published widely in the areas of small business finance, bank profitability, leverage policy, working capital management, and pension funds. He is on the faculty of the Stonier Graduate School of Banking at Rutgers University.

Must small businesses rely on commercial banks for their financial needs, or do they have a variety of suppliers to choose from? The answer to this question, Eisemann points out, is at the heart of the current debate over whether banking constitutes a single line of commerce.

As long as at least one major customer group is dependent on commercial banks, the argument goes, then banking must constitute a single line of commerce.

In a series of surveys of small businesses, Eisemann found evidence which calls the "line of commerce" argument into question.

"Not only aren't commercial banks the sole source of debt financing for small businesses," he says, "banks aren't even the major source of debt financing to these firms." Eisemann describes in detail the survey results and the questions they raise for bank regulators.

Structural Implications of Consolidations

Arnold Heggstad
University of Florida
Visiting Scholar
Federal Reserve Bank
of Atlanta

Arnold Heggstad, Chairman of the Department of Finance at the University of Florida, has written extensively on bank structure and performance, financial markets, multibank holding company structure and behavior, regulatory economics, and financial management. Before coming to Florida, Dr. Heggstad was a senior analyst with ABT Associates and an economist with the Federal Reserve Board of Governors.

The U.S. banking structure differs from other major industrial countries, Heggstad says, in that state and federal laws have created a "fragmented structure" of 42,000 depository institutions. As these geographic and product barriers are lifted, there will inevitably be consolidation of these many thousands of firms.

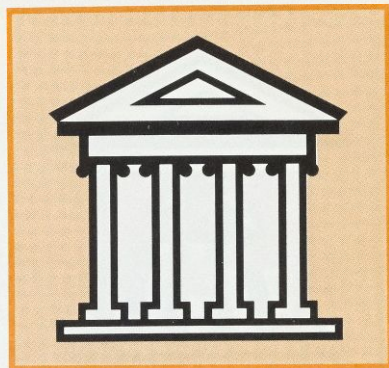
Heggstad goes on to describe how he thinks that consolidation will take shape. To what extent will banking firms seek to achieve greater size through acquisitions in new geographic markets? How will the thrift industry react to the consolidation movement? Will there be acquisitions across product lines (banks acquiring S&Ls and vice versa)?

Heggstad believes substantial diversification will remain as the industry adapts to customers whose financial needs will be "even more diverse than the structure that has developed to accommodate them."

The Changing Competitive Environment

George C. Kaufman
Loyola University

George C. Kaufman is a consultant and former senior economist to the Federal Reserve Bank of Chicago. Prior to that, he was a professor of banking and finance and director of the Center for Capital Market Research at the University of Oregon. He has served as visiting professor at several California universities, and visiting scholar at the Federal Reserve Bank of San Francisco and at the Office of the Comptroller of the Currency.

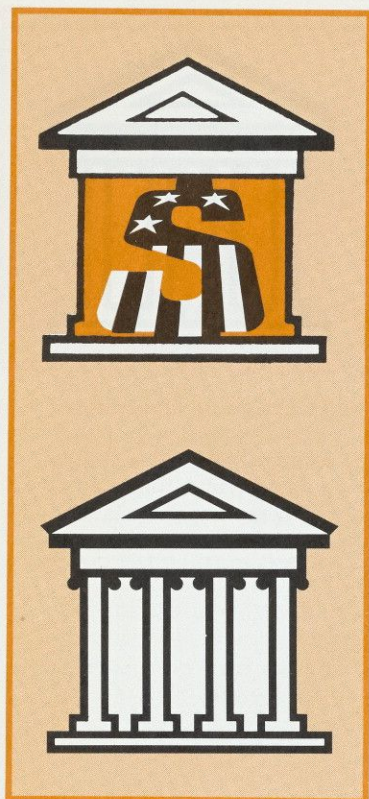


"Banking's old line of commerce and banking as a line of commerce are both dead," Kaufman begins, "and long live the new line." He then describes what killed the old line and what forces are shaping the new line.

The new line of commerce, Kaufman notes, is not developing totally along the lines predicted by knowledgeable analysts just a few years ago. The new line will be determined largely by each individual bank, "depending on its location, capital, management skills, and philosophy."

For these and other reasons, Kaufman says, "the courts will have to start from scratch." Kaufman foresees lively developments in mergers, acquisitions, and also major changes in the role of the regulatory agencies and the Department of Justice.





Implications of Federal Reserve Pricing on Check Clearing Arrangements

George C. White, Jr.
Vice President, Operations
Chase Manhattan Bank

As vice president in the Operations Department at Chase Manhattan Bank, George C. White Jr. is involved in long-range planning of payments systems developments. Selected by readers of Bank Systems and Equipment as one of 10 people who "shook the bank operations scene in the 1970s," he represents Chase on the New York Clearing House Association's (NYCHA) Payments Service Committee and the New York State Bankers Association's Electronic Funds Transfer Services Committee. He recently chaired the NYCHA Ad Hoc Committee on Federal Reserve Pricing and sits on the editorial advisory boards of several professional journals. A former director of the Bank Administration Institute, Mr. White was first chairman of the American National Standards Institute (ANSI) Check Standardization Subcommittee.

George C. White foresees a different competition coming, not from interstate banking or money market funds, but "paper versus electronics." While the financial services industry worries about the effects of Fed pricing, many industry leaders are "not paying any attention to the electronic possibilities."

By still subsidizing checks, White says, "we're not pricing to move out of paper to a more efficient electronic mechanism. White also attacks the continued existence of Fed float as an "explicit subsidization of the banking system paid for by the reserve deposits in the Federal Reserve Bank."

White goes on to appeal for marketplace solutions, "not bureaucratic solutions," and asserts that offering more electronic alternatives to customers would be consistent with the "level playing field" policy.

Current Status of Federal Reserve Check Pricing

Robert W. Eisenmenger, Sr.
Vice President and
Director of Research
Federal Reserve Bank
of Boston

For the past 12 years, Robert Eisenmenger has been senior vice president and director of research at the Federal Reserve Bank of Boston. He has chaired various Federal Reserve pricing study groups and is currently chairman of the System's Subcommittee on Pricing, which has been responsible for developing and pricing principles and fee schedules for specific services. Dr. Eisenmenger did his undergraduate study at Amherst College and earned advanced degrees from Yale University and Harvard University.

The Monetary Control Act unties the historical bonds between commercial banks and the Federal Reserve. Pricing, according to Eisenmenger, will encourage member banks to comparison shop among correspondent banks for services they had received free from the Fed.

One result of this unbundling, Eisenmenger says, is that "regional markets for interbank financial services should be much more competitive than they've ever been before."

Significant volume losses for the Fed should be offset by increased efficiency for the overall system, Eisenmenger believes. Moreover, because Reserve Banks will be operating on an individual basis, district banks can modify their service levels to meet the unique needs of their customers.

Implications of Alternative Payment Systems

Allen H. Lipis, President
Electronic Banking, Inc.

Allen H. Lipis is president and co-founder of Electronic Banking, Inc., of Atlanta and is internationally known in the field of electronic banking. Prior to founding EBI, Dr. Lipis was senior vice president and director of research for Payment Systems, Inc. He was project director of the Atlanta Payments Project, a pioneering effort into electronic funds transfer systems that led to formation of the nation's second automated clearinghouse. Over the past decade, Dr. Lipis has initiated and directed over 100 major projects and conferences on payment systems developments. He has spoken before most major banking conferences related to payment systems activities and has authored numerous articles. Dr. Lipis has a Ph.D. in operations research from the University of Pennsylvania.

Allen Lipis presents an overview of the development of electronic banking services over the last 15 years. The new services "start like opinions or jokes or fantasies," he says. "Then when they began to look somewhat real they become blasphemies and treasons, and somewhere in the mid-seventies we had EFT moratoriums and legal suits trying to prevent their implementation."

Today, Lipis says, "they are questions open to discussion....I suspect they will end up as established truth." Lipis has developed an index of five major services: automated teller machines, telephone bill payment, automatic clearing house services, check guarantee services (point-of-sale location), and point-of-sale-proprietary debit cards.

While the index does not demonstrate conclusively that EFT volume has cut into check growth, Lipis finds good reason to speculate that ATM, telephone bill payment, and ACH "are beginning to make a sizable dent in the growth rate of checks."

Expansion of Allowable Financial Powers

Carter H. Golembe
Golembe Associates

Carter H. Golembe is chairman of Golembe Associates, Inc., a Washington-based economic research and consulting firm for banks and bank holding companies, founded in 1966. Previously, he was deputy manager of the American Bankers Association.

Golembe focuses on the role of the Federal Reserve in the efforts to expand the powers of financial institutions. The Supreme Court, in Golembe's view, has ruled that Congress, when it put Section 4-C-8 in the Bank Holding Company Act in 1970, intended to expand the powers of commercial banks. The difficulty in predicting what might happen with respect to 4-C-8, according to Golembe, stems largely from the fact that the Federal Reserve Board has two responsibilities. As the central bank with the responsibility for carrying out monetary policy, Golembe says, the Board cannot afford to antagonize legislators over regulatory issues. After detailing why he sees the Fed as historically slow to initiate regulatory change, Golembe goes on to discuss the likelihood of regulatory reorganization, specifically, whether "it might be time to reconsider the 1956 decision to centralize federal authority over bank holding company regulations in the Federal Reserve Board."

Consolidation of Federal Regulatory Agencies

George Mitchell
Former Vice Chairman
Board of Governors,
Federal Reserve System

George W. Mitchell is a consultant on electronic funds transfer systems to the Board of Governors of the Federal Reserve System. A former vice chairman and member of the Board of Governors, he was the Federal Reserve representative on the National Commission on Electronic Funds Transfers. Before joining the Board in 1961, he spent ten years as a vice president at the Federal Reserve Bank of Chicago.

Is the failure to consolidate regulatory agencies due to the fact that the case for a single regulator is weak, or that the opposition of the regulated and the regulator is strong? Mitchell analyzes the interests of the various parties and concludes that while both sides have some interest in maintaining the status quo, "inertia" is actually the major barrier. Mitchell points out that while depository regulations constrain, limit and prohibit various practices, they also "shelter and protect" the regulated institutions. These sheltering aspects of regulation have built "a constituency among the regulated for their regulator—the national banks for the Comptroller or the member banks for the Federal Reserve." On the other hand, Mitchell points out, regulators may become overzealous and concerned for their industry and place such concerns ahead of the public interest.

Creating a single agency, Mitchell argues, would not eliminate the conflicts inherent in the regulatory relationship. Moreover, competition between regulators "can also produce excellence in performance and establish precedents for adapting to changes in environment."

Changing Financial Institutions: A Governor's View

Nancy H. Teeters
Federal Reserve Board of Governors

Nancy H. Teeters has been a member of the Board of Governors of the Federal Reserve System since 1978. Before being appointed to the Board, Mrs. Teeters was an economist with the Board and for the President's Council of Economic Advisors. She has also served as an economist with the Bureau of the Budget. She was a senior fellow at the Brookings Institution, a senior specialist with the Library of Congress, and chief economist for the House Committee on the Budget.

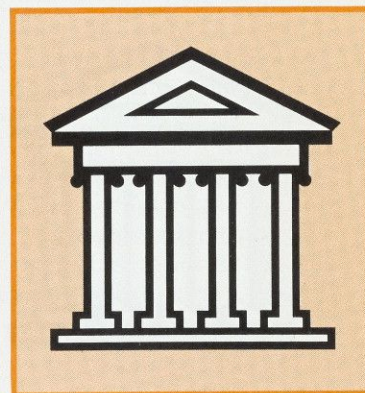
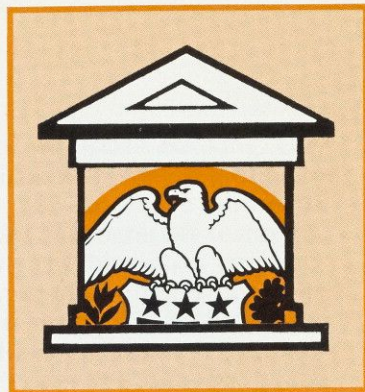
Governor Teeters presents an overview of recent developments affecting monetary policy. She suggests that there is "substantial potential for the emergence of problems in monetary control in the not too distant future."

"As these sessions illustrate," Governor Teeters says, "there has been a virtual explosion of financial innovation and change, an ongoing development that one must keep up on virtually daily in order to stay current. These economic innovations, of course, tend to benefit individual consumers of financial services. However, they also are altering significantly the public's demand for financial instruments. And a stable and predictable demand for monetary assets serves as an important basis to monetary policy."

With demands for new financial instruments in a state of flux, Governor Teeters finds "increasing uncertainty about the definition and interpretation of the monetary aggregates." No single self-evident and foolproof procedure exists on which to base monetary policy, she maintains.

None of this, however, means it is no longer possible to characterize or formulate monetary policy. "No one counseling monetary restraint to counter inflation," for example, "would argue that their advice is not being followed at the present time."

"Clearly," Governor Teeters concludes, "the most convincing and permanent solution...is to return inflation to very low levels. That is what the Federal Reserve's policy is designed to do, and it is our intention to continue such a policy until we see the results that we are seeking."



The Legislative Outlook

The Honorable Douglas Barnard (D-Ga.)

Congressman Barnard is a member of the House Committee on Banking, Finance, and Urban Affairs as well as of the Subcommittee on Financial Institutions. He worked for the Georgia Railroad Bank and Trust Co. in Augusta from 1948 until his election to Congress in 1976.

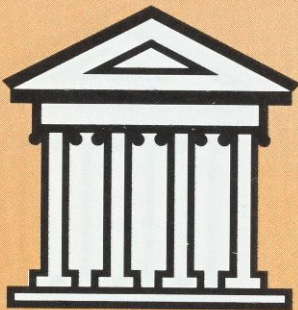
Congressman Barnard explores the current problems facing financial institutions and focuses on 'overregulation' as the most significant. He cites Reg Q, Glass-Steagall, McFadden, and Douglas as examples of regulations which "stifle competitive impulses."

Rep. Barnard advocates several actions Congress could take to remedy this overregulation, including "seriously and quickly reexamining Glass-Steagall and other restrictive legislation...to allow (financial institutions) to compete in an open market."

He also outlines current Congressional sentiment on several legislative proposals (help for thrift institutions, interstate banking, and wider powers for financial institutions).

Finally, the Congressman exhorts the financial industry to present a united front on legislative issues.

"Until there is a consensus among financial institutions on some of these problems," he says, "there will be no action possible in the Congress."



Interstate Banking

Guy W. Botts
Chairman of the Board
Barnett Banks of Florida

Since Guy Botts assumed leadership of Barnett Banks in 1973, Barnett has expanded from five to more than 145 Florida banking offices with combined assets of more than \$4 billion. A past president of the Association of Registered Bank Holding Companies, Botts is a director of the Federal Reserve Bank of Atlanta, chairman of the Corporate Planning Executive Committee of the American Bankers Association and a member of the ABA's Government Borrowing Committee.

A strong advocate of interstate banking, Guy Botts argues that U.S. banks have lost ground to international banks and domestic non-bank financial firms because of geographic restraints.

Rather than putting the blame on courts or regulatory agencies, however, Botts says "the trouble is that bankers simply will not look away from the banking industry to find their competitors." Botts acknowledges the benefits which the restrictions provide but argues that "as long as we devote our time and resources to protecting the perceived advantages we have in territorial franchises, we render ourselves incapable of facing ... the outside competition."

Botts goes on to make the case that not only is interstate banking necessary, but it should be "the essential first step" in getting banking "as deregulated as the competition."

International Banking

Peter Merrill
Peter Merrill Associates

Peter Merrill specializes in strategic planning for highly regulated industry. His recent research and consulting activities include three studies for the American Bankers Association on foreign ownership of U.S. banks, the future of U.S. banks abroad, and nonlocal expansion of U.S. banks; profit planning in consumer banking associations; strategic planning assistance to several state banking associations; and various research and consulting activities for the ABA in Federal Reserve pricing and reserve policy.

Merrill agrees with other panelists that there is "a fantastic potential global market for financial services," but argues that the present delivery system (branching) will have to change. As a result, the legislative initiatives will change. Merrill foresees heavy competitive pressure by U.S. banks to do a wide range of international business in the U.S. with domestically located devices.

Merrill also believes that "superior institutional technology" (Edge Act corporations, for example) will allow U.S. banks to get more business from large, foreign-owned corporations. He explains why and how he thinks use of Edge Acts will expand dramatically. Before significant legislative change can be achieved, Merrill says, the banking industry must focus on productivity. Bankers can thus show government officials and legislators that productivity improvement in the financial services industry is just as important as it is in the steel and automotive industries, Merrill says.

'De-intermediation': A Word for the '80s

Sanford Rose
American Banker

*Sanford Rose, writer and economic analyst with the **American Banker**, has special interests in finance, monetary policy, banking structure and performance, and international business. In addition to writing, he has been a speaker at numerous gatherings of bankers and financial executives. He was educated at the City College of New York, where he earned a B.A. degree and was elected to Phi Beta Kappa, and did graduate work at Columbia University. He is a former economist and editor for the Conference Board, associate editor and member of the Board of Editors of **Fortune** magazine, and vice president of Chase Manhattan Bank.*

"The brouhaha over interstate banking and other so-called burning issues," says Rose, "seems beside the point." Rose argues that after an initial wave of acquisitions, there will be "reconsideration and retrenchment." In fact, "many of the potential predators may shortly be giving serious consideration to abandoning their own bank charters."

"De-intermediation" is Rose's term for the "premeditated slowing of the rate of growth of bank footings" which arises as banks increasingly become funds brokers or matched maturity lenders.

As a result of this process, Rose says, "even if we lick inflation, structural changes in the form of savings may destroy the accustomed bank funding profit which is based on a positively sloped yield curve."

Rose describes the shape of the banking industry he sees for the future and concludes that banks need to prepare for a transition to "an entirely different *modus operandi*, one in which they will make as much or more profit on the flow of assets through their books as on the stock of assets on them."

Conference Summary

Peter Merrill
Peter Merrill Associates

What I will try to do is simply point out where we seemed most to agree, where we seemed most to disagree and where we might go from here, given time, energy and funding.

The incredible thing to me was that, despite the diversity of affiliation, there really weren't many conflicts over where the world is headed. Remember that the question being asked was, "what forces will shape the financial services industry of the future?" There was general agreement on what those forces were: inflation, regulation and deregulation, nonbank competition and technology. Everyone agreed that the new consumer was different from the old consumer. Everyone agreed, or at least no one disagreed, with Paul Horvitz's thesis that, if interstate branching were allowed tomorrow, it wouldn't be that big a deal.

My own bias is that the survivors in this game will be those that have a strategy, and that the strategy must be based on new and continued analysis of what consumers want. There is precious little of that information in banks at present. The beauty of the Merrill Lynch approach is that the strategy is embedded in the product. There is a definite strategy—give the consumer what he wants. The strategy is not technology-driven; it's consumer-driven.

This type of strategic thinking is not quite as evident in banking, however.

In Session II, "Banking as a Separate Product Line," the question to be addressed was, "Will banking continue to be looked upon as offering a separate product, distinct from the services offered by other types of financial service firms?"

George Kaufman, on the one hand, flatly asserted that "line of commerce is dead." This view was also supported by Peter Eisenmann, who I thought presented a sub-argument of this general thesis pretty persuasively.

At the other extreme, if there was one, it seemed to me that Bob Eisenbeis was saying there may be some need to revise line of commerce, but let's go slowly and be careful as we do it, particularly with regard to treating thrifts as banks.

Later we heard Guy Botts give his impassioned plea for interstate banking on a regional basis, based on the argument that a combination of nonbank competition and money center banks may decimate the industry rank and file, if such an interim policy is not adopted. I argued that, in addition to the U.S. national market being attractive to money center banks and nonbank competitors, it is also most attractive to foreign banks; legislative initiatives in the international banking field would most likely deal with ways to serve that market from domestic locations.

Carter Golembe, on the "powers" question, argued that:

1. Glass-Steagall and 4-C-8 are unduly restrictive;
2. Congressional intent was not to be as restrictive as 4-C-8 has since been interpreted;
3. The time is ripe for reform of these laws and regulations and
4. He is pessimistic about any of the national regulatory agencies taking the initiative.

In Session IV, Bob Eisenmenger explained the Fed's approach to pricing, the reasons for it and the likely results. He also predicted

some of the issues that would arise. George White argued that some of the proposed approaches to pricing may not be appropriate—charging the collecting bank and so on—and argued for eliminating the "Fed float subsidy." I'm sure he knows that there are some who would take issue with this. I've heard it referred to as a negative tax.

Finally, Sanford Rose presented a strong argument for banks becoming "brokers" of their assets, since the days of making a profit from predictable and stable interest rate spreads are over.

Now, summing up, where are we left by all this?

Points that we all agree on are:

- ☐ The markets are changing so fast that old concepts don't apply, and many old products are dead or dying.
- ☐ Since old products are dead, we need new products.

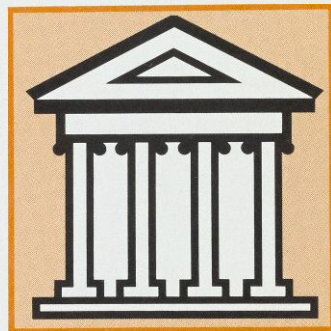
A point we somewhat agree on is:

- ☐ That some consolidation in the industry is needed.

Points that we still have significant disagreement on are:

- ☐ Whether interstate banking should be encouraged and why.
- ☐ Whether mergers and acquisitions across industry segments should be allowed.
- ☐ What solutions to the thrift crisis and housing crisis are appropriate.

BR



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