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## Economic Review

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## IRAs in the Southeast: A Laboratory for Deregulation ..... 4

The new Individual Retirement Account regulations allow, for the first time, unlimited competition for funds among depository institutions, insurance companies, and securities dealers. An Atlanta Fed survey provides an early indication of how the competition is taking shape and offers possible clues to future competitive patterns under deregulation.

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For retail bankers, competition that was nonexistent three years ago is now around every corner. What can commercial banks learn from other recently deregulated industries, and how painful is the deregulatory process likely to be?

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A two-day Atlanta conference on supply-side ecomics brought together leading economists, Reagan administration policymakers, and key congressional supply-side standard bearers. The result: lively sometimes impassioned—debate.

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The value of waterborne exports shipped from southeastern ports jumped from \$ five billion in 1970 to over \$ 30 billion in 1980. What caused the explosion, what kinds of products are sailing from southeastern ports, and what changes in national and regional exports can we expect in the 1980s?

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The 1981 Tax Act made major changes in the taxation of business income. How do these changes fit into the recent development of corporate tax policy, and how will they affect key industries in the Southeast?



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# IRAs in the Southeast: A Laboratory for Deregulation

The new, unregulated competition for individual retirement accounts presents a virtual "laboratory" situation for studying the possible effects of deregulation in the financial services industry. Results from an Atlanta Fed survey show that early competition was heated among depository institutions. Securities dealers and insurance companies are also unquestionably "in the game."

When individual retirement accounts with no interest limits became available to most workers in 1982, it presented a unique opportunity to study unregulated competition for funds among financial institutions. The new IRA regulations allow virtually unlimited competition for funds among depository institutions, insurance companies and securities dealers. How these competitors react in this unregulated market should give us clues about how they may compete as deregulation proceeds under the mandate of the Monetary Control Act.

In order to get an early line on IRA competition, the Federal Reserve Bank of Atlanta conducted a telephone survey of 121 financial institutions in the Sixth Federal Reserve District during the first two weeks of January. These institutions included commercial banks, savings and loan associations, credit unions, insurance companies and securities dealers.

Our results indicate that:

- 1. Most larger institutions and many smaller ones were offering rates competitive with rates on alternative investments.
- 2. Larger institutions of all types were offering higher rates and a broader selection of IRA plans.
- 3. In general, savings and loan associations were offering somewhat higher rates than other institutions.
- 4. Rates on the same type of account varied widely among offering institutions, even institutions of the same types.

- 5. Depository institutions, securities dealers and insurance companies offered similar rates.
- 6. Securities dealers generally offered greater investment flexibility in their IRAs.
- 7. Insurance companies and securities dealers commonly had service charges for IRAs while depository institutions generally did not.

## IRA's Aim: Stimulate Savings, Investment

The Economic Recovery Tax Act of 1981with its liberalized provisions for individual retirement accounts-addressed the need to boost savings to help finance corporate investment, provide a secure base of deposits for depository institutions, and ease pressure on the Social Security system by providing incentives for working people to save for retirement. First authorized in 1974, the individual retirement account (IRA) is a special savings plan that lets individuals defer federal income taxes on the money invested and the interest it earns until the money is withdrawn. Money deposited in an IRA cannot be withdrawn until the individual reaches age 591/2 except in the event he or she becomes totally disabled. If the money is withdrawn before then, a penalty equal to 10 percent of the amount withdrawn must be paid to the Internal Revenue Service. Additional penalties may be imposed by the financial institution where the money was invested.

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An early withdrawal will be subject to taxes at the regular rate.

Until this year, only individuals not covered by an employer's qualified plan or a government plan were allowed to establish IRAs. Beginning in 1982, anyone with earned income may establish an IRA, even if also covered by an employer's retirement plan. Banks, thrift institutions, credit unions, brokerage houses, mutual funds, and insurance companies may all offer IRA plans.

Another change in IRA laws provides additional incentive to individuals to save for their retirement by increasing the amount of deductible contributions that can be made each year to an IRA. Under the old law, contributions to an IRA were limited to the lesser of \$1,500 or 15 percent of earned income for an individual, \$3,000 or 15 percent of earned income if both husband and wife work, and \$1,750 or 15 percent of earned income for an individual with a nonworking spouse. Effective January 1, 1982, these limits were raised to the lesser of \$2,000 or 100 percent of earned income for an individual, \$4,000 or 100 percent of earned income for a husband and wife who both work, and \$2,250 or 100 percent of earned income for an individual with a non-working spouse.

So that depository and nondepository institutions may compete for IRA funds on a similar basis, banks, thrifts and credit unions have been authorized by the Depository Institutions Deregulation Committee to offer a certificate of deposit aimed specifically at IRAs. The new IRA certificate has a minimum maturity of 18 months and no interest rate ceiling. The rate is set by the individual institution and can be fixed or variable. The market for this certificate differs from most deposit markets in which commercial banks, savings and loan associations and credit unions compete because there are no regulations telling the institutions what interest rates to pay or how to structure the specific accounts. In addition, non-deposit financial institutions such as insurance companies and brokerage houses may also compete for IRAs with similar instruments.

The changes in IRA laws substantially increased the number of people eligible to open an IRA. The Treasury Department estimates 35 million full time workers were eligible for IRAs in 1980 before the new tax law took effect. Under the new law, an additional 40 to 50 million workers become eligible for IRAs. If each were to establish a \$2,000 IRA, between \$80 billion and \$100 billion would be available for IRAs each year. According to the Internal Revenue Service, 2.6 million 1980 tax returns had IRAs. This represents a participation rate of about 7.5 percent.

Studies show that financial savings increase as income rises. According to an Urban Institute study done in May 1981, participation in IRAs rose substantially as income increased. Eligible wage earners with income less than \$15,000 a year had a participation rate less than 8.0 percent. This rate rose to 52.4 percent, however, for eligible workers with yearly income more than \$50,000. According to the Department of Labor, in 1980 the median income for households covered under pension plans was 45 percent higher than the median income for all households. Therefore, these newly eligible investors are likely to have higher incomes than previously eligible IRA investors and to make more use of IRAs. If the participation rate is higher for the newly eligible, as it is expected to be, it would mean a substantial market for institutions that offer IRAs. At yearend 1980, investments and savings in IRAs amounted to \$18.4 billion. If only 10 percent of newly eligible investors open IRAs, it would mean as much as \$10 billion in new savings per year. If IRA participation follows the Canadian pattern of investment in a similar program, 12.4 percent of eligible investors would participate and new IRAs would equal about \$12.5 billion per year.1

In addition to providing savings incentives, the expanded IRA program may serve to shift the burden of retirement savings from social security to individuals. Uncertainties about the future of the Social Security Program may cause many workers to look for alternatives. In fact, reductions in social security benefits take effect this year for people retiring at age 65. IRAs will provide a way for working individuals to save for their own retirement and may help them adjust to further social security reforms.

## An Experiment In Unregulated Competition

In addition to being an attempt to raise savings (see Box) the new IRA has become an experiment in unregulated interest competition. The large new IRA market presents an attractive opportunity and a new challenge for the institutions

<sup>1</sup>Goldman Sachs Economic Research, December 1981.

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#### SAVINGS INCENTIVES

One important question that the new IRAs raise deals with the effectiveness of IRA savings incentives. It is important to know the overall impact of IRAs on the rate of savings in the U.S. economy. At one extreme, all new IRA funds might be new savings. If a \$12.5 billion per year IRA market comes into existence from new savings, the savings rate would rise by about .6%, adding 11 percent to savings out of disposable income. At the other extreme, new IRA investment could come entirely from other assets and represent no new savings.

We have little evidence on the effect of IRA savings incentives. Little time has passed since the new law took effect. Nationwide savings data is not available, and consumer surveys on such items as net new savings from any one incentive change are notoriously inaccurate. Further, IRA impacts on new savings may vary over time. Transfers from other liquid assets may occur early while new savings may be induced as other liquid assets are exhausted. Assessment of overall saving effects must await time series of well designed consumer surveys and econometric analysis.

that may offer them. How they compete in this unregulated market should give us clues about how they may compete as deregulation of deposit markets proceeds.

Our early January survey of 121 institutions sought information on IRA pricing and account characteristics from large and small depository institutions and from national and regional insurance companies and securities brokers. Firms were asked if they offered IRAs, how many plans they offered, and the features of each plan including its compounded rate, maturity, minimum balance and service charge.

For comparison purposes, we started by choosing 2 or 3 each of the five largest S&Ls and five largest commercial banks in each state of the District, as well as 2 or 3 each of the remaining commercial banks and S&Ls in each state. We chose two credit unions from each state: the largest and one at random. In all, we surveyed 80 depository institutions: 16 large commercial banks, 18 small commercial banks, 16 large S&Ls, 18 small S&Ls, 6 large credit unions and 6 smaller credit unions. We also surveyed 41 nondepository institutions: 9 national insurance companies, 12 regional

#### Table 1. Institutions Offering IRAs

Type of Institution	Number Surveyed	Number Offering IRAs		
Commercial bank		Contraction of the second		
Large	16	16		
Small	18	11		
Savings and loan assn.				
Large	16	16		
Small	18	16		
Credit Union				
Large	6	5		
Small	6	1		
Insurance Co.				
National	9	9		
Pagional	12	5		
Regional Charle brokers				
Netional	8	8		
National	12	9		
Regional	12			

insurance companies, 8 national securities dealers and 12 regional securities dealers.

Because rates paid on an account are not the only factor for attracting a potential customer, we asked about other items which might also tend to be persuading points: the maturity of the deposit, whether the rate was variable or fixed for the maturation of the certificate, how the rate was determined, and what the minimum denomination for the account was to be.

The larger institutions began the year with IRA programs. All of the large banks and savings and loan associations—each among the three largest in its state—and all but one of the large credit unions offered at least one sort of IRA. Most offered more than one plan; one bank offered six plans. All of the national insurance and brokerage firms also offered IRAs. Most offered several plans.

Smaller depository institutions were somewhat less aggressive. Fewer offered IRAs and those that did offer IRAs had fewer plans. Most of these institutions were in nonmetropolitan areas and had fewer competitors than the larger institutions in the District's metropolitan areas. Of the 18 small commercial banks surveyed, only 11 had IRA plans in service. Sixteen of eighteen small S&Ls offered IRAs, but generally restricted their services to only one plan. Only one smaller credit union and five of the regional insurance companies offered an IRA plan (Table 1).

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## Table 2. Interest Rates Paid on IRAs 18-Month Maturity

	Va	Variable Rate			Fixed Rate			
	High	Low	Median	High	Low	Median		
Small Commercial Banks	13.54	11.52	13.07	15.00	12.55	12.75		
Large Commercial Banks	16.76	12.28	13.35	16.17	12.50	13.88		
Small S&Ls	14.51	11.68	12.72	15.25	12.00	14.00		
Large S&Ls	16.65	11.91	13.54	15.02	12.75	14.45		

### FEATURES OF THE PLANS

#### Banks and Savings and Loans

The most popular plan among all the institutions was the 18-month variable rate IRA. At least 90 percent of all commercial banks and large S&Ls, and a little over half the small S&Ls, offered such a plan. In addition, about half the institutions offered a fixed-rate 18-month certificate.

A wide variety of methods was used by all institutions to determine their rates on variable rate plans. The most common methods for setting rates, though, were 1) paying the same rate paid on either the 6-month money market certificate or the 30-month small savers certificate, 2) paying a rate determined by some derivation of Treasury bill rates, 3) paying rates decided upon arbitrarily by management based on other short-term market rates, and 4) paying a rate determined by some derivation on the yield of certain money market funds.

These rates varied as widely as the methods used in determining them. Again, large institutions appeared to be the front runners, paying consistently higher rates. These large institutions were generally located in metropolitan areas where competition was greatly increased, thereby forcing rates higher in order to attract customers (Table 2).

Just as the larger institutions offered more plans, they offered higher rates than the smaller ones. The median rate paid by the large banks on an 18 month flexible rate IRA was .28 percent above that paid by the small banks. The large banks' median rate on an 18 month fixed rate IRA was 1.13 percent above the median paid by small banks. A similar pattern was established for savings and loan associations. Comparison of

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bank rates with those paid by savings and loans indicated that generally savings and loans paid more. This is consistent with the idea that the market requires a differential payment from savings and loans for deposits.

Another choice that institutions had to make in offering a profitable, but competitive, IRA was the frequency of changes in the rate. Frequent changes mean more administrative costs for the institutions, a greater risk of increasing costs of funds during rising interest rates, and a quick means of lowering the cost of funds during declining interest rates. For competitive purposes, customers would benefit from less frequent changes on the downside of the interest rate cycle and from more frequent changes on the upside. Most institutions set the rates monthly. Large commercial banks were more aggressive and generally settled on a weekly change in their variable rate IRA (Table 3).

Two other fixed-rate alternatives were commonly offered by the institutions to their IRA customers. Since the six-month money market certificate and the 30-month small savers certificate were already popular market-rate deposit instruments, many institutions offered these certificates as IRAs for their customers. The large banks particularly offered these types of plans most often.

The IRA money market certificate operated identically to the regular money certificate traditionally offered by depository institutions. This instrument was made available to pre-1982 IRA participants who could transfer existing IRA funds into the new certificate since by law the minimum denomination is \$10,000. All institutions offering such a plan paid the highest rate allowed by law at the time, 12.532 percent.

Table 3. Fr	equen 18-M	onth \	Rate C /ariable	hange e Rate	IRA P	lans
	Daily	Wkly	2 Wks.	Mthly	Qrtly.	Semi- Annually
Large						
Com. Banks Small	0	47%	0	27%	20%	7
Com. Banks	0	22%	0	44%	33%	0
Large S&Ls	7%	29%	7%	50%	7%	0
Small S&Ls	0	33%	0	56%	11%	0

The 30-month IRA was another popular plan. The rates paid on the 30-month plan were closely tied to the maximum legal limit set for small savers certificates. However, some of the commercial banks paid much lower rates than others did on their 30-month plan (Chart 1).

Other plans which did not fall into these 3 categories were either multi-year maturities at a fixed rate or open accounts with no maturity which could be used to accumulate enough funds to eventually invest in a time certificate. The longest maturity offered was an 8-year IRA paying 14.57 percent in early January.

Unlike the brokers and insurance companies, depository institutions have shied away from establishment and maintenance fees. These fees showed up rarely in the survey, with one small savings and loan charging \$10 to set up an account and one large S&L charging \$25. Maintenance fees ranged from \$5-\$50 per year, but only 5 percent of all IRA plans had maintenance fees.

Some institutions required a large minimum initial deposit to offset administrative costs in setting up the IRA. But most kept the requirements fairly low to attract small savers. The variable rate deposit had a minimum denomination of \$100 in most cases. Small banks generally kept theirs lower, at \$50. The fixed rate 18-month IRAs also had a \$100 minimum at large institutions, but the smaller instituions required a higher minimum of \$500. The 2½ year fixed rate IRAs generally held to a minimum of \$500 across all institutions. One bank required a \$5000 minimum on the 2½ year IRA in early January, but quickly dropped it to \$1,000 as potential customers were discouraged by the higher minimum (Table 4).



The large savings and loans were the only group to heavily engage in luring IRA customers with premiums. Six out of sixteen associations offered something of value, ranging from S&H Green Stamps to a free checking account.

Insurance companies and brokers were actively seeking out employers who were considering a payroll-deduction IRA plan for their workers. But this is a new area for bank marketing strategists. The large banks in our survey were the most heavily involved in establishing payroll-deduction plans. Eighty-eight percent of the large banks and 64 percent of small banks had either established a plan for employers or planned to announce one soon. Fifty percent of large S&Ls were doing the same, while only 12.5 percent of small S&Ls had shown interest. The most common arrangement for the banks and S&Ls was to offer one or a choice of their already established plans with a smaller minimum denomination and minimum deposit per person.

## **Credit Unions**

Of the six large credit unions surveyed, five were offering some sort of IRA plan: one offered a variable rate plan only, two offered a fixed rate plan only, and two offered both a fixed and variable rate plan. The one large credit union not offering an IRA plan stated that it was in the process of establishing such a plan.

Of the plans offered, there were six fixed rate plans. The average (mean) rate of return on these

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#### Table 4. Minimum Denomination

	19 10 <u></u>	18-Month IRAs						30-Month IRAs		
	Variable Rate			Fixed Rate			Fixed Rate			
	High	Low	Median	High	Low	Median	High	Low	Median	
Small Commercial Banks	2000	0	50	1000	250	500	1000	500	500	
Large Commercial Banks	250	0	100	1000	0	100	1000	100	500	
Small S&Ls	500	25	100	1000	50	500	1000	100	500	
Large S&Ls	500	10	100	250	0	100	5000	100	500	

was 11.95 percent (the median–13.02 percent). These plans required an average minimum denomination of \$506.66 (the median—\$262.50). Three variable rate plans were offered, with the average rate of return being 13.83 percent (median— 14.03 percent) and the average minimum denomination being \$500 (median—\$500).

Of the six small credit unions called, only one offered any IRA programs, three stated they would offer in the near future and two had no immediate plans for an IRA program. The one that did offer a program offered three plans, all at a fixed rate of interest. The rates of interest were 9.30, 10.38 and 11.99 percent with minimum denominations of \$0, \$500 and \$2000, respectively.

## **Insurance** Companies

The survey indicated that depository institutions are going to get stiff competition from national insurance and securities firms, at least. All of these national firms surveyed offered IRAs. Insurance companies surveyed included 9 national firms and 12 regional firms. Well before the Economic Recovery Act of 1981, the large insurance companies had inherent in their system established retirement plans and, as January 1, 1982 rolled around, already had the fundamental structure to set up a qualified IRA program. Of the smaller insurance companies contacted, less than half reported that they had an IRA program in effect. Those that offered a program, had one similar, if not identical, to the national firms. The basic IRA program described by most companies, an annuity type plan, differed very little from the standard annuity plans that the companies have been offering for a number of years.

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Two basic variations of the annuity plan were described by the insurance companies, the flexible load annuity and the no-load annuity. As far as the structure of the annuity was concerned, both options were similar: the annuity, or annuitization, was defined to be an insurance contract that required payments over a period of time. As the contract reaches maturity, the owner of the annuity has the choice of how he wants to withdraw the money, either in a lump sum (which would be subject to severe taxation) or in any installment plan that he and the insurance company agree upon.

The two options seemed to differ in only two areas, rates of return and fees (or penalties). The flexible load annuity tended to offer a slightly higher rate of return on the principle, but fees and possible penalties were attached to the front end of the payments. For example, one firm offered a flexible load annuity in which there was an annual fee of \$25 throughout the life of the annuity plus a charge of 8 per cent of each payment into the annuity for the first four years of the plan; there were no explicit penalties for withdrawing from the annuity prematurely (other than those prescribed by law). The no-load annuity offered a slightly lower rate of return than the flexible load annuity, but there were no service charges or administrative fees. However, there was a penalty for withdrawing from the plan prematurely; the penalty was a gradually downgrading percentage that faded out over a period of time. For example, one firm offered a no-load plan with no administrative costs to pay, but there were penalties for withdrawing: 10 percent of the principal for withdrawing in the first year, 9 percent for withdrawing in the second year, 8 percent in the third year, and so

"The survey indicated that depository institutions are going to get stiff competition from national insurance and securities firms."

forth until there was no penalty for withdrawing in the eleventh year.

It should be noted that a number of the companies fell into a category somewhere in between the two mentioned above, where there was a slight administrative fee, but the downgraded penalty system was not quite as lengthy (five years downgraded instead of ten, for example). Some firms required an initial establishment fee, then followed the basic structure of the no-load plan. Other firms claimed to fall into one plan or the other, but described as part of their plan characteristics of both.

Smaller insurance companies were not so quick to get into the IRA business. Only 5 of 12 of the regional firms we contacted offered IRAs; each had one annuity plan. Three were flexible load plans; two were no-load plans.

The rates that the large insurance companies were offering on the annuities fell somewhere between 13 and 15 percent, with the flexible loads bringing in perhaps .5 to 1 percent higher than the no-loads, on the average. The regional companies tended to offer somewhere between 11 and 12 percent. The rates quoted were, for the most part, variable rates, usually changing once a year. Some firms stated that they were required by state law (Florida law) to hold the rate fixed for at least 6 months. Every firm guaranteed a base rate of at least 3 to 4 percent throughout the life of the annuity.

Most companies described a "disability rider" that would be attached to each contract. Quoted as being the "selling factor" by one firm, the disability rider guarantees that, in case of disability (and some firms included death), the average payment of the annuity holder would be continued by the insurance company until the holder, or his benefactor, reaches the age of retirement.

Most of the insurance companies contacted could handle payroll deduction IRAs, but only a small number of those actually had a program in action. Generally, the insurance company would use the same program available to any individual for payroll deduction, although a couple of firms stated that they would customize a plan for a business. Under most plans, the employer would be responsible for the bulk of the administrative work such as collecting and sending the money, as well as sending a breakdown sheet of individual contributions to the insurance company. The insurance company would charge a flat fee for maintenance of the annuities to the employer; the employer could then decide whether or not to pass on the cost to the employee. Some firms suggested that it would be beneficial, in terms of employee relations, for the company to absorb the cost itself.

## **Securities Firms**

We contacted eight national securities firms in the survey and each one was ready to compete for the funds that were expected to come to market in January, 1982. From the eight firms came three distinct types of programs for investing funds with respect to the new IRA regulations. These programs were either a self-directed investment plan, a plan that invests the customer's money in various types of mutual funds, or in a plan that places funds in a money market fund. Most firms, if they offered more than one of these plans, provided the option of moving funds freely between them, dividing funds between them or simply concentrating their money on one.

Of the eight firms, six offered a self-directed investment plan. The customer can direct his funds into any type investment that the brokerage house deals in and that is not prohibited by law. Most of the establishment and maintenance fees were fairly uniform throughout the six firms, with establishment fees falling between \$20 and \$25 and maintenance fees falling between \$20 and \$35 per year. Initial deposits to the account varied greatly, however, with three firms requiring no minimum, one requiring only \$100, and the

"The large potential market for IRAs attracted most of the large financial institutions in the region and a substantial proportion of the small ones."

other two requiring \$1,500 and \$2,000, respectively; none of the six set a minimum additional deposit. When it comes time to move funds from one stock to another, two firms require no transaction fee, while the other four levy some type of commission on the sum moved.

Five of the firms also offered custodial type accounts. One of these offered two accounts which had different minimum deposits and service charges. Establishment fees varied from a maximum of \$25 to no fee at all. Maintenance fees varied as much, ranging from \$2.50 per year to \$30 plus 1.3 percent per year. Minimum initial deposits ranged the entire spectrum, from a maximum of \$2,000 to no set amount at all. Only one firm required a set additional minimum deposit , and that was set at \$10. Two firms do not levy any sort of explicit termination fee when the investment is pulled, but the other three penalize the cancellation in some way.

The mutual funds offered the customer several directions in which a customer could invest his money. Key areas were short term investments, capital investments, and bond and securities investments. The short term investments are those that concentrate on maximum current income in one or several money market instruments. The capital investments concentrate in common stocks of companies seeking long-term capital growth and appreciation; current income in these is of secondary importance. Bond and securities investments seek maximum current income by concentrating on government and corporate bonds and securities. These are three very general groups; individual firms break down and consolidate these as they deem marketable. Most firms allow freedom of movement between these groups as the customer desires.

Four of the firms offered their own money market funds. These varied with the individual firm, with only one charging an establishment fee (\$5) and the maintenance fee for all ranging around the \$2 mark. Two firms required a minimum deposit of \$250 and \$300, respectively, to initiate the account, while the other two left it open. Additional deposit requirements ranged from an open amount up to \$100. The money market funds was the only group that guaranteed any sort of return, and this was a variable rate, with the rates howing around the 12 to 13 percent mark in early January.

Of the eight firms, six replied that they would participate in a payroll deduction IRA program if given the chance. Five said they would use the same plans already set up within their organizations, probably making available only the mutual funds program. One firm, however, said that they would work with the company to set up a program suitable for all involved.

The small securities dealers were a special group in that each of those surveyed tended to be highly specialized. Because of the competitive market they were in, as well as factors relating to limitations of size, these local or regional brokers dealt mainly in one type of investment. Such investments included agricultural commodities, local utilities, etc. It was very difficult, quantitatively or qualitatively, to analyze any endeavors that they were undertaking in the newly opened market for IRA customers. Nine of the 12 smaller firms were offering IRAs but, upon further questioning, we discovered that each plan offered was not unique to the individual firm. Generally speaking, these firms acted as an intermediary between their customers and larger national brokerage houses, or nationally marketed mutual funds. They themselves were not responsible for the management of the IRA funds. They simply advised customers on an array of what was being offered and then received a fee from the company actually handling the IRA funds.

#### A Summary of Survey Results

Our survey indicated that the large potential market for IRAs attracted most of the large financial institutions in the region and a substantial

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Digitized for FRASER http://fraser.stlouisfed.org/ Federal Reserve Bank of St. Louis proportion of the small ones. Generally, the larger institutions offered market rates for the IRA funds while the smaller ones offered somewhat lower rates. Rates paid, particularly by larger institutions competing in metropolitan areas, were competitive with similar rates being offered in the market. There seemed to be little or no discount for the tax exempt status of the IRA similar to the discount usually seen in the tax-exempt securities markets. This finding may be explained by the recent decline in the spread between yields on tax-exempt securities and Treasury securities. It may also result from issuing institutions' desire to attract IRA customers who establish a long-term relationship with the issuer when they establish the IRA. Market rates should offer savers a considerable incentive to use IRAs.

Our study indicates that savings and loan associations paid higher interest rates than banks. In large institutions the median differential between thrifts and banks on 18-month flexible rate accounts was .19 percent—close to the .25 percent differential commonly found in deposit rate regulation. However, on other accounts the differential was considerly higher.

We found a large variation in rates within each institutional type. Though the median rate was an approximation of market rates, rates within institutional types varied by as much as 3.67 percentage points between high and low rates on 18 month fixed rate accounts at large commercial banks and 4.74 percentage points on 18 month variable rate accounts at large S&Ls. One would expect such price variations to diminish over time, particularly since we have found region-wide offerings of IRAs at uniform rates by competing insurance companies and securities dealers. The early variation may well be a result of inexperience in pricing of consumer accounts by depository institutions. Rates offered by large insurance companies were generally similar to those on fixed maturity IRAs offered by banks and savings and loan associations. Half of the large insurance companies' plans and all but one of the large securities dealers' plans carried annual maintenance charges. Only a small proportion of the plans offered by banks and savings and loans carried maintenance fees. The security dealers' plans, on the other hand, generally offered a choice among investment vehicles at one institution.

Our survey indicates that, when rates are not limited, depository institutions have offered an approximation of market interest rates on time deposits. Nondeposit institutions competing for the same funds have also been close to market rates. Each institution structured its plan or plans somewhat differently, and each type of institution used its own powers to differentiate its offering. As interest rate ceilings are removed over the next 31/2 years, depository institutions will be faced with more and more situations like this one-unregulated interest rates and the opportunity to go head-to-head with previously unregulated competitors. Their behavior in the IRA situations indicates that these newly deregulated institutions will be strongly influenced by their market.

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# Challenges for Retail Banking in the 80s

Deregulation may be a difficult process for some banks, but continuation of the regulatory status quo might be even more difficult. Bankers can learn from trucking and airline deregulation that creativity and ingenuity are the keys to survival.

Twenty years ago, the financial services industry comprised several sectors, all neatly packaged and all concentrating on their own specialized functions.

Commercial banks dominated the commercial and retail market in the traditional checking, saving, and lending functions. Savings and loans played the dominant role in making mortgages, offering a premium for savings deposits. Insurance companies were limited to providing insurance and taking in "time deposits" in the form of annuities. Retailers were the major providers of credit cards, while securities dealers limited themselves to investments in stocks and bonds.

Today, by crossing over into non-traditional financial fields, those non-bank industries have come to offer a wide array of financial services; some have become real financial supermarkets. For example, Sears Roebuck was once known exclusively as a department store retailer. By acquiring various financial firms, it now has diversified to offer checking, saving, time deposits, installment loans, business loans, mortgage loans, credit cards, insurance, stocks, bonds, mutual funds and real estate. Even more threatening to commercial banks is that many of Sears' operations can handle business without regard for state boundaries. Recently Sears' chairman vowed "to have a bank at every outlet."

Chart 1 shows how those institutions involved in financial services have evolved over time. Most institutions were very limited in their offerings 20 years ago. But today, a few firms in each financial service sector offer a wide array of

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"products." The depository institutions, i.e., banks, mutual savings banks and S&Ls, are obviously limited by regulations in what they can offer. Creative managers, however, are dabbling in these areas. For example, banks have teamed up with money market funds to provide cash management for consumers in the form of deposit sweeps.

### The Lure of Banking

The profitability and stability of commercial banks is the lure attracting other financial service companies into the banking business. Commercial banks' after-tax earnings rose an average 19 percent a year during each of the last five years (Chart 2). And return on assets (ROA) is much more stable than those of other financial service competitors. The ROA of New York Stock Exchange member firms ranged from a negative return in the mid-1970s recession to 31/2 percent as the recovery from that recession began; commercial banks' ROA hovered around 1 percent for the entire decade. The S&Ls have been burned by the high levels of interest they must pay on deposits while carrying low-yielding mortgages in their portfolios. Their return on assets dropped near zero in 1980, and many institutions lost money in 1981. Life insurance companies have seen their potential for earnings erode as customers have terminated policies to invest in higher yielding alternatives. The percentage of policies voluntarily terminated rose from 5.8 percent to 8.1 percent in the last 10 years.



Such problems have prompted the various financial service providers to look for ways to raid traditional banking markets by introducing new services that meet customers' needs. Money market funds have been the most visible and aggressive suppliers of new consumer services. Only four years ago, the funds were practically non-existent; they could claim a mere one percent of all interest-bearing deposits when compared with commercial banks and thrift institutions. The funds saw an opportunity in the retail market as interest rates remained at high levels and individuals increasingly put their money in Treasury securities. During the 1970s, individuals' holdings of Treasury securities increased from 13 percent to 20 percent of all holdings. The money market funds provided an easy access for all investors to the higher yields of government securities, large CDs, and other money market instruments. Today, money market funds hold 10 percent of deposits. They have evolved basically at the expense of the thrifts, whose share of deposits dropped from 50 percent to 41 percentwhile commercial banks' share held steady at 49 percent (Chart 3).

Money market funds are only one example of the success of non-traditional banking firms now competing for banking business. Today, insurance companies, retailers, and securities dealers all are offering a full product line of financial services; while commercial banks are in the same business they were 20 years ago. Even that market is slipping away to other suppliers of funds, competitors with a freedom to innovate.



Competition that was nonexistent three years ago is around every corner. An unlikely competitor is Gulf and Western, a \$5.9 billion conglomerate best known for movies such as "Raiders of the Lost Ark," "Reds," and "Ragtime." It acquired Fidelity National Bank, a commercial bank in California. after that bank had sold off its commercial loan portfolio to meet legal requirements. That portfolio sale moved Fidelity National beyond the legal definition of a bank. Gulf and Western owns a commercial loan company, several factoring companies and an insurance company. In essence, the conglomerate looks like a bank, as the basic deposit taking and lending functions are done by separate subsidiaries of the company. Household International, formerly known as Household Finance Company—HFC—used the same strategy in purchasing Valley National Bank of California and divesting its commercial loan portfolio. Even RCA, a \$7.9 billion entertainment giant, has taken the plunge into financial services by acquiring C.I.T. financial corporation.

The direct onslaught from such outsiders as Merrill Lynch and Sears has brought the issue of the financial services evolution to a head. Compare the funds Merrill Lynch has under management in the Ready Asset Trust and Cash Management Account to commercial bank deposits. Merrill Lynch ranks as the 5th largest bank in the United States, with \$41 billion under management. Sears places 20th in financial assets, not including its insurance business or its recent acquisition of the real estate firm Coldwell Banker or the Dean Witter Reynolds securities firm.

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## The Lessons of Deregulation

Bankers have found it difficult to deal with the flood of new competitors because banking regulations restrict the services that depository institutions can offer and the prices they can charge. It may well be that deregulation of the industry is necessary if commercial banks are to keep up with their competitors. Yet deregulation will not be without pitfalls. The recent experience of the trucking and airline industries operating in a less restrictive regulatory environment has been mixed. Some companies have fared better under deregulation—but some have fared much worse.

Generally, the firms that have succeeded under deregulation are those that have been able to seek out the market, trim operations, and offer the right products. And those that could not adapt have not done so well.

For example, two trucking giants—Roadway and Yellow Freight—have been affected in opposite ways by deregulation. The deregulation of truckers allowed small independent owner-operators to step into the market and offer full truckload service at a lower price than the large national carriers can afford to charge. The independents, however, cannot effectively compete in the less-than-truckload (LTL) business since they have no access to a network of terminals for distribution. The larger carriers have been forced to move into the LTL market as the independents ran away with their truckload business. Roadway has always concentrated on the LTL market and

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was prepared for deregulation. Yellow Freight, on the other hand, was hit hard by the loss of its truckload business. Discounted prices have increased the ailing firm's share of the LTL market, but not without a drastic reduction in earnings.

Roadway's revenues of \$1.1 billion in 1981 produced a profit margin of 6.4 percent, which is higher than in the previous two years. Yellow Freight's revenues of \$936 million resulted in a margin of only 1.8 percent. The firm's return on net worth, at 8 percent, was less than half of Roadway's 18 percent.

In the airline industry, deregulation has placed a premium on being a low-cost deliverer of a service. Scheduled air transportation has basically become a commodity as the traditional differences between the full-service and no-frills approaches are meaningless to the cost-conscious traveling public. When deregulation went into effect several years ago, the major airlines abandoned many of their short-haul, money losing routes. That service became a mainstay for many of the regionals. USAir (formerly Allegheny), once a regional airline in the Northeast, has taken its nofrills, low cost reputation and expanded into a widespread national carrier. Expansion has been carefully planned and controlled. The airline also benefits from the commuter network it has established which feeds passengers from lowdensity stops into the USAir system. The commuter lines have access to USAir's reservation service, through baggage-checking and discount fares. The airline found a profitable niche in the industry which was practically being ignored and built a strong business on it.

On the other hand, Braniff set out to meet deregulation and competition head on, but its strategy backfired. The airline stretched its route system by 50 percent within 2 months after the deregulation act was passed. While the firm had a strong financial and operational foundation, the pace of expansion was too fast in the midst of a weakening economy and rising fuel costs. After a massive failure of the expansion plan, Braniff is cutting back and taking its losses. The airline took in over \$1 billion in revenues in 1981, but posted an operating loss for the year. USAir, on the other hand, took in over \$1.1 billion and earned 4.6 percent on those revenues.

In both trucking and airline deregulation, the firms that anticipated the profitable markets and countered price competition with new operations strategies excelled. Those that merely moved into the new pricing structure without adjusting

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their product or their operations had difficulty maintaining old profit margins.

Likewise, commercial banks seem likely to suffer some grief under deregulation in the next few years as interest margins narrow and competitors close in. In 1970, time and savings deposits accounted for 48 percent of commercial bank deposits, while non-interest bearing demand deposits made up a larger share—52 percent. Today, bankers must pay interest on 72 percent of their deposits, and these interest bearing time and savings deposits are shifting from lower paying passbook accounts into higher yielding certificates (Chart 4).

#### Preparing for Rapid Change

While deregulation may be a painful process for some banks which are not prepared for the change, the regulatory status quo would be even more painful for all banks. If deregulation does not occur within legislative guidelines, it will continue to occur through the market. This market deregulation of financial services, which has been occurring during the past several years, threatens the future survival of even the most profitable banks. Unless banks are allowed to compete for deposits at market rates of interest, they will continue to have difficulty in attracting funds. Once the new pricing demands are understood, they can adjust their operations to profitably accommodate higher interest expense.

To keep tabs on the banking industry's health in our region, the Federal Reserve Bank of Atlanta developed a Southeast Model Bank by averaging the financial statements of seven of the region's largest holding companies. Over the past three years, the Southeast Model Bank's deposits shifted from low-paying passbook accounts to money market certificates beginning in 1978 and from checking accounts into NOW accounts in 1981. Cost of funds rose sharply, narrowing the interest spread from 3.09 percent in 1979 to 2.74 percent in 1981 (Chart 5).

As the spread narrowed, non-interest expense grew rapidly. The investment in brick and mortar branching in the late 1970s was a high price to pay; net non-interest expense rose from 2.48 percent of assets to 2.68 percent. The increase in net expense was less in 1981 than in previous years as new fees imposed on services began to offset the cost of facilities expansion (Chart 6).

Rising noninterest expense may well be a symptom of long-term problems for banks. Other financial service providers are much less committed to bricks and mortar than banks. The money market funds, for example, are one office operations. New communications technologies and explicit pricing of services (rather than emphasis on personal contact) also threaten to make branches obsolete.

At some point, commercial bankers must realize that expansion in bricks and mortar is not the wave of the future. The industry's market areas are already saturated with financial service locations. If we include commercial banks, mutual savings banks, S&Ls, credit unions, and securities dealers, we come up with 107,000 financial offices throughout the U.S. But are these all of the participants on the financial services playing field?

In 1960, only commercial banks, mutual savings banks, S&Ls and credit unions offered traditional banking services. Their offices numbered 55,000 and any one location served an average of 3,300 people. Yet today, the outlets don't end with those 107,000 offices mentioned earlier. For a more accurate count, we must add to that 25,000 automatic teller machines as well as 14,000 life insurance offices, which are competing for depositors' funds particularly in retirement accounts. That gives us 151,000 outlets, or one location for every 1,500 people.

This market saturation makes it difficult for banks to operate in the traditional sense. While battling the new competition, banks will also face the challenges of new technology, more sophisticated customer needs and desires, and,

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of course, price deregulation. Banks are likely to respond in a variety of ways. We have analyzed four possible responses to these banking challenges—(1) Electronic banking (2) Boutique or Specialty banking (3) Investment orientation and (4) Financial supermarket—of which banks may choose one or a combination.

#### **Electronic Banking**

Banks which see the declining profitability in adding to their brick and mortar branch networks have already begun large campaigns to install automatic teller machines. Our earlier definition of the 151,000 financial service locations included 25,000 ATMs.

The trend today is toward in-home banking. It is not clear yet what method of delivery for inhome services will ultimately be accepted. Some banks are offering services through two-way cable television hookups.

There are already 55,000 interactive cable TV hookups in the nation with the potential to provide banking services. With the understanding that cable television would provide only limited access to financial services, adding cable TV to the list of financial service locations brings the number to 206,000—or one limited access location for only about 1,100 people.

The second means of delivering in-home banking services is through telephone access. Two million personal computers are already in home use, and the number is increasing at a rate of



more than 500,000 a year. It is both simple and inexpensive for a personal computer to connect by modem with a host computer through local telephone numbers. If we put our imaginations to work, we can picture the industry in the year 2000, when most financial services will be electronic and accessible through a home computer via telephone or some other means of telephone transfer system. Then we will have one limited access financial service location—a telephone for every 1½ people. It may seem futuristic, but it is easy to see where retail banking could be heading. (Chart 7).

The deposit-taking and lending functions of an electronics-oriented retail bank would remain intact, but they would be done as a mass production effort. The high degree of personal contact through the branch network would become less important as customers utilize the "self-service" functions of the bank.

How quickly will consumers accept electronic banking? As with most trends, demographics will play a large role in determining the speed and ease of acceptance. Clearly, consumer surveys have demonstrated that the acceptance of ATMs is much higher among the younger population than the older age groups. As today's youthful population grows older, the demand for innovation in financial services seems certain to grow. Tomorrow's financial consumer will represent a generation familiar with electronics, a consumer who will demand both greater convenience and efficient flows of money.

Our nation's aging population will create addi-

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tional opportunities for retail bankers in this brave new world of the future. Consider that the average income of a full-time worker peaks between age 45 and 54. Over the next 10 to 20 years, the bulk of our maturing population will be moving up on the income curve, advancing into what we might call the "sweet" part of the earning years. They will be not only more prosperous, but they will be more sophisticated users of financial services. They will have a better understanding of electronic technology. And they will demand financial services that save time.

### **Boutique or Specialty Banking**

As "self-service" banking becomes more prevalent, there will still be the need to personalize services for many customers. Some banks will choose to specialize in personalized consumer services and others in commercial services. "Boutique" banks are likely to cater to the higherincome retail customer and develop individual packages which meet his needs.

While boutique banking caters to the retail customer, specialty banking is aimed at serving a defined market of business clients. There will always be a demand for loan origination which can be handled very ably by commercial banks.

#### **Investment Orientation**

Some banks may choose to transform their institutional structure by performing more like

an investment company. Instead of accepting deposits from consumers and lending to an array of customers, the bank could buy deposits and package brokered assets. This strategy would be similar to the route some savings and loan associations have taken in restructuring their operations to become more like mortgage bankers.

Essentially, all categories of the traditional bank balance sheet could be replaced with pooled assets and liabilities without involving the very costly transaction of processing and maintaining a small loan or deposit.

#### **Commercial Bank** Traditional Acting As **Commercial Bank Investment Function** Assets Cash Cash Securities Securities **Commercial Loans Commercial Loan Participations** Consumer Loans Credit Cards, Indirect Loans **Real Estate Loans** Pooled Mortgages-GNMA, FNMA Premises & Equipment Premises & Equipment **Liabilities & Equity** Demand Deposits **NOW Accounts Passbook Savings Purchased Time Deposits** Money Market Certificates (CDs greater than \$100,000) CDs less than \$100,000 CDs greater than \$100,000 Debt Debt Equity Equity

By substituting purchased deposits and pooled lending for the retail function, the commercial bank can operate more efficiently. One reason Merrill Lynch has been able to successfully diversify its financial operation is its low cost of doing business. Merrill Lynch is able to manage more funds with fewer employees than can a typical commercial bank.

Merrill Lynch employees involved with money market funds sales and operational and administrative support are responsible for an average \$4.14 million each. The commercial bank, as reflected in our Southeast Model Bank, is far more labor intensive; the Model Bank's deposits total a comparatively modest \$500,000 plus per employee.

#### **Financial Supermarket**

Some banks will choose to segment the market by concentrating entirely on in-home banking, boutique or specialty banking, or investment banking, Many institutions will find it profitable to

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merge with others and form large and diverse "financial supermarkets."

This term, "financial supermarket," has been tossed around loosely in the past year. The idea is one-stop shopping for financial services.

We can get some idea of the magnitude of change when an industry consolidates around the "supermarket" idea by looking at the evolution of the retail food store industry. Retail food distribution is similar to retail banking in several ways. Both services have traditionally been labor intensive. Operations of both are highly adaptable to computer technology. Both are sensitive to location and availability. Both offer generically homogeneous products. Indeed, the two industries differ in certain respects. Food must be physically delivered, requiring customers to go to the food store. Banking services can be delivered to the home electronically, lessening the need for physical location considerations. Food store products are more numerous and more diverse than banking services. However, the likenesses of the two industries are strong enough to make some comparisons of the evolution of food retailing, an industry under little regulatory restraint to the future of banking.

In 1929, consumers bought their food products in a variety of stores. Grocery stores which did not carry meats accounted for 26 percent of the market, and grocery stores with meats had 29 percent. General stores which also carried groceries made up 19 percent of sales. Consumers made stops at various other stores, particularly meat markets, dairy stores, candy stores, and bakeries.

The advent of the supermarket in 1930 started a consolidation of services which combined self-service, mass merchandising and one-stop shopping. Today 94 percent of food sales are at grocery stores and 74 percent of those grocery store sales take place in supermarkets. The store design has evolved over time in response to consumer bargain shopping, and changing lifestyles, with varying emphasis on nutrition, fast foods, natural foods and irregular shopping hours.

As financial services are deregulated, banks will begin to offer customer convenience particularly through electronic banking and consolidation of services. The food retail industry consolidated 586,000 stores in 1929 into 252,000 stores in 1977. The banking industry will ultimately reduce more than 95,000 depository institutions to some smaller number of consolidated financial supermarkets.

#### Summary

How do bankers survive in an era of deregulation, new competition and more demanding consumers? The key seems to be in creativity and ingenuity. Both have already been tested over the past few years, but the future will pose additional challenges.

Creativity and ingenuity are indeed generalities, but they pay off when translated into specifics. For instance, they may translate into trying to improve productivity by rewarding employees on their performance—rather than relying on the old across-the-board pay hike for all employees. Why not reward exceptional performance with exceptional pay? Connecticut Bank and Trust, for example, has an incentive program for employees who attract new deposit customers. In an increasingly competitive market environment, exceptional performance could make the difference between the winning and losing operations.

Bankers should be creative in their pursuit of new technologies, financial innovations, and alliances with nonregulated businesses. They should pay greater attention than ever before to what customers want. That need is underscored by the fact that so many aggressive new competitors are eyeing the financial services markets. The Merrill Lynches have challenged the industry to battle for those customers banks traditionally could rely on as their own.

The competitive field where banks must battle may not always be totally level. Deregulation will have its pitfalls, but the process is necessary to allow banks to compete. Without planned and controlled deregulation by the regulators, the market will continue to deregulate. Banks are clearly disadvantaged by market deregulation.

Banks face multiple challenges in the 1980s. By relying on a wealth of cumulative experience in offering financial services, and by applying creative and innovative management strategies, banks should be able to meet the challenges of new technology, new customer demands and deregulation.

> Donald L. Koch and Delores W. Steinhauser

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# Supply-Side Economics and the Vanishing Tax Cut

Although federal tax rates are being reduced between 1981 and 1983, the reduction is likely to be offset by inflation and increased Social Security, state and local taxes. Any reasonable test of supply-side theory, the author contends, requires a long-term commitment to lower taxes.

Supply-side economics hasn't worked for the Reagan Administration for one simple reason: it has never been tried.\* Contrary to all the congressional publicity raised over the Reagan tax-cut package, personal income tax rates will continue their upward trek.

Granted, federal tax rates for given income tax brackets are being cut in successive annual installments of 5, 10 and 10 percent between 1981 and 1983, a net rate cut of 23 percent, not 25 percent (because the annual cuts will be made against a progressively lower tax rate structure). However, inflation will continue to drive people into higher and higher tax brackets at both the federal and state levels. Social Security taxes also will continue their upward climb, and we can anticipate that, by 1984, state and local governments will enact additional tax increases to offset expected losses in revenue from the federal government.

#### The Meaning of the Tax Cut

What will the federal tax rate cut mean to you? It all depends. But Table 1 tells much of the tax story for three hypothetical families in South Carolina: one with a "low income" (\$15,000), one with a "median income" (\$24,000), and one with a "high income" (\$45,000) in 1980. All three families have one income earner, claim four exemptions, and take standard deductions in computing their federal and South Carolina income taxes.

The table is based on assumed annual inflation rates of 10, 9, 8, and 7 percent for 1981 through 1984. Before-tax income is assumed to rise in line with inflation. Such an assumption spotlights the net effects of tax rate reductions due to congressional action and "bracket creep" due to inflation. If income were adjusted by more or less than the rate of inflation, any change in computed tax rates would, in a way, be divided between the effects of bracket creep and the effects of shifts in before-tax purchasing power. Besides, the Reagan tax cut is an outgrowth of supply-side economics, and the efficacy of the supply-side concept depends

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<sup>\*</sup>This article is an expanded version of a column originally published by the author, "An Introduction to Personal Tax 'Cuts," Wall Street Journal (January 8, 1982), ed. page.

Table 1. Personal Income Taxes in 1980 and 1984 with the Reagan Tax Cuts

ter-Tax Average hasing Tax Power Rate 60 \$s)
2,084 19.4%
7,978 25.1%
9,420 34.6%

\*The total of Social Security and Federal and South Carolina income taxes divided by before-tax income.

critically on reductions in the tax rates at given real income levels.

Further, Social Security taxes in the table are based on scheduled increases in the rate of taxation—from 6.5 percent in 1980 on a maximum income tax base of \$27,000 to 6.7 percent in 1984 on a maximum income tax base of \$36,000. South Carolina income taxes are computed on the basis of 4 percent of the first \$10,000 in income and 7 percent thereafter.

## The "Low Income" Family

After accounting for federal and South Carolina income taxes and Social Security taxes, the low income family paid 17.8 percent of its income in taxes and retained \$12,327 to spend in 1980. This family's federal tax burden alone was \$1,242. It also paid \$975 in Social Security taxes (not counting the employer's equal share, which can also be construed as a tax on the worker) and \$456 in state taxes. Total tax bill: \$2,673, or, as noted, 17.8 percent of the family's gross income.

After adjusting its before-tax income upward in line with anticipated inflation (or by 38 percent, the compounded impact of the assumed inflation rates) and accounting for the Reagan tax rate cut, this low income family in 1984 will pay a total of \$4,034 in direct taxes. That's an increase over 1980 of 51 percent: \$1,781 in federal income taxes, \$861 in state income taxes, and \$1,392 in Social Security taxes.

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Those taxes will account for 19.4 percent of the family's income, a 1.6 percentage point increase. That means the family will have \$243 (or almost 2 percent) less in real (inflation adjusted) after-tax spending power in 1984 than it had in 1980. In spite of the Reagan tax rate cut, the family's average federal tax rate will rise from 8.3 percent to 8.6 percent, all because of the effects of inflation on taxable income.

## The "Median Income" Family

The "median income" family, earning \$24,000 in 1980, will see its total direct tax bill rise from \$5,871 in 1980 to \$8,337 in 1984, an increase of 42 percent. This family's average federal income tax rate will fall slightly from 13.4 to 13.2 (due to the fortuitous location of its income in the 1980 and 1984 tax brackets). Yet it will still see its overall average tax rate rise from 24.5 to 25.1 percent. This decline in average federal tax rates is offset exactly by the rise in the Social Security tax rate from 6.5 to 6.7 percent. The family's after-tax purchasing power will fall in terms of 1980 dollars by \$151, almost 1 percent of its 1980 after-tax income.

## The "High Income" Family

The "high income" family, receiving \$45,000 in 1980, will find that its average tax rate escalates from 33.0 percent in 1980 to 34.6 percent in 1984. Its total taxes will rise from



\$14,896 to \$21,574, or by nearly 45 percent. Federal income taxes alone will rise from \$10,656, or 23.7 percent of 1980's before-tax income, to \$15,391, or 24.7 percent of 1984's before-tax income. The high income family's after-tax purchasing power will fall during the period by \$684, or 2.2 percent. (Chart 1 summarizes average tax rates for the three income groups).

### **Income Levels and Tax Cut Benefits**

These figures should dispel commonly voiced concern that the Reagan tax cut (to the extent a cut is perceived) necessarily favors the "rich." Tax pundits have reasoned that a 23 percent cut in the rates of the "poor" in a 20 percent tax bracket is less than a 23 percent cut in the rates of the "rich" in a 50 percent bracket. True enough; the raw cuts in tax rates for the "poor" and the "rich" are 4.6 and 11.5 percentage points, respectively. However, critics have failed to realize that inflation adds dollars which are more devalued to the higher dollar incomes of the rich, which tends to drive them up through the brackets and to offset the larger average rate reductions.

The "rich" may gain because of the regressiveness of the Social Security taxes, since a smaller share of the rich's dollar income will be covered by the maximum taxable income in 1984 than back in 1980. The wealthy may also be in a better position to take advantage of taxexempt "All-Savers' Certificates" and Individual Retirement Accounts, now written into the tax law; but they do not necessarily gain to the extent advertised by across-the-board rate reductions. The rich will still have to pay progressively higher tax rates.

Still, the poor of today can benefit from reductions in tax rates on the rich (or higher income earners). Any category of poor people is fluid, with many people either temporarily impoverished by immediate family and employment circumstances or by choice. In some cases, current income is deliberately being given up as future income-earning skills are raised—as is clearly the case with many graduate students. Many poor people will remain trapped in lives of poverty. But many will (or can) benefit substantially from across-the-board tax reductions.

#### Inflation and More Taxes

Admittedly, our analysis may be the "worstcase scenario." What happens to the actual tax rates people pay depends critically upon inflation rates, and the inflation rates employed above are slightly higher than the inflation rates assumed by the administration in its 1981 tax cut proposal. Further, many families that itemize deductions may find some, but not all, of their deductions escalating with inflation. In these regards, the inflation figures may overstate the actual tax rate increase and real income decrease.

On the other hand, the inflation and income assumptions are improvements on recent economic experience. The above calculations are based on an average inflation rate of 8.5 percent, whereas the average inflation rate for 1979 and 1980 was almost 11 percent. Stephen Meyer and Robert Rossana, writing for the Federal Reserve Bank of Philadelphia's **Business Review**, found that using an average inflation rate of 8.4 percent for the 1981-1983 period (which approximates the Reagan administration's estimates), also led to tax rate increases.<sup>1</sup>

Unfortunately, we cannot be sure that inflation may not get worse in the immediate future despite its recent cooling. Nor can we be sure that average tax rates may not rise by more than indicated in the table. The spiraling inflation rates of the 1960s and 1970s offer little comfort;

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<sup>&</sup>lt;sup>1</sup>Stephen A. Meyer and Robert J. Rossana, "Did the Tax Cut Really Cut Taxes?" **Business Review** (Federal Reserve Bank of Philadelphia), November/December 1981, pp. 3-12.

Table 2	. Taxes in 1980 and 1984	
	with Future Tax Cuts Rescinded	

Income Class in 1980	Average Tax Rate 1980*	Average Tax Rate 1984
Low Income Family (\$15,000)	17.8%	22.2%
Median Income Family (\$24,000)	24.5%	29.7%
High Income Family (\$45,000)	33.1%	40.0%

\*Total of Social Security and federal and South Carolina income taxes divided by before-tax income.

and although monetary policy may have been generally "tight" over the last year with a growth of 7.4 percent in M1, between December 2, 1981 and February 3, 1982 the money stock increased at an annual rate of 17.6 percent.<sup>2</sup>

Pressure will be brought to bear on interest rates by this fiscal year's \$100-billion federal deficit and the shift of states from budget surpluses to deficits, which will add to pressure for the Fed to monetize the deficits.

President Reagan seems determined, at least for now, to hold the line on overt tax rate increases even though the 1983 budget calls for several measures that will raise tax collections. However, bipartisan coalitions are urging the postponement and/or elimination of scheduled federal rate cuts, further hikes in Social Security taxes, the elimination of additional "loopholes," restrictions on some tax deductions, and increases in a variety of excise taxes on "luxury goods" and gasoline.

Table 2 paints a graphic picture of what would happen to average tax rates if the scheduled tax rate cuts for 1982 were rescinded. The 1984 federal tax payments of the low income family would be \$586 greater than with the additional cuts. The median income family would find it must add \$1,866 to its federal tax bill, and the high income family would have to fork over an additional \$3,368.

Overall, without the additional tax rate cuts, the average tax rate of the low income family would rise from 17.8 percent in 1980 to 22.2 percent in 1984. The median income family's average tax rate would jump from 24.5 to 29.7 between 1980 and 1984, and the high income family would see its average tax rate rise from 33.1 percent in 1980 to 40.0 percent in 1984. Of course, as a consequence, household purchasing power would decrease while government purchasing power escalates.

Already, a number of state governments have raised and can be expected to continue raising their tax rates, partially to offset the loss of federal revenues but partially to finance their almost natural proclivity to expand. According to the Federation of Tax Administrators, 26 states in 1981 passed increases in their gasoline taxes, five raised their sales tax rates, and three raised their income taxes.<sup>3</sup> Several states raised some combination of sales, income, tobacco, gasoline, and liquor taxes. Called by any other name, a tax increase is still a tax increase. Accordingly, there is reason for taxpayers to doubt that between now and 1984 they will receive a tax break.

## The Policy Dilemma: Economic Needs and Political Realities

Supply-side economics is a long-term economic game plan based principally, as it must be, on improved incentives for investment through lower tax rates. It is a strategy to return "power to the people." It is not the quick-fix policy that people have been led to believe it is. Indeed, supply-side theory explicitly rejects the proposition that government can "fine tune" the economy. Time is needed to turn incentives into real plants and equipment and improved human skills. However, to make the needed investment, businesses and individuals must be convinced that tax rates will actually be cut—and will stay down for some time to come.

Therein lies the "rub"—or, better, the Achilles' heel—of "Reaganomics." There is, as yet, little reason for taxpayers to believe the immediate future will be any different from the immediate past. Many people view the recent tax rate "cuts" as they have viewed the other so-called tax cuts of the 1970s: as mid-course corrections to the anticipated upward movement of tax

<sup>2</sup>Federal Reserve Bank of St. Louis, **U.S. Financial Data** (February 10, 1982), p. 4.

<sup>3</sup>As reported in "Regions" Wall Street Journal (January 19, 1982), p. 31.

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rates. The "economic miracle" people are anticipating depends importantly on expectations about the future course of tax rates. Many people remain cautious about making the investment that must be at the foundation of any longterm growth, fearing that their earnings may go up in the smoke of greater taxes.

James Buchanan and Dwight Lee have written regarding the inconsistency between the needs of political leaders, who necessarily have their eyes on the near term and the next election, and investors, who necessarily look to the longterm and the future after-tax return on their current investment.<sup>4</sup> Politicians, who seek reelection and the funds to provide benefits to constituencies, may be inclined to take advantage of people's inability to shift out of taxable income in the short-run. If so, they would tend to maximize short-run revenue, positioning themselves on the peak of the short-run Laffer curve. In the long-run that would spell a contraction of the nation's capital stock, income, and government revenue below the maximum that could be achieved. That is to say, the short-run proclivities of politicians may push taxpayers to the upper side of the long-run Laffer curve.

The now familiar Laffer curve is represented in Chart 2 by the orange line, our long-run Laffer curve. That curve illustrates a basic proposition: over some range of tax rates, from zero to R<sub>3</sub> in the figure, the government can raise its tax rates and collect more revenue. However, beyond some rate, further increases are counterproductive: revenues go down. This is because taxpayers learn how to escape through tax avoidance and by taking their pleasures in nontaxable forms, like leisure.

In terms of Chart 2, Buchanan and Lee argue that short-run pressures can push members of Congress to the peak, identified by point A, of the short-run Laffer curve (the gray curve), which represents the only viable set of raterevenue combinations open to them. That peak can be on the upper portion of the longrun Laffer curve, meaning that a rate cut could bring a revenue increase after a period of several years.

Once at *A*, politicians are caught in a bind. They see that a tax reduction can increase government revenues *in the long run*. They also see that a reduction will cut into current

<sup>4</sup>James M. Buchanan and Dwight R. Lee, "Some Simple Analytics of the Laffer Curve," Journal of Political Economy (forthcoming). -



revenues, contract social programs, and increase budget deficits. The politicians voting for such cuts will suffer the political consequences. Members of Congress who voted for the Reagan tax cut package are, indeed, being chided for fiscal irresponsibility and insensitivity to the needs of the poor. Any benefits from real reductions in current tax rates will be reaped by future politicians who will see government revenues rise with greater national income. However, those politicians of the future will also be tempted to raise tax rates, taking advantage of future taxpayers' inability to reduce their real and human capital stock.

### **Concluding Comments**

Any reasonable test of supply-side theory requires a long-term *commitment* to lower taxes. Such a commitment could be established through quasi-constitutional devices such as tax indexing (not in 1985 as under present law, but right now), rules for governing the growth in the money stock, and restrictions on the growth in government expenditures and deficits. Otherwise, some fundamentally sound economic principles will have been discredited before they have been tried.

#### -Richard B. McKenzie\*

\*Senior Fellow at the Heritage Foundation, on leave from the economics faculty at Clemson University.

# Supply-Side Economics Conference in Atlanta

The Atlanta Conference on Supply-Side Economics in the 1980s attracted a large group to hear Milton Friedman, Martin Feldstein, Lawrence Klein, Murray Weidenbaum, and many others debate the theoretical and practical validity of the supply-side approach. This article provides excerpts from six of the featured speakers.

A major conference on supply-side economics a concept as old as 18th Century English economist Adam Smith yet as immediate as the morning newspaper—drew the attention of students of economic policy to Atlanta in March.

The two-day conference, staged by Emory University's Law and Economics Center and the Federal Reserve Bank of Atlanta, drew 323 business people, regulators and academicians, including not only supply-siders but monetarists and those subscribing to a multitude of other economic persuasions.

They flew in from around the country for "Supply-Side Economics in the 1980s," the spirited gathering that filled the Atlanta Hilton's Grand Ballroom March 17-18. Registrants heard speakers including two Nobel-Prizewinning economists, two undersecretaries of the Treasury, the chairman of President Reagan's Council of Economic Advisers, three congressmen, and other panelists, including an English banker who flew in to talk about the Thatcher government's economic policies.

Considering the ideological spectrum of the participants, it wasn't surprising that they sometimes expressed conflicting views on subjects ranging from the importance of federal budget deficits to the success of "Reaganomics" in general. Some even disagreed on a definition of supply-side economics, with one participant— Nobel laureate Milton Friedman—even declaring at one point, "There is no such thing as supplyside economics; there's only good or bad economics."

William A. Fickling Jr., chairman of the Atlanta Fed's Board of Directors, noted in opening re-

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marks that the conference's subject would attract a crowd even in a stable economic era. "But in these times when we are trying a new kind of economics and in the midst of a serious recession," he said, "I think it's particularly interesting and exciting to be able to present this kind of program."

Atlanta Fed President William F. Ford traced the conference's evolution, noting that "the interest in supply-side economics has grown out of the frustration that U.S. policy makers and business leaders have felt about the inability of demand-driven economic policies to produce non-inflationary economic growth in our country."

"Out of the frustration that so many Americans have felt about these trends in our economic performance came the search for a new concept to guide us in managing our economic policies," he said. "And that, of course, is what supply-side economics is all about."

Unlike concepts of the past, he noted, supplyside theories were legislated into fact without years of academic discussion. With that omission in mind, the conference opened with a review of supply-side thinking and its theoretical foundations, moderated by Henry G. Manne, director of Emory's Law and Economics Center. That discussion served as an affirmative exposition of supply-side philosophy. It was followed by a session on alternative perspectives, which included a rebuttal by critics of the administration's approach. That session was moderated by Donald L. Koch, the Atlanta Fed's senior vice president and director of research, who would later moderate a panel of leading journalists offering their views on supply-side policies.

An early morning session on the second day served up a sampling of academic research into the subject, with academicians presenting a series of special papers. That session was moderated by Robert E. Keleher, Atlanta Fed research officer and authority on supply-side subjects.

Making sure that all the bases were covered, Atlanta Fed President Ford moderated a concluding session covering political views of supplyside economics. That session featured two of the three congressmen on the program—W. Philip Gramm, a Democrat from Texas, and Newt Gingrich, a Georgia Republican.

The opening discussion of theoretical foundations included the third—Jack Kemp, a New York Republican—along with Paul Craig Roberts, who holds the W. E. Simon Chair of Political Economy at Georgetown University's Center for Strategic and International Studies; Michael Boskin, professor of economics at Stanford University, and David Meiselman, director of the graduate economics program at Virginia Polytechnic Institute.

Session II, the alternate perspectives panel that included Nobel laureate Lawrence Klein and Harvard's Martin Feldstein, also featured Frank Morris, president of the Federal Reserve Bank of Boston; Alan Lerner, senior vice president and money market economist at Bankers Trust Compay in New York, Alan Reynolds, vice president and chief economist for Polyconomics, Inc. of Morristown, N.J.; Thomas Sargent, Professor of Economics at the University of Minnesota; David Lomax, group economist for England's National Westminster Bank Ltd. and Rudolph Penner, director of Tax Policy Studies at the American Enterprise Institute in Washington.

Both days of the conference, though, featured speakers with impressive credentials in government as well as business and academia.

At the early session on the second day, special academic papers were presented by Gerald P. Dwyer Jr., associate professor of economics at Emory; Dwight R. Lee, research fellow, Center for Study of Public Choice, and associate professor at VPI; and James Gwartney, Florida State economics professor, who delivered a paper for himself and Richard Stroup, director of the Department of the Interior's Office of Policy Analysis.

The afternoon press panel brought together Malcolm S. Forbes, Jr., senior editor of **Forbes** magazine; Leonard Silk, economics columnist for The New York Times; A. F. Ehrbar, a member of Fortune's board of editors, and George R. Melloan, deputy editor, editorial page, The Wall Street Journal.

The first day's highlight was a lively, if not faceto-face, debate between the two Nobel Prize winners, Milton Friedman and Lawrence Klein.



#### Friedman: Reaganomics has Good Chance

Predicting that Congress would not vote for higher taxes and higher government spending, Friedman expressed optimism that inflation "will be down under 5 percent in three or four years."

Friedman, long-time distinguished professor at the University of Chicago and currently a research fellow at the Hoover Institution, cautioned that "my crystal ball is not that good," and noted that "the major sources of my optimism at the moment is really political and not from the point of view of economics."

Two political developments, in particular, are encouraging to him. One is a constitutional amendment to limit federal spending and balance the budget.

Limiting federal spending, in Friedman's view, is crucial.

"I would rather have a federal government expenditure of \$400 billion with a \$100 billion deficit than a federal government expenditure of \$700 billion completely balanced," he declared.

The amendment to limit spending has 60 sponsors in the Senate.

The second encouraging development in the political sphere is that "President Reagan is of a different breed of ducks." Friedman said that every president in his lifetime has sought to "get in front of the other ducks...to find out where public opinion was going in the short run, and get in front of it." Reagan, on the other hand, "has been flying all by himself up there in the sky for 20 years, and the ducks finally got in back of him." As a result, Friedman said, Reagan will stick to principle and be "stubborn and obstinate."

Friedman declined the opportunity to launch a detailed scholarly defense of supply-side economics. In fact, he said "there is no such thing as supply-side economics," maintaining that the



only things new about the concept are "its catchy label" and "the extent to which some people operating under that label have overpromised what it can deliver."

The essence of supply-side economics, Friedman argued, is the idea that people will move in the direction of higher rewards and will leave activities where rewards are lower. Thus, proposals to slow the personal tax reduction or raise federal excise taxes are "bad economics," because they encourage higher federal spending.

Federal spending plays a key role in Friedman's view of our current economic dilemma. It has diverted resources from productive uses into other areas. Inflation combined with high marginal taxes has induced people to put their savings in nonproductive forms like housing.

"We have been paying people not to work," Friedman said. "We have been taxing them if they worked. We have been inducing them to put their assets in nonproductive forms."

Such discouragement of work makes it very difficult to increase productivity. In fact, Friedman said, "the only reason we have done as well as we have is because of the ingenuity which people have displayed in avoiding federal taxes and regulations."

Turning to the role of monetary policy, Friedman drew chuckles by noting that some of his best friends work for the Federal Reserve. Federal Reserve performance, on average, has been "pretty good," he said. He linked the economy's ups and downs since 1979 to the erratic behavior of the money supply over that period. Nevertheless, he said, given reduced government spending, "if the Federal Reserve can stick to its average policies," the market will adjust to short term changes.

Besides slow and steady money growth, renewed economic strength depends critically on a reduction in the size of government. In Friedman's view, "our present problems date more to the explosive growth of government than to any other single thing." Citing President Reagan's four part economic program of lower government spending, lower marginal tax rates, less regulation, and moderate, steady money growth, Friedman declared "nothing else will do it. All other proposals are smoke screens."

Friedman is dismayed that total government spending in fiscal 1983 is scheduled to be higher as a percentage of national income than it was in fiscal 1982. The only way to cut government spending, he argued, is to cut government revenues. Referring to the Laffer curve theory that lower taxes may increase revenues, Friedman said, "if the Lafferites were correct in the most extreme form and a particular cut in tax rates increased revenue, then my conclusion would be we hadn't cut tax rates enough—what I want to cut is government revenue because that's what feeds government spending."

Friedman chided Democats who say Congress should raise taxes to help balance the budget. Asking "where do these born-again budget balancers come from?", Friedman answered that "they are not born-again budget balancers; they are what they have always been—big spenders. They don't want to balance the budget. What they want is to increase taxes so they will have

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more money to spend and won't have to cut spending."

The triumph of President Reagan's policy so far, according to Friedman, is that "he has made them talk on his terms." If the President were to give in now and repeal the tax increase and eliminate indexing, Friedman predicted that "inflation three years from now would be 25 percent a year... That," he said, "would be a clear sign that we are going back to our bad old ways of ever-increasing government spending and the roller coaster we have been on of up and down inflation."

But if the President sticks by his guns in reducing government spending, and the Fed can maintain its average monetary targets, "then I predict that three or four years from now the inflation rate will be down to 3 to 5 percent." The precise ending of the current recession is not the crucial question, Friedman said. "The question is whether that expansion will once again be cut short by a Federal Reserve policy of excessive reduction in the quantity of money...." If it is not, we have a good chance of continued reduction in inflation and a gradual decline in interest rates. Friedman's optimism, he concluded, is based on rising popular and political pressure to limit federal spending and on a strong president who finally "has the ducks flying behind him."

### Klein: Poor Forecasting, Untested Theories Behind Huge Deficit

Following Friedman on the program, but not following him on economics, was Nobel laureate Lawrence Klein. Klein immediately took

#### SUPPLY-SIDE ECONOMICS: A Sampling of Descriptions

One fact became abundantly clear as the conference proceeded: "supply-side economics" means many things to many people. Like Proteus, the Greek sea god who could change his appearance at will, supply-side economics appears in some descriptions as a solid body of economic thought and in others as a phantasm destined to slip beneath the waves. To help sort out just how many sides supply-side theory has, we present a sampling of descriptions gleaned from the conference's 31 speakers.

#### William F. Ford President Federal Reserve Bank of Atlanta

"Supply-side economics has grown out of the frustration that U.S. policy makers and business leaders have felt about the inability of demand-drive economic policies to produce non-inflationary economic growth in our country."

#### Murray Weidenbaum Chairman President's Council of Economic Advisers

"The fundamental effort to shift resources and decisionmaking from the government to the private sector is as needed and meritorious as ever.

Reducing the burden of taxation and regulation and slowing the growth of government spending and credit are essential steps to achieving a stronger economic performance."

"As you may have noted, I have avoided presenting a grand vision, either new or old of how the economic world works. In this regard, I recall one of the lesser known statements of Gertrude Stein to the effect that the trouble with Americans is that they always simplify when they should try to understand complexity. A part of that complexity surely involves the difficulties inherent in quickly changing basic aspects of the structure of our economy."

#### Hon. Jack Kemp U.S. House of Representatives

"... There is a point at which taxes become counterproductive. That's all (Adam) Smith was saying, that's all Keynes was saying and that's all Laffer was saying and that's all we're trying to say or even John F. Kennedy was saying in 1962 when he said the purpose of cutting tax rates is not to create a deficit but to increase investment, employment and the prospects for a balanced budget."



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the offensive by characterizing some previous speakers as "a lot of sob sisters blaming the Federal Reserve for their troubles."

The Reagan administration's economic advisers, according to Klein, are guilty of poor economic forecasting and of introducing untested economic policies. Klein, who is the Benjamin Franklin Professor of Economics at the University of Pennsylvania's Wharton School, told the conference that "the events of 1981 provide us with an extraordinary outcome in which certain popular renditions of supply side economics are shown to be false."

Klein said the Reagan policies and the policies of Prime Minister Thatcher in Great Britain are really "noncontrolled experiments on a grand scale," which he blamed for serious recessions in both countries.

Asserting that "there is no visible evidence of the (supply side) effects having occurred," Klein hammered away at two lessons he said should be learned from this episode: (1) forecast accuracy is of great importance in the making of economic policy, and (2) professional peer review is essential before sophisticated arguments should be accepted as the basis for making economic policy."

Administration economists, Klein said, originally brushed aside criticism of their forecasts of "cycle-free expansion accompanied by declining deficits, decelerating inflation, and falling unemployment." They argued that forecasts as such were not important, Klein said.

"But their forecast was so wide of the mark that they could not see the dangerous territory into which they were leading the economy."

In his defense of the need for rigorous peer review, Klein criticized administration supplyside proponents who claimed that the incentive effects (to work harder and save more) would be large enough and quick enough to justify the declining deficit projections of March and July 1981. The fact was, Klein said, that "by July everybody knew" that those estimates were overly optimistic.

Differing again from previous speakers, Klein stated that research showed supply-side effects to be minimal at best.

"We could find some effects of tax rates on labor supply or on savings," he said, "but they were so small, so slow, and sometimes not statistically significant, that they were no basis at all on which to form a grandiose public policy proposition." SUPPLY-SIDE ECONOMICS IN THE 1980s Atlanta, Georgia March 17-18, 1982

#### Session II: Alternative Perspectives On Supply-Side Economics A close inspection of neo-Keynesian, rational expectations. and Wall Street points of view.

Moderator: Donald L. Koch Senior Vice President and Director of Research Federal Reserve Bank of Atlanta

> Alternative Policies for Stable Non-Inflationary Growth Lawrence R. Klein Nobel Prize Winner Benjamin Franklin Professor of Economics and Finance University of Pennsylvania

Do the Monetary Aggregates Have A Future as Targets for Federal Reserve Policy? Frank Morris President Eederal Reserve Bank of Boston

A Wall Street Perspective Alan Lerner Sr. Vice President and Money Market Economist Bankers Trust Company The Gold Standard: A Supply-Side Element? Alan Reynolds Vice President and Chief Economist Polyconomics. Inc.

Non-Gradualist Approaches to Eliminating Inflation Thomas Sargent Professor of Economics University of Minnesota

The Thatcher Policies: A Supply-Side Experience? David Lomax Group Economist National Westminster Bank, Ltd.

The Conceptual Foundations of Supply-Side Economics Martin Feldstein Professor of Economics Harvard University President, National Bureau of Economic Research

Balanced Budgets: The Relationship to Supply-Side Policies Rudolph Penner Director of Tax Policy Studies American Enterprise Institute

Turning to his own prescription for the present slowdown, Klein advocated "prudent demand management" policies together with associated structural policies.

Structural policies are best described as industrial policies to enhance productivity and improve competitiveness, Klein said. In fact, "in a true sense, these are supply-side economic issues, much more in the spirit of supply-side than the single-minded preoccupation with tax cutting." Along this line, Klein approved of the administration's more generous tax guidelines for depreciation, but said they do not go far enough.

Klein suggested increases in investment tax credits, special support for R&D, and increased support for basic scientific research. Instead, Klein said the administration is reducing federal support of R&D and basic, non-military research.

To stimulate productivity growth, Klein argued, we need to invest not only in fixed capital but in human capital. This calls for training programs,

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especially for the young unemployed. Rather than a publicly-supported CETA type program, he would like to see a cooperative scheme between the public and private sectors.

Agreeing with supply-siders who want to promote saving, Klein suggested a scheme to make workers' pension funds more portable in the private sector, "something like the TIAA system for academic retirement accounts."

As another facet of stimulating supply, Klein said we should be prepared for a major oil supply interruption during the 1980s. The current world oversupply of oil makes this a good time to fill the strategic oil reserve and to stockpile various other basic raw materials.

The most essential issue in reducing inflation, Klein said, is not the money supply—it is the rate of productivity growth. To encourage such growth, he advocated an incomes policy which would either penalize firms that grant excessive wage increases or reward firms that restrain prices. He cited Austria as an example of successful application of such an incomes policy.

"Alternatives exist," Klein concluded, "and they go far beyond macro demand management. From my perspective, they involve many aspects of the supply side..., but not simply large scale tax cuts."

## Feldstein: Conceptual Foundation

Martin Feldstein, professor of economics at Harvard University and president of the National Bureau of Economic Research, supplied a counterpoint to Klein in his address on "The Conceptual Foundation of Supply-Side Economics."

Feldstein described supply-side philosophy as "a retreat from the Keynesian ideas that have dominated economic policy for the past 35 years." The supply-side "revolution," as Feldstein called it, rejects the Keynesian emphasis on expanding demand to raise income and also rejects the Keynesian fear of saving.

Identifying himself with the supply-side movement, Feldstein said "we recognize that more saving is a prerequisite for the increased capital formation that can raise productivity and the standard of living."

Feldstein joined Friedman, Rep. Kemp, and several other speakers in refuting the notion that supply-side theory is a new, untested fad. He traced its origins back two centuries to Adam Smith's view that a nation's wealth and prosperity depend ultimately on its capacity to produce. Smith also believed that the free market—without government interference—will in general see that capital resources and labor are allocated to their most productive uses.

This view dominated economic thinking until the depression of the 1930s "diverted attention from the long-run problem of creating productive capacity to the short-run problem of maintaining demand."

In the ensuing years, "what began as a policy of government spending intended only to stimulate the private sector back to the full use of the economy's capacity soon became the basis for widespread intervention in all aspects of the private economy." More recently, Feldstein said, "careful empirical studies have confirmed that governmental policy has not only often failed to eliminate the problems it was designed to solve but has frequently exacerbated those very problems or created new and unanticipated problems."

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<b>Special</b>	Papers
Some current ac	ademic research
on supply-sid	e economics
Moderator: Robert E. Keleher Research Officer Federal Reserve Bank of Atlanta Inflation and Government Deficits: What is the Connection? Gerald P. Dwyer Jr. Associate Professor of Economics Emory University	Where Are We On the Laffer Curve? Some Political Considerations Dwight R. Lee Research Fellow, Center for Study of Public Choice Associate Professor, Virginia Polytechnic Institute Marginal Tax Rates, Tax Avoidance, and the Reagan Tax Cut James Gwartney Professor of Economics Florida State University and <i>Richard Stroup</i> Director, Office of Policy Analysis Department of the Interior

The new policies adopted in 1981 were based not only on classical economic principles, Feldstein reminded his audience, but also on continuing academic and political discussion from the mid-1970s through 1981.

Unfortunately, he said, some administration spokesmen "actually believed the extreme supplyside theory and predicted that the new policy would cause an immediate surge in economic growth and productivity and a rapid decline in the inflation rate."

While he acknowledged that "the economy's performance is not living up to these naive and

euphoric forecasts," Feldstein stressed that it is vital to judge the program by its long-term consequences and "not by its failure to live up to the naive short-term forecasts."

Feldstein traced the high inflation, low capital formation, and declining productivity growth of the '70s to "a whole range of government policies," including:

- tax rules that penalized saving and discouraged business investment
- a Social Security program that made saving virtually unnecessary for the majority of the population
- credit rules that encouraged large mortgages and extensive consumer credit
- perennial government deficits that absorbed private saving and shrank the resources available for investment.

The 1981 tax policy, in Feldstein's view, attacks this government-inspired discouragement of saving through several substantial changes in the personal tax rules aimed at encouraging saving. He cited NBER studies indicating that the IRA accounts alone will begin producing substantial new savings after about two years.

The tax act also provides a dramatic reduction in business tax rates on new investments and should produce much higher net rates of return.

Feldstein's belief that the administration's basic approach represents sound policy rests largely on what he sees as "a complete reversal of the roles assigned to monetary and fiscal policy."

Macroeconomic policy of the '60s sought to combine easy money to stimulate investment with a tight fiscal policy to prevent inflation. "That strategy clearly failed," Feldstein said.

#### SUPPLY-SIDE ECONOMICS: A Sampling of Descriptions

#### Milton Friedman Senior Research Fellow Hoover Institution Stanford University

"I don't think there is any such thing as supply-side economics. I think there is simply good economics and bad economics."

The essence of supplyside economics is ... simply the elementary proposition that people will move in the direction in which rewards are higher and will leave activities in which rewards are lower, that demand curves slope negatively and supply curves slope positively. That's supply-side economics and almost nothing more."

#### Lawrence R. Klein Benjamin Franklin Professor of Economics and Finance University of Pennsylvania

"Aggregative policies of demand management are ... in a true sense, much more in the spirit of supply side than the single-minded preoccupation with tax cutting." Martin Feldstein Professor of Economics Harvard University

"A central feature of this revolution in economic thinking is the rejection of the Keynesian view that the way to raise income and reduce unemployment is simply to expand demand. Instead of Keynesian demand management, the new view focuses on capacity creation through capital formation and research."

"The current economic policies are not the embodiment of a radical new wishful thinking theory of supply-side economics that the administration brought to Washington. Instead, the basic program is a sound one that gradually evolved in Congress during several years of careful study." Beryl Sprinkel Under Secretary of the Treasury for Monetary Affairs

"Monetary and supply-side economics are based on the proposition that private initiative is the source of wealth and the source of higher standards of living." "What has been

characterized as the supply side of our economic policy deals with the effect government spending and financing has on the willingness and ability of individuals to take a chance on productive ventures."

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Monetary authorities will now disregard the goal of increasing investment and will focus exclusively on achieving a low inflation rate. Fiscal policy, in turn, will focus on stimulating saving and investment by targeted tax incentives. Feldstein believes the result will be "not a permanent conflict between monetary and fiscal policies..., but a coordinated mix designed to twist spending away from housing and consumption and toward business investment."

The reductions in personal tax rates will not be inflationary, according to Feldstein, but not because the tax cuts will unleash a powerful supplyside response, as called for in the "extreme form of Lafferite wishful thinking that candidate Reagan discussed early in his campaign." In reality, "there will be virtually no reduction in the share of personal income taken by taxes" because the reduction will be mostly offset by bracket creep.

"Because the administration never explained that there are essentially no personal rate cuts," Feldstein said, "its critics have charged that its fiscal policy is irresponsibly inflationary."

Feldstein believes that continued spending reductions can gradually lower the deficit and make more money available for investment. To do this, however, the administration must "look beyond the list of budget categories that it dealt with in its most recent budget." Returning nondefense spending to the same share of GNP that it had in 1970, Feldstein pointed out, would reduce federal outlays by 5 percent of GNP and achieve a balanced budget.

Noting that Congress "probably did not recognize how long and arduous the transition period would be," Feldstein declared that "the administration's economic program is on the right track and the current recession is an inevitable part of the process of reducing inflation."

## **Administration Spokesmen**

The Reagan administration was well represented at the gathering to advocate its point of view and to respond to its critics. Administration representatives included Murray Weidenbaum, chairman of the President's Council of Economic Advisers, and the two undersecretaries of the Treasury: Beryl Sprinkel, undersecretary for monetary affairs, and Norman Ture, undersecretary for tax and economic affairs.

Weidenbaum, while defending the administration's achievements to date ("The fundamental effort to shift resources and decisionmaking



from the government to the private sector is as needed and meritorious as ever") was candid in discussing its dilemmas as well.

"We have tried to avoid repeating the mistakes of the past, although no doubt we will produce a full quota of new mistakes," Weidenbaum conceded.

He forecast that the resulting educational process will make for both a stronger economy and an improved understanding of the workings of economic policy. Yet, he added, "it is far too early for anyone to make a definitive evaluation of Reaganomics."

The first year of the Reagan administration, he said, has produced such gains as lower tax burdens and dramatically reduced inflation. And, he added, the public can look for further benefits in economic growth and rising employment as the economy pulls out of its current recession.

Like other administration spokesmen, though, he indicated that the recovery's timing depends on a number of variables.

"The precise timing, speed, strength and duration of that recovery," he said, "will be affected by how quickly interest rates decline from the current high levels." At the same time, he said, those interest rate shifts during 1982 are certain to be influenced by the degree of progress in paring the federal budget deficits.

Weidenbaum noted that the fiscal year 1982 budget deficit will be in the neighborhood of \$100 billion, substantially above the 1981 figure of \$58 billion. Yet he pointed to the irony that, despite the swelling deficit projections, the closely watched Consumer Price Index inflation barometer has declined from the 12 to 13 percent

range of late 1980 to a 4-6 percent range in recent months.

"I am not so partisan as to contend the deficits of one political party are inherently less inflationary than those of another," Weidenbaum said with a smile. "But I would defend the germ of truth that is embedded in that proposition—namely, that deficits associated with tax reductions are less of a problem for the economy than those arising from a spending increase."

Weidenbaum characterized the projected deficits as "a matter of considerable concern but not national hysteria.

"The inflationary consequences so often attributed to past deficits have actually been the result of inappropriate monetary policy, which



monetized those deficits," he said. "We have contended that a policy of monetary restraint—a substantial reduction in the growth of the money supply from the rapid pace that characterized much of 1979 and 1980—would contain the inflationary potential of deficit spending."

He praised the Federal Reserve and its monetary policy for reining in the nation's runaway inflation, and reiterated the administration's support for those efforts. But he said of the Fed's monetary targets: "I wish their aim would improve but then again, they do too."

Undersecretary Sprinkel too referred to the Fed's monetary policy in a presentation he called "Reaganomics: The Monetary Component."

"The monetary component of Reaganomics is critical to the overall program," said Sprinkel, a former Harris Bank of Chicago economist.

"The supply-side promise of real growth and prosperity is sound; the incentive effects will

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work in America in the 1980s just as they have worked hundreds of times before in our own country and in other countries.

"But they will not work unless there is a fertile, stable monetary environment," he said. "You can have the best seeds in the world, but they won't grow without the proper soil."

Sprinkel argued that the Federal Reserve is capable of controlling the nation's money supply and, therefore, what he called the economy's "monetary environment."

Explaining, he said the data show that inflation, nominal GNP and interest rates all follow the growth of M1—the Fed's basic measure of money, including cash and checkable deposits in financial institutions. He said M1 growth, in turn, follows the growth of the monetary base—which he defined as "simply the sum of certain items on the Federal Reserve's balance sheet." Since the Fed can control the largest asset, its portfolio of government securities, Sprinkel said, the Fed "could, if it chose, control the base to the penny."

According to Sprinkel, the administration inherited "a pretty tough situation" when it took office early in 1981.

"In the last 12 months we have had to spend a great deal of time repairing the wreckage from the last administration," he said. "But we are now on a sure, steady course toward low inflation, low interest rates and real economic rates and real economic growth in America."

"For us fully to realize our potential," he concluded, "we must have less volatility in monetary growth."

Sprinkel disputed claims—repeated by some conference speakers—that the administration's supply-side policies are fighting with its monetarist policies: that the Reagan fiscal policy and the tight money policy of the Fed are running headlong into each other.

"In spite of the frequency of their appearance in the media, both of these statements are untrue," according to Sprinkel. "Not only are supply-side and monetarist policies compatible, it is essential that they go together."

The supply-side of economic policy, he explained, deals with the impact of government spending and financing on the willingness and ability of individuals to take a chance on productive ventures. The monetarist component, he said, deals with money in the belief that high and variable monetary growth and inflation discourage work, savings and investment and that inflation is

primarily a monetary phenomenon.

"The goal of the supply-side and monetary elements of our policy is the same: to increase the productive potential of the economy," he declared. "The only difference is that they focus on different aspects of government behavior, one on the demand side and the other on the supply."

And Reaganomics? He defined that as a combination approach "carefully designed to rid us of stagflation by limiting money growth and



inflation, while increasing incentives to produce real goods and services."

Norman Ture, under secretary of the Treasury for tax and economic affairs, joined Sprinkel in a spirited defense of the president's economic program.

The Reagan program, he cautioned, should not be construed as blind faith in the perfection of markets. Instead it holds that "the responsibility properly assigned to government is to seek to identify the sources of market failure and to seek to facilitate more efficient market operation." In turn, government must reject what Ture called the "elitist notion that public policy makers know better than private market participants what is good for them—the private market participants."

The administration program also rejects shortrun fine tuning of the economy, Ture said, and focuses instead on long run policy objectives.

To help the private market perform more efficiently, Ture said, "the policy thrust toward an ever-mounting edifice of complex regulations must be reversed." In particular, the "antique regulations of financial institutions" should be eliminated. Replying to some previous speakers who questioned how closely the Reagan program represented a supply-side approach, Ture said, "I do not mean to suggest that the President or his principal policy advisers toiled through the supplyside exegesis in order to formulate the programs." But had they done so, he maintained, "the overall program would have differed little, if at all, from that which the President presented in 1981."

Citing the supply-side rejection of a positive relationship between levels of government spending and total output, for example, Ture argued that the Reagan program sees reduced federal spending as a key to expanded output and employment.

The tax policy portion of the administration's program also reflects sound supply-side principles, in Ture's view. By reducing marginal tax rates, the 1981 tax act is intended to reduce the relative cost of working, saving, and investing. Ture took special notice of the "dramatic revision in our tax provisions pertaining to capital recovery," which he said will reduce the bias against saving and capital formation.

Turning to the more controversial question of budget deficits, Ture argued that supply-side theory rejects the view that budget deficits per se are inflationary. That erroneous view, he said, rests on the observation that those deficits tend to be monetized. Consequently, the administration program calls for the "institutional link between monetary expansion and government deficits" to be broken.

"Monetary policy," Ture said, "should pursue a firm policy of slow and steady growth in the stock of money, substantially oblivious to budget prospects or outcomes."

Ture joined Sprinkel, Weidenbaum, and Friedman in defending the intellectual and empirical basis for the administration program. Far from being "novel, exotic ... or abstract," the program rests on "an extremely rigorous and hard-headed analytical system...with an extensive empirical record."

Finally, Ture said, the program should be judged not by any short-term gains in housing, construction or other sectors, but by "the progress toward greater economic freedom, toward investing the individual with greater opportunity and responsibility for determining his or her economic status."

### Conclusion

Not every participant at the Atlanta conference agreed with the administration spokesman's viewpoint, of course, any more than everyone concurred with the criticisms voiced by supplyside's detractors. The conference's structure provided a cross-section of opinion expressed by panelists from points as distant as Wall Street and London's Threadneedle Street—panelists who, in some cases, proved as far apart ideologically as they did geographically. By virtue of its balanced nature, the gathering was designed to stimulate an exchange of conflicting views rather than a rubber-stamp unanimity.

"Supply-Side Economics in the 1980s" helped focus attention on the effects of tax rate policy on savings, investment and work effort. Participants may have differed on the importance of tax incentive policies on the national economy, but there seemed to be general agreement that it was a crucial subject too often overlooked in the past.

Sponsors had organized the program, in part, to encourage eminent opinion-shapers to discuss

two fundamental questions regarding supplyside economics. First, does the supply-side approach hold the answers to the nation's troubling economic maladies? And, if not, what are the alternatives?

Obviously, the conference didn't provide neatly packaged answers to all the questions its sponsors had raised, nor was it likely to have done so. Yet it provided an open and far-ranging forum for some of the nation's most respected thinkers to offer their perspectives on the supply-side concept. So, if the Atlanta meeting raised a multitude of perplexing questions, surely it defined a framework for producing the answers as well.

> -Donald E. Bedwell and Gary W. Tapp

#### **PROCEEDINGS FORTHCOMING**

Complete proceedings of the entire conference will be available later in the year. See future issues of the **Review** for details.

# Southeast's Ships Come In: Bright Outlook for Exports

Over one-fourth of U.S. waterborne exports are now shipped from southeastern ports, with a heavy concentration in food products and crude materials. The region could continue to expand its exports in the '80s, especially if world demand for coal heats up.

During the 1970s U. S. exports virtually doubled as a percentage of GNP, reaching more than 8 percent by 1980.<sup>1</sup>

Nowhere is that export growth more visible today than at the seaports of the Southeast, which serve as busy jumping-off points for an impressive share of American products that foreign customers are buying. High on that list of exports is food, with ever more wheat and soybeans flowing from such ports as New Orleans and Mobile to feed a burgeoning global population.

Ports in the Sixth Federal Reserve District also have emerged as major embarkation centers for exports of coal, the Southeast's answer to Middle Eastern oil. Coal exports promise to continue growing, with the planned completion of the Tennessee-Tombigbee Waterway and the hoped-for dredging of key Gulf ports to accommodate huge freighters to handle the projected future tonnage.

Along with the Southeast's exporting boom arise questions that this article will seek to answer: How has the region's share of the value of U. S. waterborne exports changed over the past decade? What changes have occurred in the kinds of commodities exported? What are the likely trends in U. S. exports in the 1980s? Answers to these questions will provide clues to the future of a growing portion of the region's economy.

## The Southeast's Share of U. S. Exports

In 1970, the value of U. S. waterborne exports flowing through District ports was almost \$5 billion, or one-fifth of the U. S. total (see Table 1). By 1980, these District exports had grown to more than \$30 billion, over one-fourth of U.S. waterborne exports. The value of southeastern exports increased at a 20 percent compound rate during the decade, far faster than the 16 percent for the rest of the nation.

New Orleans dominates exports through southeastern seaports, although its share is declining (from 70 percent in 1970 to 63 percent by 1980). Even so, the New Orleans customs district still accounted for one dollar in every six of U.S. exports in 1980.

The other four southeastern customs districts-Savannah, Tampa, Miami and Mobile—ranked in the upper half of U. S. customs districts in waterborne exports in 1980 (see Table 2). Every southeastern customs district except

<sup>&</sup>lt;sup>1</sup>In this article, "U.S. exports" refers to merchandise trade, or the dollar value of tangible goods only. A broader measure of trade includes exports and imports of such services (or "invisibles") as international travel and transportation, insurance, and investment income. In general, the U. S. balance of trade in goods and services (exports minus imports) is more favorable than for trade in goods alone. This is because of the U. S.'s important role as exporter of capital and source of technology and expertise.

	19	170	19	80	1970-80	
U.S. Customs Districts	Value <u>(Mil. \$)</u>	Percent of U.S.	Value (Mil. \$)	Percent of U.S.	Compound Annual Growth	
Savannah	320	1.3	2,154	1.8	21.0	
Tampa	281	1.2	2,782	2.3	25.9	
Miami	395	1.6	3,912	3.3	25.8	
Mobile	466	1.9	2,588	2.2	18.7	
New Orleans	3,448	14.1	19,336	16.3	18.8	
Sixth District	4,910	20.1	30,772	25.9	20.1	
Non-Sixth District	19,475	79.8	88,063	74.1	16.3	
U.S.	24,394	100.0	118,835	100.0	17.1	

# Table 1. Southeastern Exports (Value of Domestic and Foreign Waterborne Exports)

Source: U.S. Department of Commerce, Bureau of the Census, Waterborne Exports and General Imports, 1970 and 1980.

Mobile improved its ranking during the 1970s. New Orleans jumped into the number one slot in the country, surpassing New York, and Florida ports showed particularly sharp increases.<sup>2</sup>

The growth of southeastern port activity is even more impressive when measured by tonnage. The weight of southeastern waterborne exports increased even more rapidly, compared to the nation, than has the value. In 1980, the Southeast accounted for almost one-third of U. S. tonnage.

But the Southeast's fast-growing share of U. S. exports is best measured by its value. The dollar volume of exports tells us how much total income—wages and salaries, rent, interest and profit—has been generated directly in the U. S. economy by production of the commodity which is being exported.

# The Composition of Exports from the Southeast

Mainly because of the huge volume of bulk commodities flowing down the Mississippi through New Orleans, the Southeast has a high

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share of such commodities and a lower share of manufactures. Nationally, 40 cents out of each dollar of exports are manufactured goods, compared to only 25 cents for goods exported through the region's ports (see Table 3).<sup>3</sup> On the other hand, food products exports account for over one-third of Southeast exports, compared to one-fourth for the nation. This contrast is even greater when one considers that crude (nonfood) materials exports account for another 23 percent of District exports but only 17 percent for the nation. Over half of the District's crude materials exports are soybeans.

Sharp differences also appear within the region. Over 70 percent of waterborne exports from New Orleans and Mobile are food products or crude materials; in contrast, three-fourths of exports from Miami are manufactures. Savannah's composition lies between these extremes—

<sup>&</sup>lt;sup>a</sup>The importance of U. S. airborne trade through Miami should also be noted. In 1980, 6 percent of U. S. airborne exports was out of Miami International Airport (MIA). New York's John F. Kennedy International Airport, which accounted for half of U. S. airborne exports, was the only airport to rank ahead of MIA.

<sup>&</sup>lt;sup>3</sup>U. S. exports can be classified, most simply, as either agricultural or nonagricultural products. At the other extreme, commodity information can be presented in terms of a seven-digit product classification scheme based upon the Standard International Trade Classification (SITC). In this article, detailed commodity information is aggregated and presented in five commodity groupings. The 10 single-digit SITC groupings are combined as follows:Food and live animals, beverages and tobacco, and oils and fats (animal and vegetable) are grouped together as "farm products," three other groupings correspond to the SITC classifications "inedible crude materials," "mineral fuels," and "chemicals," It is emphasized that these classifications are made for analytical convenience and are somewhat arbitrary. Nevertheless, presentation of the data in this form does allow us to examine important structural features of waterborne U. S. exports through southeastern ports.

1980		1970
Ranking	Customs District	Ranking
1	New Orleans, Louisiana	2
2	New York City, New York	1
3	Houston, Texas	4
4	Baltimore, Maryland	6
5	Norfolk, Virginia	3
6	Los Angeles, California	7
7	San Francisco, California	5
8	Seattle, Washington	9
9	Miami, Florida	15
10	Portland, Oregon	8
11	Galveston, Texas	10
12	Charleston, South Carolina	22
13	Philadelphia, Pennsylvania	11
14	Tampa, Florida	18
15	Mobile, Alabama	12
16	Savannah, Georgia	17
17	Port Arthur, Texas	13
18	Cleveland, Ohio	14
19	Duluth, Minnesota	19
20	Wilmington, North Carolina	20

Table 2

borne Exports and General Imports, 1970 and 1980.

almost half of its exports are manufactures but crude materials account for another 30 percent. Chemicals exports are dominant in the Tampa customs district.

## **Behind the Pattern**

The pattern of southeastern exports is related to resource endowments. The Southeast has abundant natural resources and labor relative to other parts of the nation. Thus, the Southeast exports more primary goods while the nation as a whole exports more manufactured goods. Central Florida's huge phosphate deposits, coupled with a growing world need for fertilizers, explains the dominant role of chemicals exports from the Tampa district. As the U.S. supplies more of the world's food, the Mississippi River becomes a vital conduit for corn, wheat, and soybeans from the Midwest, expanding the importance of food products and crude materials exports through New Orleans. Southeastern soybeans, ores and pulpwood flow through Mobile, while soybeans, forest products, and textiles are dominant exports from Savannah. Miami provides the primary U.S. link with Latin American markets for manufactured goods.

# The Southeast's Share of U. S. Commodity Exports

By commodity, the Southeast's share of U. S. exports parallels the same patterns. Thus, the Southeast accounts for over one-third of U. S. food products and crude materials exports, but only 17 percent of the nation's manufactured exports (see Table 4). The Southeast specializes in exports of these commodities, but not in manufactured goods. Similarly, the Southeast has a light specialization in chemicals exports but none at all in mineral fuels exports.

Clearly, the dominant feature of 1980 trade in the Southeast is the massive flow of corn, grain, and soybeans out of New Orleans: food products and crude materials exports from this customs district represent nine percent of total U. S. waterborne exports. Despite this emphasis, flows of mineral fuels, chemicals or manufactures through New Orleans account for sizable shares of U. S. exports. Among southeastern customs districts, only Miami rivals New Orleans as an exporter of manufactures and only Tampa approaches New Orleans in chemical exports (see Table 5).

### Recent Changes in Southeastern Commodity Flows

When we examine the 1970-80 growth rates for five kinds of commodities, we notice several important changes.<sup>4</sup> First, compared to the nation, both manufactured exports and crude materials from the Miami region have grown much more rapidly, while such exports from the New Orleans region have grown less rapidly. Chemicals and manufactures grew particularly fast in the Miami region, while food was the fastest-growing export from the New Orleans region.

In general, changing supply and demand factors—in the Southeast, elsewhere in the nation, and abroad—have shaped the changing pattern of exports through southeastern ports. Thus, exports from the Southeast have grown more rapidly than for the nation because of the region's above-average rate of general economic

<sup>&</sup>lt;sup>4</sup>Strictly speaking, the growth rates for the Miami Customs region reflect the influence of changes in the growth and composition of commodity flows out of some customs districts and ports not located in the Sixth Federal Reserve District. However, we believe that the important trends revealed by these data reflect major changes in the District portion of the Miami Customs region.

Southeast Commodity Profile 1980 (Percent Value of Domestic Waterborne Exports)							
Savannah	Tampa	Miami	Mobile	Orleans	District	U.S.	
7.9	12.7	12.5	34.0	45.6	34.8	24.6	
29.6	19.5	2.6	38.9	24.5	22.9	17.3	
0.1	0.1	0.3	5.5	3.0	2.4	5.7	
16.3	51.5	7.5	8.4	10.7	14.2	13.1	
46. <u>1</u>	16.2	77.1	13.2	16.2	25.7	39.3	
100.0	100.0	100.0	100.0	100.0	100.0	100.0	
	Soi (Percent V Sevannah 7.9 29.6 0.1 16.3 46. <u>1</u> 100.0	Southeast Common           Southeast Common           (Percent Value of Dommon           Savannah         Tampa           7.9         12.7           29.6         19.5           0.1         0.1           16.3         51.5           46.1         16.2           100.0         100.0	Table 3.           Southeast Commodity Profil (Percent Value of Domestic Waterb           Savannah         Tampa         Miami           7.9         12.7         12.5           29.6         19.5         2.6           0.1         0.1         0.3           16.3         51.5         7.5           46.1         16.2         77.1           100.0         100.0         100.0	Table 3.           Southeast Commodity Profile 1980 (Percent Value of Domestic Waterborne Exports           Savannah         Tampa         Miami         Mobile           7.9         12.7         12.5         34.0           29.6         19.5         2.6         38.9           0.1         0.1         0.3         5.5           16.3         51.5         7.5         8.4           46.1         16.2         77.1         13.2           100.0         100.0         100.0         100.0	Table 3.           Southeast Commodity Profile 1980 (Percent Value of Domestic Waterborne Exports)           Savannah         Tampa         Miami         Mobile         Orleans           7.9         12.7         12.5         34.0         45.6           29.6         19.5         2.6         38.9         24.5           0.1         0.1         0.3         5.5         3.0           16.3         51.5         7.5         8.4         10.7           46.1         16.2         77.1         13.2         16.2           100.0         100.0         100.0         100.0         100.0	Name 3.           Southeast Commodity Profile 1980 (Percent Value of Domestic Waterborne Exports)           Savannah         Tampa         Miami         Mobile         Orleans         Sixth District           7.9         12.7         12.5         34.0         45.6         34.8           29.6         19.5         2.6         38.9         24.5         22.9           0.1         0.1         0.3         5.5         3.0         2.4           16.3         51.5         7.5         8.4         10.7         14.2           46.1         16.2         77.1         13.2         16.2         25.7           100.0         100.0         100.0         100.0         100.0         100.0	

Sources: U.S. Department of Commerce, Bureau of the Census, U.S. Exports: World Area by Commodity Groupings, FT 455/Annual 1980; Dialog Information Retrieval Service: U.S. Exports, File 126.

Table 4.

	Shares of Southeastern Customs Districts in U.S. Commodity Exports, 1980 (Percent Value of Domestic Waterborne Exports)									
	Miami	Tampa	Savannah	Mobile	New Orleans	Sixth District	<u>U.S.</u>			
Food Products	1.7	1.2	.6	3.0	30.2	36.7	100.0			
Crude Materials	.5	2.6	3.1	4.9	23.1	34.2	100.0			
Mineral Fuels	.1	-	_	2.1	8.5	10.7	100.0			
Chemicals	1.9	9.3	2.3	1.4	13.3	28.2	100.0			
Manufactures	6.4	1.0	2.1	.7	6.8	17.0	100.0			
Total	3.3	2.3	1.8	2.2	16.3	25.9	100.0			

Sources: U.S. Department of Commerce, Bureau of the Census, U.S. Exports: World Area by Commodity Groupings, FT 455/Annual 1980; Dialog Information Retrieval Service: U.S. Exports, File 126.

growth and the proximity of regional ports to growing world markets.

Factors related to the region's domestic growth, such as the migration of people and jobs to the Southeast in the 1970s, also influenced trade. Specifically, the Miami region's manufactured exports grew more rapidly than the nation, in part, because of the increase in manufacturing in Florida—especially in central Florida, where the production of goods such as high-technology computers has soared. The fact that ports in this region serve as the primary link to growing Latin America also helps explain rapid growth in manufactured exports from southeastern ports.<sup>5</sup>

But changes at the national level also help account for the differences in growth rates. Food

products was the fastest-growing category of U.S. exports in the 1970s; it was also the fastestgrowing export from the New Orleans customs region. Because of the important role the Mississippi River plays in draining corn, grain, and soybeans from farms in the Midwest, ports in the New Orleans region have an advantage in exporting U. S. farm products.

Such changes in the pattern of southeastern exports are consistent with the changes in the overall pattern of U.S. trade in the 1970s. Net agricultural exports moved from near balance to substantial surplus; chemicals, capital goods, and airplanes were strong export performers.<sup>6</sup>

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<sup>&</sup>lt;sup>5</sup>A "technical" factor is also involved in the rapid growth of manufactured exports from the Miami Customs region. The Port of Miami specifically prohibits all "dirty and dusty" cargo, such as petroleum, bulk minerals, grains, and scrap metal because of the tourism orientation of the city.

<sup>&</sup>lt;sup>6</sup>In addition to the analysis of trade patterns discussed here, the reader is referred to the following papers, which discuss important aspects of recent U. S. trade flows: William H. Branson, "Trends in U. S. Trade and Comparative Advantage: Analysis and Prospects," unpublished paper prepared for the U. S. National Science Foundation (September 1980); Thomas O. Bayard, Trends in U. S. Trade, 1960-79, Economic Discussion Paper #7, U. S. Department of Labor, July 1980; Harry Bowen and Joseph Pelzman, A Constant Market Share Analysis of U. S. Export Growth, Economic Discussion Paper #10, U. S. Departmentof Labor, October 1980.

	Customs Di	s				
SITC Commodity	Mobi	le	Mian	ni	Tamp	ba
	(\$000)	(%)	(\$ 000)	(%)	(\$ 000)	(%)
0 Food and live animals	874,963	33.8	417,155	6.4	339,770	12.2
1 Beverages and tobacco 2 Inedible crude materials	2,887	.1	116,437	1.8	5,967	.2
except fuels 3 Mineral fuels, lubricants	1,007,210	38.9	128,221	2.0	541,522	19.4
and related materials 4 Animal and vegetable	141,469	5.5	10,634	.2	214	-
oils and fats 5 Chemicals and	375	-	32,773	.5	9,534	.3
related products	218,466	8.5	452,689	6.9	1,430,707	51.3
6 Basic manufacturers 7 Machinery and	241,132	9.3	916,056	14.0	191,267	6.8
transportation equipment 8 Miscellaneous	84,058	3.3	3,445,051	52.8	196,257	7.0
manufactured goods 9 Goods not classified	15,694	.6	966,407	14.8	74,731	2.7
by kind, except military	423	-	40,289	.6	1,463	.1
TOTALS	9,586,677		6,524,721		2,791,432	

Source: Dialog Information Retrieval Service: U.S. Exports, File 126.

The New Orleans customs region in 1980 exported large quantities of wheat, corn, soybeans, and animal feed to the communist countries of eastern Europe, the U.S.S.R. (before the embargo), and China. Eleven percent of the New Orleans exports were to these nations in 1980, up from 2.5 percent in 1970. Of total U. S. exports to communist countries, New Orleans accounted for almost half in 1980, up from three-eighths in 1970. Agricultural exports to non-communist countries expanded significantly in the 1970s to provide markets for U. S. food products.

### The Future of Southeastern Exports

Extrapolation is warranted. The growth of southeastern exports in the 1980s will depend generally on the same factors which have boosted growth in the past: the growth of markets abroad and the region's price advantages. The location advantage of District ports and growth of the regional market at an aboveaverage rate invite expansion of southeastern port trade and export-oriented production in the District in the 1980s. More specifically, U. S. food products and crude materials exports are likely to continue to expand briskly. The world's population continues to grow and the U. S. can be expected to continue to fill the food gap. Given the advantages of ports in the New Orleans customs region in this trade, it is likely that such exports as wheat, feed grains, and soybeans, particularly from these ports, will continue to grow rapidly.

Lumber, wood pulp, paper and paperboard exports are important throughout the Southeast. The outlook for such exports from the region during the 1980s is also good. Pulp (and paper) mills are becoming more concentrated in the Southeast, owing partly to the timber base of the region. These new plants are the most efficient in the world and thus enhance the comparative advantage of U. S. exports.

Chemicals exports from the region should also continue to show strength—especially agricultural chemicals. Pesticide, insecticide, and fertilizer export expansion will be fueled by both demographic and economic growth factors. Feeding the one-half increase in the world's population expected in the last quarter of this century will require crop yield increases

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New Orl	New Orleans		nah	District Total		
(\$ 000)	(%)	(\$ 000)	(%)	(\$ 000)	(%)	
7,768,310 42,753	40.0 .2	166,091 4,357	7.0 .2	9,565,289 172,401	28.4 .5	
4,725,506	24.4	643,127	27.2	7,045,586	20.9	
571,935	3.0	1,577	.1	725,829	2.2	
990,339	5.1	453	_	1,033,484	3.1	
2,062,968 1,226,213	10.6 6.3	364,230 605,214	15.4 25.5	4,529,060 3,179,891	13.4 9.4	
1,797,165	9.3	493,464	20.9	6,015,995	17.9	
214,585	1.1	80,034	3.4	1,351,451	4.0	
5,950	_	7,457	.3	55,582	.2	
19,405,724		2,366,014		33,674,568		

which will, in turn, depend upon increased use of agricultural chemicals. Also, as countries develop, they will increase their per capita consumption of grain-intensive meat; this will require higher grain production and thus more fertilizer. Agricultural chemicals production is heavily dependent on oil and gas; in the Southeast, the energy industry is centered in the New Orleans area. Also, phosphate rock, the base for producing phosphate fertilizers, abounds in central Florida.

There is a mounting worldwide demand for coal in response to the increase in world oil prices. Some ports in the region—New Orleans, Mobile, Savannah—hope to expand dramatically their exports of coal to Asia and Europe. Coal exports from the New Orleans customs region are already large and growing rapidly. In 1970, coal exports were \$21 million (2 percent of the U. S. total); by 1980 they were \$353 million (7.4 percent of the U. S. total).

According to the U. S. Department of Commerce, the immediate barrier to expanding U. S. coal trade is a limited capacity to store and load coal at the ports. The Ports of New Orleans and Mobile plan to dredge their shipping channels to a minimum depth of 55 feet (from 45 feet) to allow large coal (and grain) vessels to call at their ports. The Tennessee-Tombigee Waterway should spur coal exports through the Mobile area. Even without these major improvements, new coal terminals and other port developments are likely to lead to continued rapid expansion of coal exports from the region.

One factor in the growth of manufactured goods from the region will be whether Florida becomes more of a manufacturing-based state. Because of the Southeast's "Latin connection," another important factor which will help spur the growth of manufactured exports will be the pace of development in Latin America. Perhaps the key to the growth of manufactured exports, however, lies with the efforts that small to medium-sized companies make in selling abroad. The U.S. Department of Commerce is currently working hard to create a greater export awareness among U. S. producers. The outlook for future manufactured goods exports from the Southeast appears, on balance, to be less certain than that for the other major commodities.

#### **Summing Up**

An increasing share of rapidly growing U. S. exports is flowing through southeastern ports, dominated by a massive flow of farm products out of the New Orleans customs region. Food product exports are the fastest-growing category of U. S. exports, and the New Orleans region has a comparative advantage in exporting these products. Compared to the nation, the Southeast exports fewer manufactured goods. Only the Miami customs district, with its proximity to growing markets in Latin America, specializes in the export of manufactured goods.

Looking ahead, the growth of southeastern exports in the 1970s should continue through the mid-1980s, dominated by food products with less emphasis on manufactured goods. The major exception is that, as worldwide demand for coal soars, coal exports may be the "trade event" of the 1980s.

-William J. Kahley

#### FEDERAL RESERVE BANK OF ATLANTA

# Industrial Impacts of the 1981 Business Tax Cuts

The Accelerated Cost Recovery System (ACRS) included in the 1981 Tax Act provides more rapid write-offs of depreciable assets for businesses. Manufacturing industries important to the Southeast, however, may benefit somewhat less from ACRS than U.S. manufacturing as a whole.

#### Introduction

In addition to substantially reducing the statutory tax rates on personal income, the Economic Recovery Tax Act of 1981 (ERTA) made major changes in the taxation of business income. The most significant change is the adoption of the Accelerated Cost Recovery System (ACRS) which speeds up the rate at which business capital can be depreciated for tax purposes. Indeed, it is estimated that ACRS accounts for some 96 percent of the total tax savings generated by business.

As a result of these tax savings due to ACRS, federal corporate tax receipts should grow at a rate well below the average annual growth rates of the last three decades. One consequence of this lower growth rate is that the share of corporate taxes in total federal taxes should decline substantially.<sup>1</sup>

How does ACRS fit into the development of post-World War II corporate tax policy? What is the economic rationale for ACRS? Finally, how will ACRS affect specific industries, particularly those industries important to the economic base of the Southeast?

#### Corporate Tax Policy Before ACRS

The Accelerated Cost Recovery System continues a post-war trend toward progressively more rapid write-offs of the costs incurred in using depreciable assets in production. Prior to 1954, firms received no tax credits for new investment and were essentially required for tax purposes to use a straight-line depreciation formula based on legally prescribed asset lives. For example, if the useful life of a particular depreciable asset was "n" years, 1/nth of the initial cost of the asset could be taken as a depreciation deduction in computing taxable income. In 1954, taxpayers were for the first time allowed to use accelerated depreciation formulas. Though the pre-1954 definitions of useful asset life were retained, the accelerated formulas permitted taxpavers to write off more than 1/nth of the asset cost in the "early" years of its useful life and less than 1/nth of asset cost in later years. This effectively allowed taxes on the income generated

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<sup>&</sup>lt;sup>1</sup>For a more detailed overview of the Reagan tax spending program, see James R. Barth, "The Reagan Program for Economic Recovery: An Historical Perspective," this **Review**, October 1981.

by depreciable assets to be deferred, thereby lowering the effective tax rate on business income.

Between 1954 and 1962, the useful lifetimes for determining depreciation allowances were gradually reduced. In 1962 the lifetimes were thoroughly revised, and generally shortened, resulting in a further acceleration of capital recovery. In addition, Congress adopted an investment tax credit for purchases of equipment in 1962. This credit was subsequently made somewhat more generous in 1964, and then suspended and restored twice between 1966 and 1971. In 1971, the investment credit was reinstated and the Asset Depreciation Range (ADR) system was adopted.

The enactment of ADR further liberalized tax depreciation rules. Under ADR, taxpayers could shorten or lengthen the period over which they took depreciation by as much as 20 percent relative to the 1962 guidelines. In 1975 the rate of the investment tax credit was increased. Finally, the investment tax credit was made permanent in 1978.

Thus, the system for recovering business capital costs prior to ACRS was the product of successive tax policies which provided enhanced incentives for capital spending. Many observers considered such policies necessary to offset the impact of increasingly higher inflation on the real value of depreciation deductions.

Under traditional accounting techniques, depreciation allowances are calculated on the basis of the historical rather than the replacement cost of assets. During periods of inflation this practice can result in an overstatement of "true" profits. The reason is that, while business receipts are likely to rise with inflation, one important cost of generating those receipts-namely depreciation or the wearing out of existing capital—is measured as a constant, when in fact the cost of replacing depreciating capital is actually rising. Failure to measure depreciation on a replacement cost basis therefore results in an overstatement of taxable profits during periods of inflation. This in turn increases the effective, if not statutory, tax rate on business income.

One means of reducing the adverse impact of inflation is to permit taxpayers to use depreciation allowances more rapidly, as was done in the 1950s, '60s, and the early '70s. However, beginning in the mid '70s, the existing capital cost recovery system, which was a modified version of the ADR system adopted in 1971,

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increasingly was criticized as inadequate in an environment of persistently high inflation rates.<sup>2</sup> In particular, critics argued that unless depreciation rules were further liberalized, inflation would generate significant, though unlegislated, increases in the effective tax rate on capital income; and that this in turn would discourage capital spending by U. S. industry. In response to these concerns, the Reagan administration proposed and Congress adopted in August of 1981 the Accelerated Cost Recovery System as a replacement for the ADR system.

#### **Provisions of ACRS**

The ADR system attempted to match the stream of nominal depreciation deductions for the cost of an asset with the stream of income earned by the asset. In practice, this meant that the Treasury, on the basis of actual industry experience, specified a midpoint life for industrial equipment. Taxpayers could then elect lives 20 percent longer or shorter than the midpoint life. ADR midpoint lives ranged from 2.5 years for certain special manufacturing tools to 50 years for certain public utility equipment. For assets not eligible for ADR and for taxpayers who did not elect ADR, useful lives were determined according to the facts and circumstances pertaining to each asset or by agreement between the taxpayer and the IRS.

By comparison, ACRS places all depreciable assets in one of four classes based on their previous ADR midpoint life. These classes determine the length of time over which capital costs may be written off for tax purposes. In general, the recovery periods for different types of assets-3 years, 5 years, 10 years, and 15 years-are shorter than the corresponding recovery periods under the ADR system. The rate of investment tax credit allowed for certain short-lived assets is also somewhat more generous under ACRS than under ADR. Table 1 shows comparisons of both the recovery periods and the investment tax credits allowed for different types of assets under ACRS and the ADR system. Clearly, ACRS reduces the recovery period substantially for some assets and modestly for others. Note also

<sup>&</sup>lt;sup>2</sup>See, for example, Joseph J. Cordes, "Tax Policies for Encouraging Innovation: A Survey" and Dale W. Jorgenson, "Taxation and Technical Change," in Ralph Landau and N. Bruce Hannay, eds., Taxation, Technology and the U.S. Economy, New York: Pergamon Press, 1981.

## Table 1. Capital Cost Recovery Periods and Investment Tax Credits Under ACRS and ADR

	Inve	stment Tax Credit	Cost Recovery Periods (Useful Lifetimes)			
Asset	Old Law	ACRS	Old Law	ACRS		
1 Furniture and Fixtures	0.100	0.100	8.00	5.00		
2 Fabricated Metal Products	0.100	0.100	10.00	5.00		
3 Engines and Turbines	0.100	0.100	12.48	5.00		
4 Tractors	0.067	0.100	5.00	5.00		
5 Agricultural Machinery	0.100	0.100	8.00	5.00		
6 Construction Machinery	0.100	0.100	7.92	5.00		
7 Mining and Oil Machinery	0.100	0.100	7.68	5.00		
8 Metalworking Machinery	0.100	0.100	10.16	5.00		
9 Special Industry Machinery	0.100	0.100	10.16	5.00		
10 General Industrial Equipment	0.100	0.100	9.84	5.00		
11 Office and Computing Machinery	0.100	0.100	8.00	5.00		
12 Service Industry Machinery	0.100	0.100	8.24	5.00		
13 Electrical Machinery	0.100	0.100	9.92	5.00		
14 Trucks, Buses, and Trailers	0.067	0.100	5.00	5.00		
15 Autos	0.033	0.067	3.00	3.00		
16 Aircraft	0.100	0.100	7.00	5.00		
17 Ships and Boats	0.100	0.100	14.40	5.00		
18 Railroad Equipment	0.100	0.100	12.00	5.00		
19 Instruments	0.100	0.100	8.48	5.00		
20 Other Equipment	0.100	0.100	8.16	5.00		
21 Industrial Buildings	0.0	0.0	28.80	15.00		
22 Commercial Buildings	0.0	0.0	47.60	15.00		
23 Religious Buildings	0.0	0.0	48.00	15.00		
24 Educational Buildings	0.0	0.0	48.00	15.00		
25 Hospital Buildings	0.0	0.0	48.00	15.00		
26 Other Nonfarm Buildings	0.0	0.0	30.90	15.00		
27 Railroads	0.100	0.100	24.00	15.00		
28 Telephone and Telegraph	0.100	0.100	21.60	15.00		
29 Electric Light and Power	0.100	0.100	21.60	15.00		
30 Gas	0.100	0.100	19.20	10.00		
31 Other Public Utilities	0.100	0.100	17.60	10.00		
32 Farm	0.0	0.0	25.00	15.00		
33 Mining, Shafts and Wells	0.0	0.0	6.80	5.00		
34 Other Nonbuilding Facilities	0.0	0.0	28.20	15.00		
35 Residential	0.0	0.0	40.00	15.00		
36 Inventories	0.0	0.0	0.0	0.0		
37 Land	0.0	0.0	0.0	0.0		

Source: Don Fullerton and Yolanda K. Henderson, "Long Run Effects of the Accelerated Cost Recovery System," Discussion Pages No. 120, Woodrow Wilson School, Princeton University, Princeton, N. J., December 1981, adapted from Table 1.

that the substitution of ACRS for ADR does not affect the tax treatment of inventories and land.

The intent of ACRS is to provide businesses with more generous allowances for the costs of capital recovery. However, these more liberal allowances are of actual value to firms only if they are able to use them. The ability of any given firm to fully utilize its depreciation allowances in any given year is largely determined by its taxable income. A firm with sufficient taxable income will be able to use all of its depreciation allowances as deductions against its gross income and all of its investment tax credits as offsets against the remaining tax liability.

For firms with insufficient taxable income, however, the value of depreciation deductions along with other business expenses may exceed gross income, resulting in net operating losses

(NOLs). In such situations, firms would also be unable to utilize any investment tax credits. Still other firms might be able to utilize fully all depreciation deductions, but yet might have sufficiently low taxable income once such deductions were taken to preclude the full use of tax credits. Net operating losses and/or unused credits would either have to be carried backward for a period of up to 3 years—that is, applied to prior years' tax liabilities—or carried forward against future tax liabilities for a period of up to 7 years under ADR and 15 years under ACRS.

Firms with sufficient taxable income in earlier years would, in effect, still be able to fully utilize available credits and deductions through the use of carrybacks. However, firms with insufficient ability to carryback would have to defer using at least some credits and deductions earned in the current year. The firms likely to be in this position are firms which have been unprofitable for several years, and new firms which are often unprofitable in their start-up years and with no ability to carryback.

Firms that are constrained in their ability to utilize depreciation deductions and the investment tax credit are placed at a disadvantage relative to other firms because they are less able to take advantage of investment incentives in the tax code. There is considerable evidence that many firms were encountering difficulties in fully utilizing available depreciation deductions and tax credits under the ADR system, which provided less generous capital recovery allowances than does ACRS.<sup>3</sup>

Thus, without some mechanism to facilitate the use of the additional deductions created by ACRS, a larger number of corporations than before are likely to encounter problems in fully using capital cost recovery allowances. This situation would have several consequences. First, if a significant number of firms were compelled to carry unused deductions and credits forward, the objective of ACRS, which was to permit firms to take deductions more rapidly, would not be completely achieved. Second, as noted above, firms which could not fully utilize deductions and credits would receive

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#### SIGNIFICANT CHANGES IN POST-WAR CORPORATE TAX POLICY

	Change in Corporate Tax Policy
1954	Accelerated depreciation formulas in place of straight-line formulas permitted.
1962	Asset lifetimes revised and shortened; tax credit for new investment enacted.
1964	Investment tax credit liberalized, corporate tax rate reduced from 52 to 48 percent.
1966-71	Investment tax credit suspended and restored twice during this period.
1971	Asset Depreciation Range System enacted.
1975	Rate of investment tax credit increased.
1978	Investment tax credit made permanent and allowed to offset a higher maximum fraction of corporate tax liability, corporate tax rate reduced from 48 to 46 percent.
1981	ACRS enacted.

a less than proportionate share of the tax savings resulting from ACRS. Moreover, such firms would become prime targets for takeover attempts by other firms interested in part in acquiring unused tax credits and deductions.

Two mechanisms to facilitate the use of the investment incentives created by ACRS were included in the administration tax package: (1) an extension of the carryforward period for net operating losses from 7 to 15 years, and (2) liberalization of rules governing leasing arrangements between firms. These provisions are intended to help firms with insufficient taxable incomes to use at least some benefits from otherwise unused deductions and credits.

Increasing the carryforward period from 7 to 15 years would be of some immediate benefit to corporations about to exceed the prior 7 year limit. However, the long run impact of extending carryforwards is likely to be modest since the present value of credits or deductions carried forward that far would be worth a fraction of their initial value.

Liberalization of equipment leasing rules to allow a wide variety of transactions to be characterized as leases for tax purposes should, however, have a discernible impact. The new rules permit sufficient flexibility in arranging lease terms so that firms that otherwise would be unable to fully utilize increased depreciation deductions and tax credits conceivably could

<sup>&</sup>lt;sup>3</sup>For a detailed discussion of this issue, see Joseph J. Cordes, and Steven M. Sheffrin: "Taxation and the Sectoral Allocation of Capital in the U.S., **National Tax Journal**, December 1981; and "The Tax Advantage of Debt Finance," **1981 Proceedings of the National Tax Association**, forthcoming.

capture all the tax benefits from ACRS through appropriately structured leasing arrangements.

As the leasing market develops, firms with insufficient taxable income will lease an increasing fraction of their new investment to profitable lessors. This means that potential loss of credits and deductions on new investment will be of less concern. That's because the new leasing rules effectively permit deductions and credits to be transferred from firms with insufficient taxable income to firms less likely to experience utilization problems.

### The Industrial Impacts of ACRS

To assess the relative impact of ACRS among different industries, we first must consider how the economic impact of investment tax incentives is to be measured. One procedure frequently used is to translate the amount of allowable investment credit and depreciation deductions into an "equivalent first-year deduction." Another is to estimate the impact of different depreciation rules and tax credit schemes on the effective tax rate levied on the capital income flowing from different investments.

While the equivalent first-year deduction measure is easily calculated and interpreted, it has important limitations. Most notably, this measure is not a price variable since it does not directly measure the impact of different tax regimes on either the price of capital services or the return to capital investment. This latter information is essential if one wishes to assess the impact of tax policy on the allocation of capital to different investment activities and ultimately to different industries.

One approach which has been widely used to obtain this information is based on user cost of capital formulas of the sort initially developed by Hall and Jorgenson.<sup>4</sup> These formulas are used to estimate the *real pre-tax return*, *R*, that a hypothetical project of \$1 invested in a particular asset in a particular industry would have to earn in order to provide investors with some pre-determined after-tax real rate of return, *r*, *given* some assumed values of the inflation rate and relevant tax parameters. The size of the effective tax wedge between the

ACRS Class and Asset Detail	(1) ADR	(2) 1982 ACRS	(3) 1986 ACRS	(1) ADR
3-Year	4.9	3.5	2.8	4.3
Automobiles	4.8	3.5	2.8	4.4
Light Trucks	4.9	3.5	2.8	4.1
Small Tools	5.0	3.5	2.6	4.4
5-Year	5.2	3.8	3.1	4.6
Machinery & Equipment	5.1	3.8	3.2	4.6
Heavy Trucks	4.7	3.6	2.5	4.1
Computers	4.5	3.6	2.4	3.7
Vessels	6.1	3.9	3.4	5.7
Aircraft	5.5	3.7	2.9	4.8
Bus-Vehicle	4.5	3.6	2.5	3.7
Steam	5.5	3.9	3.6	5.2
Furn & Fixtures	4.6	3.8	3.2	4.2
Small Tools	4.7	3.5	N.A.	3.6
10-Year	7.1	5.7	4.9	6.5
Machinery & Equipment	7.0	5.7	4.9	6.5
Pollution	6.5	5.2	4.6	6.1
15-Year Equip.	9.4	7.8	6.7	8.9
Machinery & Equip	9.4	7.8	6.7	8.9
15-Year Bld.	8.1	6.6	6.6	7.8
Buildings	8.1	6.6	6.6	7.8
TOTAL	7.5	5.7	5.1	6.9

Table 2. Real Pre-Tax Rate of Return Required

to Provide a 4 Percent Real After-Tax Return

After-tax real return=4%

Inflation

rate=8%

After tax real

(2)

1986

ACRS

2.3 2.4 2.4

2.1

27

3.0

N.A.

N.A.

3.2 2.4

N.A

3.5

3.0

N.A.

4.4

4.4

4.3

6.2

6.2

6.3

6.3

4.6

return=4

Inflation

rate=6%

Source: Calculated by the authors from U.S. Treasury Department data.

pre- and the after-tax rate of return on each investment may then be calculated as (R-r), while the effective tax rate on each investment can be estimated from the ratio (R-r)/R.

This approach has the attractive feature of being prospective: it measures the expected tax consequences if a particular investment is undertaken given certain assumptions that the investor makes about the future course of tax policy and of inflation. However, as Bradford and Fullerton have recently noted, estimates of the effective tax rate calculated from the general formula R-r/R may be highly sensitive to empir-

<sup>&</sup>lt;sup>4</sup>Robert E. Hall and Dale W. Jorgenson, "Application of the Theory of Optimal Capital Accumulation," in Gary Fromm, ed., **Tax Incentives and Capital Spending**, Washington, D.C., Brookings Institution, 1971.

ical assumptions used to estimate the required pre-tax return.<sup>5</sup>

Moreover, calculated values of the effective tax rate are undefined when R is zero and make little economic sense for values of R close to zero. Hence, rather than use estimated effective tax rates, we have chosen to compare the impact of ADR and ACRS in terms of the required pre-tax real return—R—that different assets would have to earn to provide an investor with a 4 percent real return after corporate taxes.

The first three columns of Table 2 compare the required pre-tax return needed for a 4 percent real after-tax return when the inflation rate is assumed to be 8 percent. Clearly, the required pre-tax return differs among various assets under both ADR and ACRS. Indeed, under both systems the required pre-tax return increases with the life of the asset.<sup>6</sup> Thus, if the required pre-tax return is viewed as a "hurdle rate" which the return to a prospective investment must meet or exceed in order to be worthwhile, both ADR and ACRS favor investment in shorter-lived assets.

Moreover, though ACRS reduces the required pre-tax return for all assets, it reduces it relatively more for shorter-lived than for longer-lived assets. For example, assuming the inflation rate is 8 percent, the fully phased in 1986 version of ACRS may be expected to reduce the required pre-tax return of 3-year assets by 42 percent, of 5-year assets by 40 percent, of 10-year assets by 31 percent, of 15-year equipment by 29 percent, and of buildings by 18 percent. If the inflation rate is assumed to be 6 percent, the reduction in the required return due to adoption of ACRS would be 47 percent in the case of 3year assets, 41 percent for 5-year assets, 32 percent for 10-year assets, 30 percent for 15year equipment, and 19 percent for buildings.

<sup>5</sup>David F. Bradford and Don Fullerton, "Pitfalls in the Construction and Use of Effective Tax Rates," Working Paper No. 688, National Bureau of Economic Research, June 1981.

<sup>6</sup>For an analysis of the potential reductions in economic efficiency resulting from this differential treatment of assets, see Jane G. Gravelle, "The Social Cost of Non-neutral Taxation: Estimates for Non-residential Capital," in Charles R. Holten, ed., **Depreciation, Inflation, and the Taxation of Income from Capital,** Washington, D.C.: The Urban Institute, 1981.

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 Table 3: Real Pre-Tax Return Required to Provide a 4 Percent Real After-Tax Return

	After ta	eturn=4% =8%	
	(1) ADR	(2) 1986 ACRS	(3) % Reduction in Required Return Due to ACRS
Agriculture	6.5	4.8	26
Mining	6.2	3.7	40
Logging	6.5	4.3	34
Wood Products & Furn	7.6	5.3	30
Glass, Cement, & Clay	7.2	4.6	36
Primary Metals	6.5	4.2	35
Fabricated Metals	8.3	5.4	35
Machinery & Instruments	7.0	4.9	30
Electrical Machinery	6.4	4.6	28
Motor Vehicles	6.0	3.4	43
Transportation Equipment	7.0	4.8	31
Food	7.7	5.1	34
Tobacco	7.0	4.4	37
Textiles	6.3	4.3	32
Apparel	7.2	5.2	28
Pulp & Paper	6.1	3.9	36
Printing & Publishing	6.8	4.5	34
Chemicals	6.1	4.3	30
Petroleum Refining	6.7	3.9	42
Rubber	6.6	4.3	35
Leather	8.2	5.6	32
Transportation Service	6.4	3.7	42
Utilities	7.5	5.4	28
Communications	7.2	4.3	40
Services and Trade	9.1	6.6	27
TOTAL	7.5	5.1	32

Source: Computations made by the authors based on U.S. Treasury Department data.

# How Will ACRS Affect Specific Industries in the Southeast?

The estimates in Table 2 indicate that ACRS will not provide equal incentives to all types of capital investment. Since different industries are likely to rely on different mixes of capital, this implies that the adoption of ACRS, though benefitting all industries, will benefit some industries more than others. In particular, ACRS will favor industries for which short-lived equipment represents a large share of total capital.

Table 3 presents estimates of the pre-tax return required under both ADR and fullyphased-in ACRS to earn a 4 percent real after-

Chart I. Industrial Impacts of AC
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tax return in various industries. Column 3 of Table 3 shows the percent reduction in the required pre-tax return attributable to ACRS.

These ACRS reductions will have varying impacts on manufacturing industries in the Southeast and in the U. S. The first column of Chart 1 contains manufacturing industries ranked by the benefits received from ACRS. The second column shows each industry's share of manufacturing employment in the Southeast and the U.S.

Chart 1 suggests that, relative to U.S. manu-

ş										
	District States' Share of Manufacturing Employment (Percent)									
FL	GA	LA	MS	TN						
0										
.7	.6	1.3	1.1	3.4						
.2	.2	5.5	1.1	.2						
.8	.2	-	-	.2						
3.9	3.1	4.0	3.3	3.0						
4.3	5.4	7.7	2.7	3.4						
1.3	2.6	3.4	1.3	3.6						
6.8	4.0	6.9	4.3	6.8						
3.0	.6	1.3	1.1	4.4						
8.3	3.5	4.0	2.1	4.9						
2.6	9.7	13.2	8.3	7.6						
.5	.8	1.1	1.0	.1						
1.3	24.1	1.3	3.6	5.5						
1.1	.6	.1	1.0	3.6						
0.3	6.4	11.3	14.3	1.8						
6.7	6.1	6.9	16.2	8.0						
8.2	4.2	5.1	6.3	6.8						
6.0	3.1	15.5	3.0	10.8						
8.9	15.7	5.7	17.8	14.3						
1.7	3.3	5.2	8.3	7.8						

facturing as a whole, manufacturing industries important to the industrial base of the Southeast may benefit somewhat less from the investment incentives provided by ACRS. The comparisons are, of course, more striking in the case of some industries than others. For example, the two

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Digitized for FRASER http://fraser.stlouisfed.org/ Federal Reserve Bank of St. Louis industries which rank first in terms of their share in Southeast manufacturing employment, chemicals and apparel, rank at the bottom of manufacturing industries in terms of the estimated investment stimulus provided by ACRS.

Differences in the impact of ACRS are likely to be still more striking at the state level. Chart 1 also presents some information on the industrial impacts of ACRS in the southeastern states.

Chart 1 suggests that the industrial impacts of ACRS are likely to vary among states in the Southeast. In particular, manufacturing industries important to the economies of Alabama and Louisiana will benefit relatively more than manufacturing industries important to other states in the region, while manufacturing industries important to the economies of Georgia and Mississippi should benefit relatively less.

#### Conclusion

As this article shows, the Accelerated Cost Recovery System included in the 1981 Tax Act provides more rapid write-offs of depreciable assets for businesses. Manufacturing industries important to the Southeast, however, may benefit somewhat less from ACRS than U.S. manufacturing as a whole.

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	MAR	FEB	MAR	ANN. %		MAR	FEB	MAR	ANN. %
	1982	1982	1981	CHG.		1982	1982	1981	CHG.
Commercial Bank Deposits	1 107 074	1 000 303	008 500	+ 11	Sevings & Loens				
Demand	286,543	289,113	298,370	- 4	Total Deposits	524,297	521,441	510,074	+ 3
NOW	54,550	53,777	34,819	+ 57	NOW	8,667	8,377	4,093	+112
Savings	148,047	148,282	157,545	- 6	Savings	91,811	92,743	100,227	- 8
Time Contraction Description	647,213	634,123	540,915	+ 20	Time	424,412	420,811	405,142	+ 5
Share Drafts	43,030	41,552	35,578	+ 21	Mortgages Outstanding	508 240	509 133	495 415	+ 3
Savings & Time	37,602	36,283	31,955	+ 18	Mortgage Commitments	15.547	15.163	15.893	- 2
SOUTHEAST	a second second								
Commercial Bank Deposits	119,830	118,492	107,556	+ 11	Savings & Loans				
Demand	34,317	34,161	34,941	- 2	Total Deposits	77,150	76,566	74,240	+ 4
Sovings	14 711	14 714	4,329	- 6	Sevings	1,425	1,372	12 824	- 9
Time	67.075	65,409	56.192	+ 19	Time	64.037	63.471	60.592	+ 6
Credit Union Deposits	4,225	4,088	3,253	+ 30		JAN	DEC	JAN	
Share Drafts	293	278	211	+ 39	Mortgages Outstanding	74,418	74,633	71,593	+ 4
Savings & Time	3,621	3,487	2,827	+ 28	Mortgage Commitments	3,364	3,488	3,382	- 1
ALABAMA Commercial Bank Deposits	13 511	13 409	12 196	+ 11	Savings & Loans				
Demand	3,420	3,504	3.477	- 2	Total Deposits	4.412	4.404	4.369	+ 1
NOW	622	612	397	+ 57	NOW	74	71	32	+131
Savings	1,523	1,530	1,642	- 7	Savings	571	579	654	- 13
Time	8,389	8,190	7,058	+ 19	Time	3,791	3,782	3,692	+ 3
Credit Union Deposits	734	717	526	+ 40	Montgages Outstanding	3 070	1 003	3 060	+ 0
Savings & Time	625	617	478	+ 31	Mortgages Commitments	49	4,000	138	- 64
FLORIDA	010				Baba				
Commercial Bank Deposits	39,636	39,219	36,312	+ 9	Savings & Loans				
Demand	12,362	12,174	13,067	- 5	Total Deposits	46,917	46,371	45,151	+ 4
NOW	3,164	3,107	1,892	+ 67	NOW	998	962	461	+116
Time	18,681	18,152	15,361	- 8 + 22	Time	37,958	37.444	35.792	+ 6
Credit Union Deposits	1,925	1,845	1,502	+ 28		JAN	DEC	JAN	
Share Drafts	163	156	118	+ 38	Mortgages Outstanding	45,536	45,702	43,188	+ 5
Savings & Time	1,523	1,431	1,176	+ 30	Mortgage Commitments	2,913	3,059	2,721	+ 7
GEORGIA	16 259	16 151	14 020	+ 17	Souings & Loons				
Demand	5.837	5.877	5.865	- 0	Total Deposits	9,657	9.720	9,431	+ 2
NOW	1,010	997	621	+ 63	NOW	146	143	53	+175
Savings	1,578	1,573	1,589	- 1	Savings	1,166	1,183	1,329	- 12
Time	8,893	8,634	7,070	+ 26	Time	8,380	8,430	8,050	+ 4
Credit Union Deposits	778	755	551	+ 41	Montgogog Outstanding	JAN 0.224	0 240	JAN 0.226	- 0
Savings & Time	720	703	524	+ 37	Mortgage Commitments	113	111	175	- 35
LOUISIANA			021		in the bab of the internet of the	110			
Commercial Bank Deposits	21,605	21,511	19,062	+ 13	Savings & Loans				
Demand	6,194	6,227	5,934	+ 4	Total Deposits	7,577	7,519	6,972	+ 9
NOW	977	941	572	+ 71	Souings	1 209	1 916	1 210	+184
Time	12,716	12,493	10.718	+ 19	Time	6,298	6.238	5.742	+ 10
Credit Union Deposits	115	114	83	+ 39		JAN	DEC	JAN	
Share Drafts	12	8	4	+200	Mortgages Outstanding	7,151	7,140	6,810	+ 5
Savings & Time	107	106	77	+ 39	Mortgage Commitments	235	208	225	+ 4
MISSISSIPPI	10.002	0.700	9 0 1 0	+ 12	Souings & Loons	and the second			
Demand	2.362	2,336	2,419	- 2	Total Deposits	2.382	2.378	2.354	+ 1
NOW	536	521	326	+ 64	NOW	40	37	14	+186
Savings	734	731	780	- 6	Savings	221	222	242	- 9
Time	6,637	6,449	5,678	+ 17	Time	2,136	2,131	2,100	+ 2
Share Drefts	N.A.	N.A.	N.A.		Montgages Outstanding	2 200	2 20F	2 1 9 9	+ 1
Savings & Time	N.A.	N.A.	NA.		Mortgage Commitments	2,200	2,203	4,108	- 75
TENNESSEE					Babo commencina	10		01	10
Commercial Bank Deposits	18,724	18,402	17,046	+ 10	Savings & Loans				
Demand	4,143	4,044	4,179	- 1	Total Deposits	6,205	6,173	5,963	+ 4
Savinga	860	852	521	+ 65	NUW	5 47 A	5 445	5 910	+136
Time	2,130	11,491	10,307	+ 14	Time	673	657	5,210	+ 14
Credit Union Deposits	673	657	591	+ 14	. The	JAN	DEC	JAN	
Share Drafts	37	36	29	+ 28	Mortgages Outstanding	6,228	6,234	6,102	+ 2
Savings & Time	646	630	572	+ 13	Mortgage Commitments	39	42	62	- 37

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. 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.



## **EMPLOYMENT**

				ANN.					ANN.
	FEB 1982	JAN 1982	FEB 1981	CHG.		FEB 1982	JAN 1982	FEB 1981	CHG.
UNITED STATES									
Civilian Labor Force - thous.	108,324	108,014	107,015	+ 1	Nonfarm Employment- thous.	89,863	89,760	90,138	- 0
Total Employed - thous.	97,946	97,831	98,401	- 0	Manufacturing	19,385	19,440	20,065	-3
Inemployment Rate - % SA	10,378	10,183	8,614	+20	Construction	3,080	3,700	3,901	- 0
Insured Unemployment - thous	N.A.	N.A.	N.A.		Government	16.084	15,890	16,458	- 2
Insured Unemple, Rate - %	N.A.	N.A.	N.A.		Services	18.675	18,510	18,126	+ 3
Mfg. Avg. Wkly. Hours	38.9	37.1	39.5	- 2	Fin., Ins., & Real Est.	5,324	5,329	5,245	+ 2
Mfg. Avg. Wkly. Earn \$	325	312	306	+ 6	Trans. Com. & Pub. Util.	5,058	5,059	5,076	- 0
SOUTHEAST									
Civilian Labor Force - thous.	13,824	13,804	12,801	+ 8	Nonlarm Employment- thous.	11,447	11,424	11,320	+ 1
Total Unemployed - thous	1 306	1 371	954	+ 37	Construction	679	678	673	+ 1
Unemployment Rate - % SA	9.2	9.4	7.5		Trade	2.676	2.695	2.619	+ 2
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	2,153	2,133	2,194	+ 2
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	2,215	2,195	2,095	+ 6
Mfg. Avg. Wkly. Hours	39.5	32.7	40.0	- 1	Fin., Ins., & Real Est.	637	637	623	+ 2
Mfg. Avg. Wkly. Earn \$	289	244	267	+ 8	Trans, Com. & Pub. Util.	696	695	691	+ 1
Civilian Labor Forda - thous	1 669	1 673	1 620	+ 2	Nonform Employments thous	1 229	1 2 2 2	1 342	- 0
Total Employed - thous.	1,437	1,426	1,484	- 3	Manufacturing	352	348	359	- 2
Total Unemployed - thous.	232	248	155	+50	Construction	63	62	63	õ
Unemployment Rate - % SA	13.3	14.0	9.1		Trade	271	273	265	+ 2
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	293	292	300	- 2
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	212	212	207	+ 2
Mig. Avg. Wkly. Hours	39.7	29.3	39.6	+ 0	Fin., Ins., & Real Est.	59	59	59	0
FLORIDA	288	228	271	+ 6	Irans. Com. & Pub. Util.	71	71	71	0
Civilian Labor Force - thous.	4,558	4.511	4.015	+14	Nonfarm Employment- thous,	3,813	3,805	3,704	+ 3
Total Employed - thous.	4,236	4,165	3,763	+13	Manufacturing	468	469	465	+ 1
Total Unemployed - thous,	322	346	252	+28	Construction	268	274	274	- 2
Unemployment Rate - % SA	7.3	7.4	6.7		Trade	1,019	1,027	976	+ 4
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	621	614	631	- 2
Insured Unempi. Rate - %	N.A. 20 5	N.A.	N.A.	- 1	Services	919	901	853	+ 8
Mfg. Avg. Wkly. Earn \$	270	267	258	+ 5	Trans. Com. & Pub. Util.	200	228	200	+ 0
GEORGIA									
Civilian Labor Force - thous.	2,607	2,607	2,396	+ 9	Nonfarm Employment- thous.	2,160	2,156	2,163	- 0
Total Employed - thous.	2,397	2,387	2,239	+ 7	Manufacturing	505	504	513	- 2
Total Unemployed - thous.	210	220	157	+34	Construction	99	97	100	- 1
Insured Unemployment - thous	NA	NA	0.4 N A		Covernment	493	496	496	- 1
Insured Unemple, Rate - %	N.A.	N.A.	N.A.		Services	361	359	351	+ 3
Mfg. Avg. Wkly. Hours	39.3	29.9	40.1	- 2	Fin., Ins., & Real Est.	114	114	113	+ 1
Mfg. Avg. Wkly. Earn \$	274	208	245	+12	Trans. Com. & Pub. Util.	142	142	143	- 1
LOUISIANA									
Civilian Labor Force - thous.	1,836	1,849	1,761	+ 4	Nonfarm Employment- thous.	1,628	1,622	1,592	+ 2
Total Unemployed - thous.	1,001	1,009	1,034	+ 2	Construction	209	210	216	- 3
Unemployment Rate - % SA	9.2	10.1	6.9	100	Trade	370	372	357	+ 4
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	311	308	307	+ 1
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	294	293	281	+ 5
Mfg. Avg. Wkly. Hours	40.5	34.9	40.8	- 1	Fin., Ins., & Real Est.	76	76	76	0
Mfg. Avg. Wkly. Earn \$	375	328	341	+10	Trans. Com. & Pub. Util.	132	131	130	+ 2
MISSISSIPPI	1.009	1.051	1.010		New Providence Alexander	0.00	0.07	014	
Total Employed - thous	1,002	1,051	1,010	+ 3	Manufacturing	809	807	814	- 1
Total Unemployed - thous.	108	112	89	+21	Construction	40	40	39	+ 3
Unemployment Rate - % SA	9.5	10.0	8.2	A second	Trade	161	161	158	+ 2
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	188	185	194	- 3
Insured Unempl. Rate - %	. N.A.	N.A.	N.A.	- Anna	Services	121	121	120	+ 1
Mig. Avg. Wkly. Hours	38.6	28.7	39.1	- 1	Fin., Ins., & Real Est.	33	33	32	+ 3
TENNESSER	246	181	230	+ 7	Trans. Com. & Pub. Util.	40	40	40	0
Civilian Labor Force - thous	2,093	2,113	1,980	+ 6	Nonfarm Employment- thous	1.600	1 701	1 705	- 0
Total Employed - thous.	1,835	1.857	1.806	+ 2	Manufacturing	486	490	503	- 3
Total Unemployed - thous.	258	256	174	+48	Construction	73	72	64	+14
Unemployment Rate - % SA	11.4	10.9	7.8		Trade	362	366	367	- 1
Insured Unemployment - thous.	N.A.	N.A.	N.A.		Government	301	298	321	- 6
Insured Unempl. Rate - %	N.A.	N.A.	N.A.		Services	308	309	283	+ 9
Mig. Avg. Wkly. Hours	39.4	34.4	39.4	+ 0	Tin., Ins., & Real Est.	75	75	77	- 3
mig. Avg. WRIY. Earn >	218	201	200	- y	Trans. Com. & Pub. Util.	84	83	81	+ 4

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.

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## CONSTRUCTION

12-Month Cumulative Rate	FEB 1982	JAN 1982	FEB 1981	ANN % CHG		FEB 1982	JAN 1982	FEB 1981	ANN % CHG
UNITED STATES									
Nonresidential Building Permits	- \$ Mil.	50 000	46 900	+10	Residential Building Permits		20 200	45 500	.15
Industrial Bldgs.	7.001	7,181	7,961	-12	Residential Permits - Thous.	30,334	39,300	40,009	-15
Offices	14,718	14,809	10,497	+40	Number single-family	528.5	543.2	693.9	-24
Stores	6,070	6,195	6,235	- 3	Number multi-family	395.8	403.3	468.9	-16
Hospitals	1,640	1,441	1,375	+19	Total Building Permits	00 510	00.005		
Schools	790	776	750	+ 5	value - \$ Mill.	89,512	90,365	91,808	- 3
SOUTHEAST									
Nonresidential Building Permits	- \$ Mil.		e e00		Residential Building Permits	7 700	7 054	0.000	00
Industrial Bldgs	0,393	783	860	- 2	Residential Permits - Thous	1,100	1,994	9,000	-20
Offices	1,380	1,398	1,181	+17	Number single-family	109.6	113.6	152.1	-28
Stores	1,059	1,097	922	+15	Number multi-family	94.2	98.4	127.2	-26
Hospitals	267	254	202	+32	Total Building Permits				
Schools	83	78	123	-33	Value - \$ Mil.	14,293	14,510	16,353	-13
ALABAMA									
Nonresidential Building Permits	- \$ Mil.	491	502	-15	Residential Building Permits	07.9	901	410	_99
Industrial Bldgs.	432	431	87	-20	Residential Permits - Thous	213	291	410	-33
Offices	56	57	61	- 8	Number single-family	4.9	5.2	8.8	-44
Stores	55	58	73	-25	Number multi-family	5.1	5.5	8.0	-36
Hospitals	31	25	54	-43	Total Building Permits				
Schools	8	6	15	-47	Value - \$ Mil.	705	722	916	-23
FLORIDA									
Nonresidential Building Permits	- \$ Mil.	0 400	0 504	-	Residential Building Permits	F 000	F 400	0 500	10
Industrial Bldgs	3,400	3,403	3,384	- 5 + 4	Residential Permits - Thous	5,293	5,496	6,520	-19
Offices	629	680	509	+24	Number single-family	64.7	67.5	88.3	-27
Stores	623	648	486	+28	Number multi-family	66.9	70.0	88.9	-25
Hospitals	150	139	53	+183	Total Building Permits				
Senools	20	19	22	- 9	Value - \$ Mill.	8,693	8,959	10,104	-14
GEORGIA									
Total Nonresidential	- \$ Mil.	1 044	1 114	- 5	Residential Building Permits	1 0.95	1 0 9 0	1 1 9 0	-13
Industrial Bldgs.	1,055	184	178	- 1	Residential Permits - Thous.	1,023	1,025	1,100	-15
Offices	250	220	309	-19	Number single-family	20.2	20.5	26.1	-23
Stores	112	118	108	+ 4	Number multi-family	8.5	8.8	9.4	-10
Hospitals	30	30	19	+58	Total Building Permits	0.070	0.070	0.004	
Senoois	28	26	46	-39	value - \$ Mill.	2,078	2,073	2,294	- 9
LOUISIANA		1000							
Total Nonresidential	- \$ M111.	019	790	117	Velue - * Mil	500	601	624	_ 0
Industrial Bldgs.	87	69	115	-24	Residential Permits - Thous.	304	001	034	- 0
Offices	277	270	198	+40	Number single-family	9,7	9.7	11.3	-14
Stores	123	124	87	+41	Number multi-family	7.5	8.3	8.0	- 6
Hospitals	29	33	38	-24	Total Building Permits				
Senools	19	19	23	-17	Value - \$ Mil.	1,423	1,413	1,354	+ 5
MISSISSIPPI	A 147				Bedde del D. 111 B. 1				
Total Nonresidential	- \$ Mil. 174	173	200	-13	Kesidential Building Permits	146	159	974	-47
Industrial Bldgs.	18	17	28	-36	Residential Permits - Thous.	140	102	214	
Offices	45	46	38	+18	Number single-family	3.1	3.4	5.2	-40
Stores	32	31	57	-44	Number multi-family	1.7	1.6	5.1	-67
Hospitals Schools	8	9	5	+60	Total Building Permits Value - \$ Mil.	320	325	474	-32
					, and , and	020	020		
Nonresidential Building Permits	- \$ Mil				Residential Building Permits				
Total Nonresidential	693	633	574	+21	Value - \$ Mil.	381	385	637	-40
Industrial Bldgs.	53	53	82	-35	Residential Permits - Thous.				and the second second
Offices	123	125	66	+86	Number single-family	7.1	7.3	12.4	-43
Hospitals	114	118	111	+ 3	Number multi-family	4.5	4.2	7.7	-42
Schools	19	18	33 16	-56	Value - \$ Mil.	1.074	1.018	1.211	-11
			10	00	turuo y min	1,014	1,010	1,011	

NOTES: Data supplied by the U. S. Bureau of the Census, <u>Housing Units Authorized By Building Permits and Public Contracts</u>, C-40. Nonresidential data excludes the cost of construction for publicly owned buildings. 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. Publication of F. W. Dodge construction contracts has been discontinued.



	FEB 1982	JAN 1982	FEB 1981	ANN. % CHG.		MAR 1982	FEB R 1982	MAR R 1981	ANN. % CHG.
UNITED STATES									
(Dates: 10, 40, 10)	2.412.9	2.340.5	2,155.8	+12	Agriculture Prices Rec'd by Farmers				
Retail Sales - \$ mil SA (MAR)	87,164	87,574	86,128	+ 1	Index (1977=100)	132	133	143	- 8
Plane Pass. Arrivals (thous.) (JAN)	N.A.	N.A.	N.A.		Broiler Placements (thous.)	82,723	79,341	84,089	- 2
Consumer Price Index	8,684.4	8,695.1	8,506.2	+ 2	Call Prices (\$ per cwt.) Broiler Prices (¢ per lb.)	62.10 26.9	58.90	69.80	-11
1967=100	283.4	282.5	263.2	+ 8	Soybean Prices (\$ per bu.)	5.88	6.04	7.59	-23
Kilowatt Hours - Mils. (NOV)	162.1	168.7	162.2	- 0	Broiler Feed Cost (\$ per to	n) 207	209	229	-10
Borsonal Incomer <sup>®</sup> bil SAAR					Agnigultung				
(Dates: 1Q, 4Q, 1Q)	282.1	272.8	249.2	+13	Prices Rec'd by Farmers				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		Index (1977=100)	117	119	131	-11
Plane Pass. Arrivals (thous.) (JAN)	3,941.9	4,239.7	4,185.6	- 6	Broiler Placements (thous.)	32,829	31,402	31,061	+ 6
Consumer Price Index	1,397.4	1,405.7	1,437.1	- 3	Broiler Prices (\$ per cwt.)	26.0	25.5	28.6	-10
1967=100	N.A.	N.A.	N.A.		Soybean Prices (\$ per bu.)	6.10	6.25	7.22	-16
Kilowatt Hours - Mils. (NOV)	25.0	27.6	25.5	- 2	Broiler Feed Cost (\$ per to	n) 205	205	223	- 8
ALABAMA Personal Income-\$ bil SAAR					Agriculture	<u></u>			
(Dates: 1Q, 4Q, 1Q)	32.4	31.4	29.1	+11	Farm Cash Receipts - \$ mil				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		(Dates: DEC, DEC)	2,089	-	1,927	+ 8
Plane Pass. Arrivals (thous.) (JAN)	139.6	105.2	106.8	+31	Broiler Placements (thous.)	10,497	9,874	11,141	- 6
Consumer Price Index	30.4	99.0	91.9	- 2	Broiler Prices (& per CWL)	25.0	24.5	27 5	-15
1967=100	N.A.	N.A.	N.A.		Soybean Prices (\$ per bu.)	6.09	6.25	7.10	-14
Kilowatt Hours - Mils. (NOV)	3.5	3.9	3.8	- 8	Broiler Feed Cost (\$ per to	1) 225	225	220	+ 2
Personal Income-\$ bil SAAR					Agriculture				
(Dates: 1Q, 4Q, 1Q)	102.4	98.3	88.8	+15	Farm Cash Receipts - \$ mil				
Taxable Sales - \$ mil. (MAR)	67.3	67.2	59.7	+13	(Dates: DEC, DEC)	3,910	-	3,746	+ 4
Plane Pass. Arrivals (thous.) (JAN)	1,999.3	2,109.3	2,193.2	- 9	Broiler Placements (thous.)	1,979	2,006	1,771	+12
Consumer Price Index - Miami	84.0 JAN	89.0 NOV	123.7 JAN	-32	Call Prices (\$ per cwt.) Broiler Prices (\$ per lb.)	61.40	58.10	69.50	-12
Nov. 1977 = 100	155.2	153.6	137.3	+13	Sovbean Prices (\$ per bu.)	6.09	6.25	7.10	-10
Kilowatt Hours - Mils. (NOV)	7.0	7.8	7.0	0	Broiler Feed Cost (\$ per tor	n) 225	225	255	-12
GEORGIA Personal Incomers bil SAAR		<u> </u>			Amendation				
(Dates: 10, 40, 10)	48.7	47.6	43.7	+11	Farm Cash Receipts - \$ mil				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		(Dates: DEC, DEC)	3,141	-	2,826	+11
Plane Pass. Arrivals (thous.) (JAN)	1,401.6	1,599.1	1,455.5	- 4	Broiler Placements (thous.)	12,546	12,182	10,695	+17
Consumer Price Index - Atlanta	N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	55.80	54.00	64.00	-13
1967 = 100	279.8	282.2	263.0	+ 6	Sovbean Prices (\$ per bu.)	5.90	5.92	28.5	-10
Kilowatt Hours - Mils, (NOV)	3.7	4.1	3.7	0	Broiler Feed Cost (\$ per tor	n) 185	189	220	-16
LOUISIANA Personal Income-\$ bil SAAR					Amigulture	Sec. and			
(Dates: 1Q, 4Q, 1Q)	40.4	39.1	35.3	+14	Farm Cash Receipts - \$ mil				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		(Dates: DEC, DEC)	1,704	-	1,648	+ 3
Plane Pass. Arrivals (thous.) (JAN)	248.5	255.2	268.3	- 7	Broiler Placements (thous.)	N.A.	N.A.	N.A.	
Consumer Price Index	1,103.0	1,104.3	1,155.4	+ 1	Call Prices (\$ per cwt.) Broiler Prices (\$ per lb.)	61.00	58.60	68.00	-10
1967 = 100	N.A.	N.A.	N.A.		Soybean Prices (\$ per bu.)	6.10	6.42	7.28	-16
Kilowatt Hours - Mils. (NOV)	4.1	4.8	4.0	+ 3	Broiler Feed Cost (\$ per tor	) 250	245	250	0
MISSISSIPPI Personal Incomers bil SAAR					Aminulture				
(Dates: 10, 40, 10)	18.3	17.7	16.5	+11	Farm Cash Receipts - \$ mil				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		(Dates: DEC, DEC)	2,258	-	2,028	+11
Plane Pass. Arrivals (thous.) (JAN)	27.9	30.8	36.8	-24	Broiler Placements (thous.)	6,441	6,035	6,118	+ 5
Consumer Price Index	94.0	94.4	100.5	- 6	Calf Prices (\$ per cwt.)	62.80	55.10	67.00	- 6
1967 = 100	N.A.	N.A.	N.A.		Sovbean Prices (\$ per bu.)	6.22	6.29	30.5	- 8
Kilowatt Hours - Mils. (NOV)	1.6	1.9	1.6	0	Broiler Feed Cost (\$ per tor	) 195	189	215	- 9
TENNESSEE									
(Dates: 1Q, 4Q, 1Q)	39.8	38.8	35.8	+11	Farm Cash Receipts - \$ mil				
Taxable Sales - \$ mil.	N.A.	N.A.	N.A.		(Dates: DEC, DEC)	1,910		1.830	+ 4
Plane Pass. Arrivals (thous.) (JAN)	124.9	140.1	130.8	- 5	Broiler Placements (thous.)	1,366	1,305	1,336	+ 2
Consumer Price Index	N.A.	N.A.	N.A.		Calf Prices (\$ per cwt.)	58.90	54.40	61.90	- 5
1967 = 100	N.A.	N.A.	N.A.		Southean Prices (\$ per ib.)	24.5	25.0	27.5	-11
Kilowatt Hours - Mils. (NOV)	5.1	5.1	5.4	- 6	Broiler Feed Cost (\$ per ton	) 210	191	225	- 7
and the second							Station and State		

#### 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 25 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. R = Revised

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